

1<sup>st</sup> INTERNATIONAL CONFERENCE

South-East European Countries toward European Integration

20<sup>th</sup> October 2012

Elbasan – Albania

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**SECTION I: CHALLENGES FOR THE INTEGRATION TO THE EUROPEAN UNION****APPROXIMATION OF ALBANIAN COMMERCIAL AND COMPANY LAW WITH EU LAW  
(CORPORATE GOVERNANCE PRINCIPLES IN THE ALBANIAN LEGISLATION ON COMPANIES)**

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**Abstract:**

*The Albanian path towards European integration involves several matters, different changes on a large range of issues, particularly on legal reforms, law modifications, approximation and harmonization. This paper aims on presenting a panorama of the new Albanian law on entrepreneurs and companies, its approval, historical view, efforts and achievements, and its main changes due to the approximation and convergence with European Union Law. This panorama includes other respective European Union documents and rules adopted by State members on such matter, and how these affected the entire Albanian Commercial Laws. Considering that good corporate governance is one of the most important topics on commercial and company legislation, this paper attends the special issue of principles and standards on corporate governance, development of Albanian principles and standards on corporate governance, as well as clarifying the distinction between “Corporate management” and “Corporate governance”. Conclusions summarize the efforts to accomplish approximation of the Albanian commercial and company legislation towards European legislation, as an entire reform along the Albanian integration process.*

**Keywords:** European integration, approximation, Albanian Company Law.

**JEL Classification:** K19.

**1. Chapter I****1.1. Section I: About harmonization programme and approximation process.**

From what and from where arise the call for harmonization, approximation, implementation of European Union (EU) laws, institutions, reforms among State Members, and in an expansive process among others States who aspire a position through EU State Members. The harmonization programme it's not a nowadays term:

“The company law harmonization programme began soon after the European Economic Community was formed.

The programme has a purpose function so that for the effectiveness of the internal market the harmonization of company laws would enable all those dealing with companies in the Community to be operating within a broadly similar legal structure with comparable rights and obligations.”

But what exactly brought to the approximation of laws and standards in the field of Company Law? The free movement of persons as individuals, represent at the same time the need for those individuals not only to be physically established but also to generate, to work and to prosper, having the same or equal rights, outside their countries but inside the so called “common market”.

“The steps taken by the European community were focused on the ‘approximation’ of the laws of the Member States in order to facilitate the creation and functioning of the common market and aimed at providing equivalent protection for shareholders and third parties in each Member State, together with facilitating freedom of establishment for companies. This has led to a European Community company law which now influences significantly the national company laws of the Member States”.

Albanian Legislation regarding companies, entrepreneurships, includes a large number of laws, acts and decrees. “The list of legal acts that deal with the field of commercial activity is a large one, furthermore due to the very fast development process during the last years and a lot of changes made to related legislation, it's quite impossible to make a definitive list”. Let's mention some of the main acts on commercial laws, according to a summary published from the Centre for Official Publications, on 2010:

Law n. 9901, date 14.4.2008 “On entrepreneurs and companies”; Law n. 9723 date 3.5.2007 “For the National Centre of Registration”, amended with the law n. 9916, date 12.5.2008; Decree of Council of Ministers n.537, date 1.8.2007 “On naming and denomination rules”; Law n. 9754 date 14.6.2007 “On penal responsibility of legal persons”.

Other important laws on the field are: Law n. 9879, date 21.02.2009 “On securities”; Law n. 10236, date 18.02.2010 “On supervision of public companies”.

Main subject for the purpose of preparing this thesis will be the above-mentioned Law n. 9901, date 14.4.2008 “On entrepreneurs and companies”, (also known as “The Albanian Company Law”), due to the very principal position of this Law on behalf of Albanian Companies, its drafting process and approval according to Stabilization and Association Agreement between Albania and the European Union.

## **1.2. Section II: Stabilization and Association Agreement, as a basic act in the course of European integration.**

Stabilization and Association Agreement between the European Communities and their Member States, and the Republic of Albania entered into force on 1 April 2009, after the ratification from 25 State Members who were part of European Union at the moment of signing of Stabilization and Association Agreement, and its approval from the Albanian Parliament.

Approximation and implementation of the *acquis communautaire* inside the national legislation is the main request for the European integration of the states that aim to be part of European Union.

But what does ‘*acquis communautaire*’ mean?

The *acquis communautaire* is the whole corpus of European Union legislation as: European Treaties, international agreements, directives, rules, decrees, recommendations, sentences of the European Court of Justice, principles and standards of the European Union. It is evident that the *acquis* is dynamic as well as the laws that represent it. Despite its dynamic character and continuous changes, Member States must act in accordance with the *acquis communautaire*. Other European States, aiming to become members, in the status of candidate or not, are bound (according to mutual agreement between each state and the Community) to fulfil all the harmonization and approximation requirements, in order to approach the national legislation with the *acquis*.

“The Albanian Company Law “On entrepreneurs and companies” was drafted so as to implement (with limited exceptions) the European company law standards (the so called “*acquis*”) and thereby to fulfill article 70 of the Stabilization and Association Agreement between Albania and the European Union, which aims at full approximation to the *acquis communautaire* within 10 years”.

“The Parties recognize the importance of the approximation of Albania's existing legislation to that of the Community and of its effective implementation. Albania shall endeavor to ensure that its existing laws and future legislation shall be gradually made compatible with the Community *acquis*. Albania shall ensure that existing and future legislation shall be properly implemented and enforced.”

“...approximation shall focus on fundamental elements of the Internal Market *acquis* as well as on other important areas such as competition, intellectual, industrial and commercial property rights, public procurement, standards and certification, financial services, land and maritime transport – with special emphasis on safety and environmental standards as well as social aspects – company law, accounting, consumer protection, data protection, health and safety at work and equal opportunities.”

According to this article, the Community legislation definitely will affect the Albanian legislation all along the integration process.

“However, it has to be noted that there is no coherent body of European Company Law. For joint stock company European law treats only certain topics, e.g. the provisions on capital and the distribution of dividends, but contains little rules on others, e.g. the management of the company or corporate governance issues. For matters not regulated by European law, the new Albanian Companies Law relies heavily on inspiration from the company laws of Germany and England”.

- **Section III: Some European Council Directives relating to the harmonization programme.**

The Harmonization Directives: - The First Directive (Directive 68/151) – This Directive was adopted in 1968 and applies to all types of companies both private and public. The Directive establishes a system of public disclosure. - The Second Directive (Directive 77/91) – This Directive was adopted in 1976 and covers the raising, maintenance and alteration of the capital of public limited companies. - The Third Directive (Directive 78/885).

This Directive was adopted in 1978 and lays down common rules for company mergers taking place within a single Member State and involving the acquisition of one company by another. - The Fourth Directive (Directive 78/660) – This Directive was adopted in 1978 and provides for the introduction of a standard format for the balance sheet and profit and loss account and the minimum information to be published in the notes to a company's annual report. - The Sixth Directive (Directive 82/891) – This Directive was adopted in 1982 and concerns the division or "scission" of a public limited company into several undertakings. - The Seventh Directive (Directive 83/349) This Directive was adopted in 1983 and lays down the circumstances under which a group of companies may prepare consolidated accounts and the basis upon which such accounts are to be prepared. The Directive also covers the rules for auditing such accounts and publication requirements. - The Eighth Directive (Directive 84/253) – This directive adopted in 1984 sets out common professional standards for statutory auditors to companies and requires a full audit to be carried out in respect of a company's account annually. - The Eleventh Directive (Directive 89/666) – This Directive was adopted on December 21, 1989 and is designed to harmonise the rules governing the establishment of a branch throughout the Community. Under the Directive, branches of companies established in other Member States will not have to publish annual accounts of their own activities provided that they submit a consolidated and duly audited report for their parent company. - The Twelfth Directive (Directive 89/667) – This Directive was adopted on December 21, 1990 and requires Member States to permit the establishment of single-member private limited companies in order that individual business operations are able to take advantage of limited liability.

**Community Regulations:** In addition to the harmonization directives by virtue of which Member States are required to bring national laws in line with Community standard, the Community has also introduced the following regulations which have immediate effect throughout the Community as directly enforceable legislation: The EEIG Regulation – A measure introducing the concept of a European Economic Interest Grouping / The Merger Regulation – A measure imposing Community control of Community Dimension Mergers.

## 2. Chapter II

### 2.1. Section I: What have been left out of the Albanian Company Law "On entrepreneurs and companies"?

"There are some regulatory sets deriving from European Company Law, which were not adapted by the new Albanian company law: The EU Directive 2006/43/EC "On Statutory Audits of Annual Accounts" was not transposed because the complexity of its provisions. The fact that they are rather auditing and not company law provisions convinced Albanian Law-makers to set this issue aside for special legislation. Takeover Law also was intended to be outside the scope of company law (as in many EU jurisdictions).

Supranational EU company forms and the new rules on cross border mergers were also not transposed by the new Law. This regards Regulation (EEC) 2137/85 on the European economic Interest grouping (EEIG), Regulation (EC) 2157/2001 On the Statute of a European Company (SE) and Directive 2005/56/EC On cross-border mergers. All these regulatory sets involve relations between jurisdictions which are already Member States.

### 2.2. Section II: Approximation of Albanian commercial legislation relating to the European Directives.

Some issues, important objects of European Directives, have been directly provided inside the new Albanian company law "On entrepreneurs and companies" and the law "On National Registration Centre", as will see in brief in this section, as well as the association and the transposition approach. It must be stressed, that due to the defined size of this paper, it's impossible to collect, to interpret, to reassume all the aligned and transposed European directives, rules, international acts, inside the Albanian commercial legislation.

**The First Directive** seeks to harmonize: - publicity requirements applying to companies; - the circumstances, in which company transactions will be valid; - the rules relating to the nullity of companies. According to disclosure requirements provided by article 3 of the First Company Law Directive 68/151/EEC (as amended by Directive 2003/58/EC), these have been transposed to Article 21 "Impacts of registration and publication" of Albanian Law on National Registration Centre, which have been considered one of the most important provisions of that Law. In general terms, every data registered and made public on commercial register, it will be evaluated as public and can be addressed to third parties from the very day of its publications.

Registrations of commercial register are accepted always as known and represent an official document for public authorities. Article 7 of the First Directive provides: "If, before a company being formed has acquired legal personality, action has been carried out in its name and the company does not assume the obligations arising from such action, the persons who acted shall, without limit, be jointly and severally liable therefore, unless otherwise agreed." On the other side, article 10 (1) "Liability of Founders" of Albanian Law n. 9901, date 14 April 2008 "On Entrepreneurs and companies", provides: "Persons acting in the name of the company, before a company has acquired legal personality, shall be jointly and severally liable for any transactions conducted on its behalf."

To continue with article 8 of the First Directive: “Completion of the formalities of disclosure of the particulars concerning the persons who as an organ of the company, are authorized to represent it shall constitute a bar to any irregularity in their appointment being relied upon as against third parties unless the company proves that third parties had knowledge thereof”. Article 12 (2) of the Albanian Law “On Entrepreneurs and companies” provides as follows: “Legal representatives shall apply all limitations in their powers of representation as established by the statute or approved by respective company organs. Unless a company proves that the third party knew about a limitation or could, in view of evident circumstances, not have been unaware of it, a limitation of powers may not be relied on as against third parties, even if it has been made public in a manner other than those provided by Law n. 9723 date 03.05.2007 “On the National Registration Centre”.

The publication of the limitation through the publication of the decision of a competent company organ or the statute shall not of itself be sufficient proof of the knowledge of the third party, where that limitation has been made public in a manner other than those provided by the Law on the National Registration Centre”. Article 9 (1) of the First Directive: “Acts done by the organs of the company shall be binding upon it even if those acts are not within the objects of the company, unless such acts exceed the powers that the law confers or allows to be conferred on those organs.

However, Member States may provide that the company shall not be bound where such acts are outside the objects of the company, if it proves that the third party knew that the act was outside those objects or could not in view of the circumstances have been unaware of it; disclosure of the statutes shall not of itself be sufficient proof thereof.”

The above article inside the Albanian Law “On Entrepreneurs and companies”, align with article 12 (3) that provides: “Acts done by the legal representatives of the company shall be binding upon the company even if those acts exceed its objects, unless such acts exceed the powers of representation that the law confers or allows to be conferred on them. The company shall not be bound by those acts, if it proves that the third party knew that an act fell outside of the scope of those objects or could, in view of evident circumstances, not have been unaware of it. Publication by means of an amendment to the statute shall not of itself be sufficient proof thereof, where that amendment has been made public in a manner other than provided by the Law on the National Registration Centre.”

According to **nullity of the company**, article 11 of the First Directive provides that nullity may only be ordered by decision of a court of law and on the following grounds:

- Failure to execute an instrument of constitution or comply with the rules of preventive control or the requisite legal formalities;
- Unlawfulness or conflict with public policy or company’s object;

We can compare it, with article 7 of Albanian Company Law, state for the “Lawful Objects”: A company may engage in any activity that is not prohibited by law.

**The Second Company Law Directive** deals with the formation of public limited companies and the maintenance and alteration of their capital. Article 2 provides that the statutes or instrument of incorporation must indicate:

- The type and the name of company;
- The objects of the company;
- When the company has no authorized capital, the amount of the subscribed capital, When the company has an authorized capital, the amount thereof and also the amount of the capital subscribed at the time the company is incorporated or is authorized to commence business, and at the time of any change in the authorized capital, without prejudice to Article 2(1) of Directive 68/151/EEC;
- In so far as they are not legally determined, the rules governing the number and the procedure for the appointing members of the bodies responsible for representing the company with regard to third parties, administration, management, supervision or control of the company and the allocation of powers among those bodies;
- The duration of the company, except where this is indefinite.

Articles 32 of Albanian Law n. 9723, date 03.05.2007 “On the National Registration Centre”, provides: Mandatory data for companies.

For the initial registration of companies are obligatory these data:

a) the name of the company; b) the form of the company; c) the date of establishment; ç) identity’s data of the founders; d) the seat; dh) the object, if it is defined; e) the duration, if it is defined; ë) identity’s data for the responsible persons for administrations and the representation of the company with the third parties, competencies of representation, and the duration of such nomination; f) signatures of persons who represent the company with the third parties.

Articles 33, 34, 35, provide special required data for other company’ types (the general partnership, the limited partnership, the limited liability company). Article 36 provides additional data for anonymous companies (also known as joint-stock companies), besides the requirements of article 32. It requires data for the initial capital subscribe and paid up; the number and form of subscribe shares; nominal value of each share; number of subscribe shares from each shareholder; value and type of contribution for each shareholder and the paid capital from any shareholder; special conditions that limit the transfer of shares (if any).

Some transposed articles concerning the Third Directive. The **Third Directive** applies where: (1) One or more companies transfer all their assets and liabilities to another existing company, which issues shares to the shareholders of the transferring company or companies which are then dissolved; (2) Several companies transfer all their assets and liability to a company they have formed, which issues shares to the shareholders of the transferring companies which are then dissolved; or (3) One or more wholly-owned subsidiaries transfer all their assets and liabilities their parent and are then dissolved. Related to the point number 1, let's see article n. 215 of the Albanian Law "On entrepreneurs and companies".

Two or more companies may be merged on the basis of: 1. Transfer of the whole assets and liabilities of one or more companies, called acquired companies, to another company called acquiring company, in exchange for shares of that company. That process shall be called merger by acquisition; 2. Formation of a new company to which all assets and liabilities of the merging companies are transferred, in exchange for shares of the new company. That process shall be called merger by formation of a new company.

Related to the point number 3, article n. 225 of the Albanian Law "On entrepreneurs and companies", prevent merger by acquisitions in special cases and what happened: If at least 90 percent of the basic capital a subsidiary joint-stock company is owned by the parent company and if 100 percent of the shares are owned by a parent company.

Other elements of the Third Directive as Mergers by the formation of the new company relate to article 226 of the Albanian Law "On entrepreneurs and companies", and division of a company as requested from the directive is enclosed into the article 227 of the Albanian Company Law.

**The Eleventh Directive** extends to branches of companies governed by the law of countries outside the Community "to ensure that its purposes ... are fully realized and to avoid any discrimination on the basis of a company's country of origin. According to this Directive, the Albanian Law "On entrepreneurs and companies", provides rules for "Branches and Representation offices" on the article 9 and respective articles (37) of the Law "On national registration centre".

### **2.3. Section III: Albanian improvement regarding corporate governance, best practices and international principles related.**

The "corporate governance" as a conception on company laws, finance, has raised its importance during concrete events (like Enron fall) and has been a subject to implementation inside national' legislations. According to OECD: "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined."

We will have a view inside the OECD Principles of Corporate Governance, since: "Notions mentioned in these principles are reflected in all legal acts, internal and international, approved in this field, not excluding Albanian Legislation that sets rules about formation, registration and functioning of the companies."

OECD Principles of Corporate Governance: 1. Ensuring the Basis for an Effective Corporate Governance Framework - The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities. 2. The Rights of Shareholders and Key Ownership Functions - The corporate governance framework should protect and facilitate the exercise of shareholders' rights. 3. The Equitable Treatment of Shareholders - The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. 4. The Role of Stakeholders in Corporate Governance - The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. 5. Disclosure and Transparency - The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. 6. The Responsibilities of the Board - The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Adopting international principles and standards, legislation concerning corporate governance in Albania is wide and includes a considerable number of legal acts: Law "On entrepreneurs and companies"; Law "On securities"; Law "On Banks in Republic of Albania"; Regulations on Tirana stock exchange.

This panorama has been enriched with the Albanian Manual on Corporate Governance, published from the programme on corporate governance of International Finance Corporation (IFC) World Bank Group, and the Albanian Code on corporate governance for Albanian not listed joint-stock companies.

To illustrate also from the new Albanian Company Law "On entrepreneurs and companies": "A joint stock company shall have the following organs: General Meeting and, subject to the provisions of the statute: - Board of Administration as a single management organ, exercising both management and supervision of the company's activity (one-tier system);

- Supervisory board and one or more administrators, where management and supervisory functions are divided between these two organs (two-tier system). In this case, the administrators may be elected and removed by the General Meeting or Supervisory board, as provided by the statute.”

According to article 161 (2) of the Albanian Law “On entrepreneurs and companies”, the board has to elect a chairman and a vice chairman. The chairman of the Board of Administration must not be an administrator at the same time. This can most likely be seen as a reaction to recent corporate scandals in Europe and the US. Distinction between supervisory board and board of administrators makes easier the difference between corporate governance and corporate administration during the life-time of a company. “Corporate governance is the process that direct and control the company, meanwhile administration is the process that fulfills the policies established by supervisory Board and General Meeting, is the process of every day functions and operations within the company.”

### 3. Conclusions.

As a conclusion from this paper, it's clear and evident that integration process for Albania towards European Community has lead to a large and considerable approximation and convergence of Albanian commercial legislation with European company laws and other international company principles, reforms and standards.

Old laws have been repealed, new laws, legislative acts, and legal documents have been adopted, in order to complete the entire frame on company laws in Albania. The realization of such a process, it's not important only for the integration process in general, but will improve the position and the possibilities of Albanian companies, will improve the position and the possibilities of individuals establishing such entities, to interact with other European States, and not only, having equal rights and being subject to same treatment. Such interaction will affect also foreign bodies and entities willing to be established in Albanian territory. The convergence and approximation of Albanian laws with *acquis communautaire* is a requirement for European integration, but due to its immense profit can also be seen as a significant achievement on itself.

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## MARKET ABUSE AND INSIDER TRADING LIABILITY AFTER THE CHANGES INTRODUCED IN THE ALBANIAN CRIMINAL CODE: COMPARATIVE PROFILES WITH THE ITALIAN EXPERIENCE

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### **Abstract:**

*Meeting international standards when building or rearranging the State institutions and their functions seems to be the viewpoint from which Albania wants to paint her future. This is inspiring but for an emerging country, it's also a big bet. Our purpose here is to describe in a brief way which are the changes brought to the Criminal Code concerning the financial market abuse. To this moment, there exist a body of laws and dispositions which aim to timidly enable this market of immaterialized goods but it is yet to be seen how they'll be implemented. What is insider trading and market abuse? What is the relationship between administrative sanctions and criminal ones with regards to these main offenses? Since these changes comply broadly with European Community guidelines we've chosen to bring a comparative viewpoint with the Italian experience, especially since the Italian Criminal Code has been an important reference point for the Albanian Criminal Code of 1995. It seems like a natural step to use the Italian experience as a bridge when making hypothesis and suggesting answers.*

**Keywords:** insider trading, market abuse, criminal liability, administrative misdemeanour, financial instruments.

**JEL Classification:** K14.

### **I. Market abuse and insider trading viewed from the Albanian lenses.**

For the purposes of this study we are choosing to forgo the criminal offense pursuant Article 143/a/1 of the Criminal Code (C.C) "Market manipulation" dealing with fraudulent increase or decrease of the price on the market of goods, services and currency as its juridical object is not the integrity of the financial market but indeed that of the market of goods and services .

According to this Directive, market abuse includes two distinctive cases<sup>1</sup>: **insider trading** which basically consists on the operator (active subject) making certain operations based on information he possesses before this comes of public knowledge: on the other hand, in **market manipulation**, the operator spreads false information or simulates operations in way to alter the price of the financial instruments.

These legal norms aim to protect and give a sanction in case of violation of the same juridical object, which is: "to ensure the integrity of Community financial markets and to enhance investor confidence in those markets"<sup>2</sup>. "Insider dealing and market manipulation prevent full and proper market transparency, which is a prerequisite for trading for all economic actors in integrated financial markets"<sup>3</sup>.

There are several acts which further support, on communitarian level, the principle of transparency within the financial market: Directive 2003/124/EC which defines market manipulation<sup>4</sup>; Directive 2003/125/EC which regulates the correct presentation of recommendation of investment and the communication of conflict of interest to the public<sup>5</sup>; Commission Regulation 2273/2003/EC with regards to the exemptions for buy-back programmes and stabilisation of financial instruments<sup>6</sup>.

Moving on to one of the practices encompassed under the notion of *market abuse* (as established by the DIR. 2003/6/EC) there is Article 143/a/2 "Unauthorized use and disclosure of inside information" bringing liability to any subject who gets into contact, in an authorized or unauthorized way, with inside information unknown to the public in way to obtain personal benefit, benefit for a third party or damage this last:

<sup>1</sup> Commission Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse), retrieved from [http://www.esma.europa.eu/system/files/Dir\\_03\\_6.pdf](http://www.esma.europa.eu/system/files/Dir_03_6.pdf), (12).

<sup>2</sup> Commission Directive 2003/6/EC, Ibid

<sup>3</sup> Commission Directive 2003/6/EC, Ibid, (15)

<sup>4</sup> Commission Directive 2003/124/EC, retrieved from [http://www.esma.europa.eu/system/files/MADImplDir\\_2003\\_124.pdf](http://www.esma.europa.eu/system/files/MADImplDir_2003_124.pdf).

<sup>5</sup> Commission Directive 2003/125/EC, retrieved from [http://www.esma.europa.eu/system/files/MADImplDir\\_2003\\_125.pdf](http://www.esma.europa.eu/system/files/MADImplDir_2003_125.pdf)

<sup>6</sup> Commission Regulation (EC) No 2273/2003 of 22 December 2003, retrieved from [http://www.esma.europa.eu/system/files/MADImplReg\\_2273\\_2003.pdf](http://www.esma.europa.eu/system/files/MADImplReg_2273_2003.pdf)

- a) by using inside information for the acquisition or disposal of financial instruments in the Albanian territory or issued within it
- b) knowing it is inside information, by communicating it to a third party without any authorization (*tipping*)
- c) knowing it is inside information, by recommending a third party to buy or sell financial instruments in Albania or from a issuer based in Albania (*tuyautage*)

How does inside information affect the financial market? The price of the financial instruments is set by a full interaction between an informative moment and an evaluating moment, therefore any person who gets in contact with inside information is advantaged by the knowledge that some expectations based on public information are wrong and by this he reveals to the investors the risk of their investments and the lack of guarantees.

The definition of inside information is given by Directive 2003/6/EC<sup>7</sup> as:

*“...any information of a precise nature which has not been made public, relating, **directly or indirectly**, to one or more issuers of financial instruments or to one or more financial instruments. Information which could have a significant effect on the evolution and forming of the prices of a regulated market as such could be considered as information which indirectly relates to one or more issuers of financial instruments or to one or more related derivative financial instruments”*

Directive 2003/124/EC further specifies that as any information should be deemed as of precise nature *“if it indicates a set of circumstances which exists or may reasonably be expected to come into existence or an event which has occurred or may reasonably be expected to do so and if it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative financial instruments.”*<sup>8</sup> On the same article of DIR 2003/124/EC it is further explained that by *“information which indirectly relates to one or more issuers of financial instruments”* (as it was prescribed by DIR 2003/6/EC) *“(...)shall mean information a reasonable investor would be likely to use as part of the basis of his investment decisions”*

These definitions were later adopted by Law nr. 9879 *“On financial instruments”*, specifically in Article 93 (Law nr. 9879). So which could it be the object of this inside information? It could be either **corporate information** (anything concerning the financial situation, assets of a company and its organisational issues) or **market information** such as administrative sanctions in favour or against an issuer or its holding or some general regulations concerning a certain type of financial instrument<sup>9</sup>.

The definition of “financial instruments” is found in Art. 3 of Law nr. 9879 and is equivalent to securities such as stock options, loans, bonds evaluated and approved by the Authority of Financial Supervision<sup>10</sup>. As pointed out in the Directive 2003/6/EC, inside information is such because it concerns directly or indirectly the life of a company. The *CESR Guidelines* come in help when listing, in a non exhaustive way, some information which **directly** affects the issuer<sup>11</sup>:

- Changes in control and control agreements;
- Changes in management and supervisory boards ;
- Changes in auditors or any other information related to the auditors activity;
- Operations involving the capital or the issue of debt securities or warrants to buy or subscribe securities;
- Decisions to increase or decrease the share capital
- Mergers, splits and spin-off;
- Purchase or disposal of equity interests or other major assets or branches of corporate activity;
- Restructurings or reorganizations that have an effect on the issuer’s assets and liabilities, financial position or profits and losses;
- Decisions concerning buy-back programmes or transactions in other listed financial instruments;
- Changes in the class rights of the issuer’s own listed shares;

<sup>7</sup> Commission Directive 2003/6/EC, Ibid, paragraph (16).

<sup>8</sup> Directive 2003/124/EC, Art. 1, 1., retrieved from [http://www.esma.europa.eu/system/files/MADImplDir\\_2003\\_124.pdf](http://www.esma.europa.eu/system/files/MADImplDir_2003_124.pdf)

<sup>9</sup> Sandrelli, G., (2006), *“I reati di market abuse”*, La responsabilita amministrativa delle societa e degli enti, nr. 1, pp. 68-69.

<sup>10</sup> Law nr. 9879 21.02.2008, retrieved from [www.ligjet.org](http://www.ligjet.org), Art.3.

<sup>11</sup> CESR advice on Possible Level 2 Implementing Measures for the proposed Market Abuse Directive, 02-089d (2002), retrieved from [http://www.esma.europa.eu/system/files/02\\_089d.pdf](http://www.esma.europa.eu/system/files/02_089d.pdf), pp. 12-13.

- Filing of petitions in bankruptcy or the issuing of orders for bankruptcy proceedings;
- Significant legal disputes;
- Revocation or cancellation of credit lines by one or more banks;
- Dissolution or verification of a cause of dissolution;
- Relevant changes in the assets' value:
- Insolvency of relevant debtors;
- Reduction of real properties' values;
- Physical destruction of uninsured goods;
- New licences, patents, registered trade marks;
- Decrease or increase in value of financial instruments in portfolio;
- Decrease in value of patents or rights or intangible assets due to market innovation;
- Receiving acquisition's bids for relevant assets;
- Innovative products or processes;
- Serious product liability or environmental damages cases;
- Changes in expected earnings or losses;
- Relevant orders received from customers, their cancellation or important changes;
- Withdrawal from or entering into new core business areas;
- Relevant changes in the investment policy of the issuer;
- Ex-dividend date, dividend payment date and amount of the dividend; changes in dividends policy payments

It then follows with the information which concerns the issuer **indirectly**, such as:

- Data and statistics published by public institutions disseminating statistics;
- The coming publication of rating agencies' reports, research, recommendations or suggestions concerning the value of listed financial instruments;
- Central bank decisions concerning interest rate;
- Government's decision concerning taxation, industry regulation, debt management, etc.
- Decisions concerning changes in the governance rules of market indices, and especially as regards their composition ;
- Regulated and unregulated markets' decisions concerning rules governing the markets;
- Competition and market authorities' decisions concerning listed companies;
- Relevant orders by government bodies, regional or local authorities or other public organizations;
- Relevant orders to trade financial instruments;
- A change in trading mode (e.g., information relating to knowledge that an issuer's financial instruments will be traded in another market segment: e.g. change from continuous trading to auction trading); a change of market maker or dealing conditions.

The subjective element consists of malice and the juridical object is violated right away with the communication of inside information or through tipping or recommending a third party to undertake a certain action. If no operation is taken based on inside information the criminal offense is considered to have remained in the attempted phase, same if the inside information becomes of public knowledge before the action is taken. There's a problem when establishing which is the moment the criminal offense is fully consumed, since the object of the offense is not materialized. The Italian jurisprudence considers this moment to be that of the transfer of ownership of the financial instrument from one subject to an other. That would be the moment of registration of a credit done by the intermediary to the account of the buyer<sup>12</sup> and is so described in Art.118 of Law nr. 9879<sup>13</sup>.

The subjects liable for this offense are the ones listed in Article 94 of Law nr. 9879 which is traced out from the provisions of Directive 2003/6/EC<sup>14</sup> namely the subjects who are members of the administrative, management or supervisory bodies of the issuer or more generally subjects who come in contact with inside information because of employment, profession or duty<sup>15</sup>. The Albanian norm however leaves out the last liable category mentioned in the Directive 2003/6/CE: "...any person who possesses that information by virtue of his criminal activities". This refers to the subject who commits a criminal offense in way to obtain an inside information i.e. through breaking into a person's computer or house. Another interpretation of this disposition is to include subjects who produce an inside information by committing terroristic acts which affect the financial market<sup>16</sup>.

## II. Stock price manipulation and the dissemination of misleading information.

<sup>12</sup> Cassazione Penale nr. 7769, 23.02.2009, retrieved from [www.cortedicassazione.it](http://www.cortedicassazione.it)

<sup>13</sup> Ligji nr. 9879, 21.02.2008 "Për titujt", Ibid, Art. 118

<sup>14</sup> Commission Directive 2003/6/EC, Ibid, Art. 2

<sup>15</sup> Law nr. 9879, 21.02.2008 "Për titujt", Ibid, Art. 94

<sup>16</sup> Fratini, M., Gasparri, G., (2012) "Il testo unico della finanza", UTET Giuridica, pp. 2368

According to article 143/a/3 of the C.C this criminal offense is consumed by any action or omission to act consisting in:

- a) improper transactions (selling/substitution of financial instruments<sup>17</sup>) in which there is no genuine change in actual ownership of the security or derivative contract (*wash sales*);
- b) transactions where both buy and sell orders are entered at the same time, with the same price and quantity by different but colluding parties (*improper matched orders*)
- c) dissemination of false or misleading market information through media, including the Internet, or by any other means. The dissemination is done in order to move the price of a security, a derivative contract or the underlying asset in a direction that is favourable to the position held or a transaction planned by the person disseminating the information

The International Organization of Securities Commissions, list the subjects involved and capable of having an effect on price manipulation<sup>18</sup>:

- a) issuers of securities;
- b) participants in the securities market, derivatives market or underlying cash market;
- c) market intermediaries;
- d) any combination of the above acting in cooperation with one another

Through a comprehensive read of the article, these actions can be categorized in: *a*) simulation of actions (*action based manipulation*) and *b*) dissemination of false information (*information based manipulation*). Both require for the conduct to have a significant effect on the price of those financial instruments or on the price of related derivative financial instruments (*price sensitivity*). According to Kern “*this is the most essential feature of (...) inside information. This criterion, rather than the issue of how qualitative the information actually is, which really matters and which, ultimately, will be the determining factor (...) whether information is inside information. Price sensitivity can only be determined at the moment of the deal when, by definition, the information is not known to the public and can have no impact on the price*”<sup>19</sup>.

**Action based manipulation:** Both wash sales and improper matched orders<sup>20</sup> are typically action based manipulative actions. It was noticed there’s a moment which is particularly sensitive with reference to the setting of the prices within the financial market and that moment is when the stock market opens or closes up (i.e. marking the close). Therefore it is through wash sales that one subject simulates several actions in order to make the price of a certain title drop or represent the stock market much more active than it is. Same goes for improper matched orders, only difference being that the simulating actions are perpetrated by several subjects in agreement with each other<sup>21</sup>. The simulating actions do not need to be illicit acts *per se* in order to bring liability pursuant article 143/a/3 of C.C but it is important they are brought to life artificially. The intention of the subject is important, but not indispensable, in order to qualify liability and the fiction that features this simulative actions or omissions to act is an element addressable to the objective element (manner of committing the violation) of the criminal offense rather than to the subjective one (motivation)<sup>22</sup>.

**Information based manipulation:** Is the dissemination of false, but apparently reliable, information that may reflect in the price of the securities which they are related to. May fall into this category, the dissemination of studies and reports containing intentionally incorrect analysis of the purchase or sale of financial instruments. This behaviour is configurable as an offense of price manipulation, especially if the author of the study is the same as the subject who acts in contrast to the suggestion he makes of public knowledge<sup>23</sup>. Dissemination is configured when done “*...through the media, including the Internet, or by any other means*” basically implying that it is directed to a considerable number of persons. (...) *In respect of journalists when they act in their professional capacity such dissemination of information is to be assessed, without prejudice to Article 11, taking into account the rules governing their profession, unless those persons derive, directly or indirectly, an advantage or profits from the dissemination of the information in question*<sup>24</sup>. The information has to be false in order to activate criminal as well as administrative liability<sup>25</sup>.

<sup>17</sup> Article 143/a/3, Criminal Code, retrieved from [www.ligjet.org](http://www.ligjet.org)

<sup>18</sup> Technical Committee of the International Organization of Securities Commissions, (2000), Investigating and prosecuting market manipulation, retrieved from <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD103.pdf>, pp.6

<sup>19</sup> Kern, A. (2001), "Insider Dealing and Market Abuse: The Financial Services and Markets Act 2000", ESRC Centre for Business Research, University of Cambridge Working Paper No. 222, retrieved from [http://www.econ.cam.ac.uk/cgi-bin/cbr\\_wp3.pl?conf\\_file=cbr.conf&terms=2001&series=cbrwps&criteria=All&boolean=AND&case=Insensitive](http://www.econ.cam.ac.uk/cgi-bin/cbr_wp3.pl?conf_file=cbr.conf&terms=2001&series=cbrwps&criteria=All&boolean=AND&case=Insensitive)

<sup>20</sup> Art. 132/a/3 of the C.C, a) and b), retrieved from [www.ligjet.org](http://www.ligjet.org).

<sup>21</sup> Damilano M., De Vincentiis P., Isaia E., Pia P. (2002), “Il mercato azionario”, Torino, Giappichelli, pp. 32.

<sup>22</sup> Cassazione Penale, Sez. V, n°2063, 02.10.2008, retrieved from [www.cortedicassazione.it](http://www.cortedicassazione.it).

<sup>23</sup> Damilano M., De Vincentiis P., Isaia E., Pia P. (2002), Ibid

<sup>24</sup> Directive 2003/6/EC, Ibid, Art.1, 2(c)

<sup>25</sup> Ligji 9879 “Për titujt”, Ibid, Art.99, Art. 100.

In the Italian legal system, criminal liability starts only when the information is false but the administrative one is activated when such information although won't qualify as false is misleading, therefore affecting the financial market by offering a distorted representation of reality<sup>26</sup>.

Article 1 of the Dir. 2003/6/CE lists a series of practices which can be considered as market abuse<sup>27</sup> and which for the purposes of this study can be interpreted also as the objective element of the criminal offense:

- a) conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument which has the effect of fixing, directly or indirectly, purchase or sale prices or creating other unfair trading conditions
- b) the buying or selling of financial instruments at the close of the market with the effect of misleading investors acting on the basis of closing prices,
- c) taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument (or indirectly about its issuer) while having previously taken positions on that financial instrument and profiting subsequently from the impact of the opinions voiced on the price of that instrument, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way

Besides this Directive there are some guidelines provided by CESR (Committee of European Securities Regulators) which list 4 categories of practice that CESR members would consider to constitute market manipulation<sup>28</sup>:

Transactions or orders to trade:

- a) which give, or are likely to give, false and misleading signals as to the supply of demand for or price of financial instruments (for ease of reference this might be termed *false or misleading transactions*). This includes ("*wash trades*"): the practice of entering into arrangements for the sale or purchase of a financial instrument where there is no change in beneficial interests or market risk or where the transfer of beneficial interest or market risk is only between parties who are acting in concert or collusion; ("*painting the tape*"): the practice involves engaging in a transaction or series of transactions which are shown on a public display facility to give the impression of activity or price movement in a financial instrument; ("*improper matched orders*"): these are transactions where both buy and sell orders are entered at or nearly at the same time, with the same price and quantity by different but colluding parties, unless the transactions are legitimate trades carried out in conformity with the rules of the relevant trading platform; ("*Placing orders with no intention of executing them*"): this involves the entering of orders, especially into electronic trading systems, which are higher/lower than the previous bid/offer. The intention is not to execute the order but to give a misleading impression that there is demand for or supply of the financial instrument at that price. The orders are then withdrawn from the market before they are executed.
- b) which secure by a person or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level ("*price positioning*") unless the transaction/order to trade had a legitimate reason and conforms to accepted market practices on the regulated market concerned. This includes mainly: ("*Marking the close*"): this practice involves deliberately buying or selling securities or derivatives contracts at the close of the market in an effort to alter the closing price of the security or derivatives contract. This practice may take place on any individual trading day but is particularly associated with dates such as future/option expiry dates or quarterly/annual portfolio or index reference/valuation points; ("*Abusive squeeze*"): this involves a party or parties with a significant influence over the supply of, or demand for, or delivery mechanisms for a financial instrument and/or the underlying product of a derivative contract exploiting a dominant position in order materially to distort the price at which others have to deliver, take delivery or defer delivery of the instrument/product in order to satisfy their obligations.
- c) transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance ("*fictitious devices*") which include mainly ("*Pump and dump*"): this practice involves taking a long position in a security and then undertaking further buying activity and/or disseminating misleading positive information about the security with a view to increasing the price of the security. Other market participants are misled by the resulting effect on price and are attracted into purchasing the security the manipulator then sells out at the inflated price; ("*Trash and cash*"). this is the opposite of *pump and dump*. A party will take a short position in a security; undertake further selling activity and/or spread misleading negative information about the security with the purpose of driving down its price.

<sup>26</sup> Manna, A., (2010), "Trattato di diritto penale - Parte Speciale Vol. V: I delitti contro la fede pubblica e l'economia pubblica", UTET Giuridica, pp. 724, cit. Conti, L., (1976), "Rialzo e ribasso fraudolento dei prezzi o valori", pp. 844.

<sup>27</sup> Directive 2003/6/EC, Ibid, Art.1

<sup>28</sup> CESR guideline 04/505b (2005), retrieved from [http://www.esma.europa.eu/system/files/04\\_505b.pdf](http://www.esma.europa.eu/system/files/04_505b.pdf), pp. 9

- d) The manipulator then closes their position after the price has fallen; Opening a position and closing it immediately after its public disclosure: the unfair conduct consists in closing the position previously acquired immediately after having publicly disclosed it putting emphasis on the long holding period of the investment.
- e) Dissemination of information through the media which gives or is likely to give false and misleading signals as to financial instrument where the person who made the dissemination knew, or ought to have known, that the information was false or misleading ("*false or misleading information*")

The range of subjects liable for this particular criminal offense is broader when compared to that of *insider trading*, as defined by article 143/a/2 of the C.C, as no special link to the issuer or collaboration with him is required. If the person liable for price manipulation is also an insider then this should be taken into consideration by the judge when applying the sanction.

### III. General considerations regarding the criminally liable for market abuse.

The subjects involved in this kind of criminal offense all carry a specific role being them either market operators or structures meant to supervise these operators (with exception of subjects involved in stock price manipulation Art.143/a/3 C.C). The criminal liability involves most of the time a group of subjects operating on different levels of the hierarchy of these mega-structures<sup>29</sup>. The way these structures are organized influences the distribution of liability with regards to these "*multiperson offenses*". These subjects are liable within the limits of their material or moral contribution in committing the offense therefore autonomous investigation should be lead for each subject. The material contribution is restricted only to people placed in executive positions within the company as set by the relevant civil law norms but this doesn't overrule the chance of accomplice liability for persons outside the company<sup>30</sup>. Some of the criminal offenses do not point specifically out to the group of liable subjects (leaving therefore this duty to the civil law norms) but simply prescribe a more generic "whoever or any person".

There has been an evolution in the Italian jurisprudence concerning the criminal liability of a company administrator. The formal aspect of being invested as an administrator has been surpassed by the importance of the subject who actually exercises executive functions within a company without formally holding the status of "administrator" because he was never appointed as such or because the appointment results for whatever reason invalid (i.e. the person is elected in presence of ineligibility reasons or because he continues to operate after his power has expired or is revoked or he exercises functions which do not pertain to him)<sup>31</sup>. For such reason, any subject that is not formally invested with the status of administrator can be qualified as an "actual administrator", therefore is held liable for such reason and not through "accomplice liability", which features generic subjects.

On the other hand, the formal administrator who acts on behalf of others who administrate *de facto* the company is liable at least for omitting to control and guard as the position he accepted would ask to<sup>32</sup>. The liability of the person who exercises *de facto* administrative powers rises only when these bear continuity and significance comparable to the behaviour of the subjects recognized by law as liable<sup>33</sup>. The same frame of mind is supported by the Albanian legal system by jurisprudence<sup>34</sup>. in compliance with Law nr.9754 of 14.06.2007 "*On criminal liability of legal persons*" specifying pursuant Art. 3 "*A legal person is responsible for offenses committed:*

a) *in name of or to its own benefit, by its organs or representatives;*

b) *on behalf of or for the benefit of it, by a person who is under the authority of the person who represents, leads and manages this legal person*".

There is to be considered also the range of the passive subjects, the victims of this kind of criminal offenses which vary from potential investors, to stakeholders or in general, any person using the financial market<sup>35</sup>.

The changes introduced in the C.C with regards to the criminal offenses occurring in the financial market finally internalize within the Albanian law the regulation made by the DIR 2003/6/EC on this issue.

### IV. Criminal offense versus administrative misdemeanour.

<sup>29</sup> Piergallini, C. (2004), "Danno da prodotto e responsabilità penale. Profili dommatici e politico-criminali", Milano, Giuffrè, pp. 302.

<sup>30</sup> Alessandri, A., (1992), "Impresa (Responsabilità penali)", Digesto, IV edizione, Discipline penalistiche, Vol. VI, Torino, UTET, pp. 209.

<sup>31</sup> Corte di Cassazione, Sezione Penale, 15 maggio 1987, in Rivista Penale 1988, La Tribuna, pp.91

<sup>32</sup> Corte di Cassazione, Sezione Penale, 27 ottobre 1996, nr. 10941, Giustizia Penale (1997), Volume II, pp.526.

<sup>33</sup> Relazione governativa al d.lgs 61/2002, retrieved from [http://www.tuttocamere.it/files/dirsoc/2002\\_61\\_Relazione.pdf](http://www.tuttocamere.it/files/dirsoc/2002_61_Relazione.pdf), August 2012, pp.11

<sup>34</sup> Supreme Court Decision nr. 00-2011-326, of 03.09.2011, retrieved from <http://www.gjykataelarte.gov.al/>

<sup>35</sup> Manes, V., (2005), "Il principio di offensività nel diritto penale", Torino, Giappichelli, pp. 174

The most common stand of current doctrine is to treat criminal liability as original and autonomous from the administrative one showcasing the principle of fragmentation in cases when a criminal offense constitutes also a non-criminal illicit<sup>36</sup>. This stands at the opposite of previous theories which attributed the criminal law a merely vicarious function (by setting penalties when a juridical relationship is violated) seeing any criminal offense as already illicit by a private or public law norm<sup>37</sup>.

Like many EU countries (including Italy<sup>38</sup>) Albania has decided to apply a binary sanction system, where the same fact if constituting both an administrative and criminal offense, it is punishable according to each jurisdiction autonomously and in no way this is an infringement of the “*ne bis in idem*” principle<sup>39</sup>. Sometimes the legislator clearly establishes through the principle of subsidiarity that if the offense set forth in the *lex specialis* does not constitute a criminal offense, it constitutes an administrative violation<sup>40</sup> i.e. Law no. 9879 of 21.02.2008, “*On financial instruments*”, art. 147 provides that: “*Any violation of the obligations set forth in the provisions of this law and conducted by the subjects authorized to conduct transactions with securities, when it does not constitute a criminal offense, constitutes an administrative offense punishable by a fine of 100 000 (one hundred thousand) to 1000 000 (one million)*”<sup>41</sup>. On the other hand, some criminal provisions specify that criminal liability will rise only in case administrative sanctions were applied beforehand for the same fact or if the damage is higher than a certain amount<sup>42</sup>.

In addition to this, the Italian doctrine brings up the principle of proportionality establishing that when the danger of altering the price of the financial market is concrete then criminal liability is activated, whereas when such danger is alleged or abstract through action or information based manipulation that does not affect in a sensitive way the prices of the financial instrument the liability is administrative<sup>43</sup>.

Another important point for both these criminal offenses is the subjective element. Both offenses require the illicit actions to be carried with the purpose of reaching a personal benefit or that of a third party or to the damage of this last. This means that in order to be criminally liable there should be proof of such purpose, same as for the link between the action and the event (consequence). When it comes to the liability for damage caused by dissemination of false information (upon request of the damaged part) pursuant Article 100 of Law “*On financial instruments*” it is established that the burden of proof falls upon the issuer who disseminated this false information when the third party<sup>44</sup>:

- a) *has purchased securities after the publication of false information and still owns them at the moment once it becomes of public knowledge that the information was inaccurate.*
- b) *bought titles(financial instruments) before the publication of false information and sold it before it became clear that the information was inaccurate.*

Then again, as cited above when any of the obligations set by this law is violated, administrative liability pursuant Art. 147 of the Law “*On financial instruments*” rises if the action does not constitute a criminal offense.

## Conclusions.

Insider trading and market abuse are rampant in developed countries therefore the criminal regulation adopted in Albania concerning these issues is rightfully seen as a step towards compliance with EU regulation. Said compliance now exists formally but it is still to be seen if the structures bound to implement the regulations are efficient with the tools they were handed. We also wanted to offer just a glimpse of the normative, doctrinal and jurisprudence current standing while not pretending to be exhaustive in any way in addressing the issue. Although market abuse and insider trading are criminal offenses which liability is strongly linked to administrative liability we deemed it was important to analyze the constituting elements of these criminal conducts in way to offer a criminal law interpretation of a conduct typically regulated by the civil law.

<sup>36</sup> Fiandaca, G., Musco, E., (2008), “Diritto penale, Parte generale”, Bologna, Zanichelli, pp. 36.

<sup>37</sup> Grispligni, F., (1952), “Diritto penale italiano, vol. I”, Milano, Giuffrè, pp. 232.

<sup>38</sup> Cassazione Penale, Sez.VI, nr. 15199, 03.5.2006, retrieved from [www.cortedicassazione.it](http://www.cortedicassazione.it)

<sup>39</sup> Gjykata Kushtetuese, Vendimi 5, 08.03.2005, retrieved from <http://www.gjk.gov.al/>

<sup>40</sup> For more see (Methasani) Çani E., (2010), “Administrative misdemeanours: lack of clear definitions and the obligation to fulfil regional European recommendations”, International Conference, University of Utrecht, the Netherlands, Tirana, Albania, pp. 3

<sup>41</sup> Law 9879 “Për titujt”, Ibis, Art. 147.

<sup>42</sup> Art. 180, 181 and 181/a of the C.C, retrieved from [www.ligjet.org](http://www.ligjet.org)

<sup>43</sup> Vizzardi, M., (2006), “Manipolazione del mercato: un «doppio binario» da ripensare?”, Rivista Italiana di Diritto e Procedura Penale, Giuffrè, pp. 729

<sup>44</sup> Law 9879 “Për titujt”, Ibis, Art. 100

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## THE IMPACT OF MILLENNIUM DEVELOPMENT GOALS IN ALBANIA DEVELOPMENT

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### **Abstract:**

*Millennium Development Goals were established by an agreement of 193 UN members and at least 23 international organizations, in September of 2000 and with a time deadline in 2015. The United Nations Millennium Declaration commits world leaders to combat poverty, hunger, disease, illiteracy, environmental degradation, and discrimination against women. Major successes in combating extreme poverty, improving school enrolment and child health and controlling spread of killer diseases like AIDS, Malaria and TB in almost all developing countries- even in the poorest countries – demonstrate that the Millennium Development Goals (MDGs) are achievable. Albania is part of this agreement and a monitoring group is to observe the progress of these goals. Considering that the fulfillment of these goals is a big step for EU integration, in this paper will be conducted a study on the impact of these goals, in the economic development as a significant part of overall and sustainable development of Albania. So all the eight goals will be analyzed in order to estimate the situation in Albania. Through an econometric model, it is examined the impact of some of the goals in the economic growth, coming up with the conclusion that which of them is the most important for the overall development.*

**Keywords:** *Millennium Development Goals; European Integration; Economic Development; Econometric Model*

**JEL Classification:** *I32, I38.*

### **1. Millennium Development Goals (MDGs).**

In September 2000, 147 heads of state and government which represented 193 members of United Nations were gathered to sign a declaration in which they pledged that by 2015 they would meet the fulfillment of certain goals that would improve the overall development of the world states mainly of developing and of poor countries. These goals were called Millennium Development Goals and were as above: eradicating extreme poverty and hunger, achieving universal primary education, promoting gender equality and empowering women, reducing child mortality rates, improving maternal health, combating HIV/AIDS, malaria, and other diseases, ensuring environmental sustainability and developing a global partnership for development. In this initiative, were also participating the EU States and this latter has made a specific commitment to attain these goals in 2015. According to the European Commission President these goals are achievable if all the EU countries follow a strong political commitment with the right policies and the right resources. So for the European Union the progress toward the Millennium Goals is a very important issue and for all those countries who are potential candidates to be part of this Union the fulfillment of these goals must be an obligation.

#### **Millennium Development Goals in Albania.**

Given that from 14 December 1955 Albania is a member of United Nation then it together with 192 other members has pledged that it will be ready to do it best to achieve these goals in 2015. On July 2003, Albanian parliament passed a resolution in support of the Millennium Development Goals (MDGs). Also the UN office that operates in our country supervises and coordinates the national efforts of Albania to achieve these goals. The Government has prepared its National Strategy for Development and Integration (NSDI), 2007-2013, which is based on a number of sectional and cross-cutting strategies, including national strategies for regional development and social inclusion.

The UN has been an active partner in the consultation process to develop the NSDI and sector strategies, including the incorporation of MDGs in this national plan. The aim of this paper is not finding the best way how these goals can be reached, but to emphasize the importance of some of the goals, in the economic and overall development and to determine which of them is the most important for the Albanian development.

## 2. The Econometric Model of MDG in Albania Economic Development.

### 2.1. The econometric Model.

It was a difficult choice the unit of measure of economic development because this latter has a more complex nature, and is measured with a fully indexed, but it was thought that GDP per capita would be the most appropriate evaluator of Indian economic development. Economic development of a country is due to the interaction of many factors simultaneously, but in our model we are mainly focused on those factors that match millennium goals. So we decided to study the development of India depending on five factors which are explained more specifically in the following paragraphs. To build econometric model is used EViews software. The data are constructed in the form of time series and are evaluated by the method of ordinary least squares. The equations presented are mainly log-log form which means that variables are expressed in percentage. But we have presented and equations of lin-log form where one of the variables is expressed in units and the other variable in percentage. The establishment of an econometric model is a difficult process because many models should be proved in order to choose the right one. Problems such as multicollinearity, made difficult the existence of some explanatory variables in the same model and in many cases the model is not the right one. For this reason, dozens of different models are built by taking in consideration all the possible combinations of variables until deciding which model will predict accurately the same situation in the future. The selection of econometric model is made relying on several factors, but in this case as criteria for validation are used Fisher statistics (F) and the coefficient of determination ( $R^2$ ). In many cases, it happens that in the final model are not include all variables that are thought as appropriate at the beginning.

### 2.2. The variables of the econometric model.

The factors that are thought to affect GDP growth are explained as below:

- *Reducing children mortality rate* - This data gives the number of deaths of children under five years old in a given year per 1,000 live births in the same year. This rate is often used as an indicator of the level of health in a country, so if this rate is significantly higher, then we can affirm that the country has a problem with the health care system. There is an inverse relationship between children mortality rate and GDP per capita. If a country is not economically developed, his health care system will “suffer” and consequently the number of children’s deaths will increase because their parents may not have the necessary income to cure them. So if the country has a high rate of children mortality then it is not economically developed.
- *Women empowering* - Empowering the role of women in society affects directly growth and development. The reason is because female and male are both individuals who can and should contribute to the society where they live. If women were deprived of this right the society will incur the consequences. According to statistics it is observed that in countries where women are suppressed and where men are the only ones who can work and contribute to economic development, than those states aren’t economically developed. So women should be more active in every field of society. In this model as a symbol of women empowerment is taken the percentage of Albanian women in the country's parliament. Through this indicator is expresses how influential are women in the decision making process, which then directly affects the development of a country.
- *Primary Completion Rate* - Education is the foundation of economic development. An educated youth is the best asset a country may have and for this reason Albanian government has pledged to achieve “Education for all” by 2015. In this study is taken into account the number of children who have finished primary school. These data are taken by the Ministry of Education and Science. The relationship between the index of GDP per capita and percentage of children who have completed primary education is positive because if children are educated they will contribute to future development. Ignorance is the main factor that hinders development.
- *Mother mortality rate* – As seen by the table Albania is going to meet this goal of reducing mother mortality by 2015 because this rate has been decreased almost 4 times from 1999 to 2010. The relationship is mutual inverse because a low GDP per capita means less revenue and therefore women not having any opportunity to take care during pregnancy. The higher this rate is more mothers die, which bring more orphaned children where in most cases their unfortunate future is known.

All these children will become problematic young people which will affect negatively on the overall development. On the other hand, maternal death means reduction in the number of women, whose empowerment should be encouraged in order to have economic development.

- *Develop global partnership for development* – the aim of this goal is that wealthy countries and developing countries should work in partnership to reach Millennium Development Goals and it emphasizes the collaboration with private sector in order to benefit from the new technologies, especially information and communication. In fact it is noticed a strong growth in Albania overall availability, including basic telephony services. As seen in the following table the percentage of internet users has been increased from 0.081% in 1999 to 45.003% in 2010.
- *Environment protecting* – there are a lot of index to measure the environment development like proportion of land area covered by forest, energy use per unit of GDP, proportion of the households using solid fuels or the carbon dioxide emissions per capita. In this study as indicator of measurement is chosen this last because it is revealed an increase of carbon dioxide, causing more harm than help to the country development.

All the data related to millennium goals indicators for the period 1999-2010 are presented in the table below.

Year	GDP per capita (current US\$)	Children mortality rate	Percentage of women in parliament	Total number of children who have finished the primary	Mother mortality rate	Percentage of internet users	carbon dioxide emissions per capita
1999	1,117.71	17.5	12.1	553411	20.7	0.081	127
2000	1,200.14	16	5.2	543967	22.6	0.111	120
2001	1,329.39	17.5	5.2	535238	22.7	0.331	113
2002	1,440.03	17.3	5.7	523253	21.2	0.391	122
2003	1,819.40	15.5	5.7	503992	17.7	0.972	120
2004	2,388.73	15.1	5.7	491541	7.5	2.422	110
2005	2,666.14	14.7	6.4	474637	23.2	6.042	119
2006	2,893.16	13	7.1	450702	16.7	9.614	107
2007	3,377.22	11.9	7.1	447302	14.5	15.044	100
2008	4,076.40	11.1	7.1	428435	20.9	23.863	90
2009	3,772.61	10.3	7.1	457886	0	41.203	72
2010	3677.410	9.7	16.4	439995	5.9	45.003	65

The records above are used to create an econometric model which will demonstrates the key factors that affect economic development in order to know where to focus in the near future for achieving the millennium goals. The econometric model is as follow:

$$\text{GDP} = -21949.7999945 - 2513.95469666 * \text{LOG}(\text{CHMR}) - 6.17194331215 * \text{MMR} + 2098.94071015 * \text{LOG}(\text{EDU}) + 1730.27301201 * \text{LOG}(\text{ENVIR})$$

Considering the above model, can be stated that 1% increase in infant mortality will have a negative impact by 2514 dollars, in the GDP per capita. On the other hand an increased by 1% in education will increase GDP per capita in the amount of 2099 dollars. From the equation it is noticed a positive correlation between the increasing of CO2 and GDP growth. This connection is somehow surprising considering the fact that the growth of carbon dioxide has a negative effect on the environment and therefore the relationship should be negative. But taking into account the fact that the body produces approximately 1 kg of carbon dioxide per day per person and considering that year after year the number of population has risen then is more than logical that the connection is positive. Regarding mother mortality, the effect in the real GDP is negative and for every one maternal death GDP per capita decreased by 6.17 dollars.

As shown in the model are used only 4 out of 6 initial variables. The reasons are explained at the first half of this chapter. This econometric model must be considered as correct for future forecast because Fisher statistic is equal to 34.48 meaning that this model is statistically important. Also R-squared which is a Statistical measure that explains how well a regression line approximates real data points is relatively high by 0.9517 meaning that the econometric model is representing the reality in the measure of 95.17%.

### **Conclusions.**

The Millennium Development Goals (MDGs) are the world's biggest promise - a global agreement to reduce poverty and human deprivation at historically unprecedented rates through collaborative multilateral action. Albania as part of United Nations and as aspiring member of European Union must pay great importance to the 8 goals, but mostly it should be focused on the education of youth as one of the greatest strengths of a nation and in the reducing children mortality.

This was also highlighted in the model above, where the increase of the educated youth by 1% would affect GDP growth in the amount of 2099 dollars and the decrease of the children mortality rate by 1% will increase GDP per capita by 2514\$. The implementation of these goals will not only affect the country's economic development, but will have quite an impact on overall development of the country. Also should not be neglected the fulfillment of the other goals which affect the economic growth in different sizes. However, has to be acknowledged the fact that Albania is one of those countries which has made much progress in achieving the millennium goals. This fact can be taken into consideration by the EU given that this latter is now the largest aid donor (55%) of the Official Development Assistance (ODA).

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**EFFICIENCY IN THE LEGAL PROTECTION OF TRADEMARK AND FOREIGN DIRECT INVESTMENT  
IN REPUBLIC OF MACEDONIA**

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**Abstract:**

*The aim of this paper is observation of the economic functions of trademarks of improving the competitiveness and development of the business community in Macedonia, attracting foreign investment and thus economic development and growth of the national economy. The data obtained from structural analysis of trademarks will be compared to the amount of foreign direct investment and will identify any relations among them. It will also aim to detect the violations of trademark rights in R. Macedonia in order to discover the effects they have on the business community as right holder, but also on the functioning of market and national economy as a whole. It will try to discover the problems the business community faces as a holder of trademark rights in seeking legal protection, critical review of the speed and effectiveness in the reaction of courts and administrative bodies, and comparative observations of Southeast Europe countries with recommendations for improvement. In this research, the method of scientific description and explication of existing theoretical views will be used, as well as the analytical method and the comparative method. This paper supports the thesis that a significant part of the business community in Macedonia is still at the beginning of the utilization of economic benefits arising from the registration of a trademark, particularly in terms of economic benefits from the transfer of rights of trademark, without any serious understanding of the advantages of the registration of trademarks. This requires strong efforts for continuously informing the business community regarding the potential that the protection of trademark brings for them, along with the reforms of the institutions responsible for prevention of the violations and protection of the rights of trademarks, which is one of the factors that promotes the growth of the foreign direct investments that could result in growth of the national economy.*

**Key words:** trademark, registration, rights, foreign investment.

**JEL Classification:** K11.

**1. Trademarks and economic functions**

Capital and wealth of companies are no longer measured exclusively by the material goods they possess. Slowly but surely the information, knowledge, skills, patents, distinctive signs, and other intangible goods take greater importance in all economic relations. Intellectual property which as its object of study has the creations of human intellect, is inseparably linked with the intellectual activities in the economy.

Republic of Macedonia, a candidate for European Union membership, a member of the World Trade Organization and signer of the Agreement on Trade-Related Aspects of Intellectual Property Rights, following the trends of liberalization and smooth trading in goods and services, in the past very directly faced the new reality that intellectual products and services are one of the most important resources for the development of today's economy. This is why it is necessary to determinate the importance of intellectual property rights through the discovery of opportunities offered in development of the business community in Macedonia and building their competitiveness and recognition on the domestic and foreign market. It is often said that the intellectual property right-trademark as a distinctive sign for marking goods and services is the greatest business advantage enjoyed by enterprises.

In Article 15 (1) of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)<sup>45</sup>, similarly to the Law on Industrial Property of the Republic of Macedonia<sup>46</sup>. Mark is defined as „Any sign, or any combination of signs, capable of distinguishing the goods or services of one undertaking from those of other undertakings, shall be capable of constituting a trademark.“ A trademark protects signs that can be distinguished such as: words, letters, numbers, pictures, drawings, combinations of colors, three-dimensional shapes, including shapes of goods or their packaging, as well as combinations thereof. Registering a trademark provides the holder the exclusive right to use the mark in trade for marking its goods or services<sup>47</sup>.

Recognition of the trademark right is the formal side, while the real essence of the trademark consists of providing economic benefit for the right holder, the company, the country and for the whole society, which when summarized means economic growth and development. Trademark is a strong instrument for achieving the economic objectives of the companies, and thus the national economy. When talking about functions of the trade mark means talking about function of the transmission of information which includes ,besides function of marking the origin of the product, a distinctive function also, warranty or quality function, advertising function, and competitive function which subsumes promotional function, creating monopoly power and profits and new products launching on the market. Thus the rights of the trademark ensure that consumers will be able to distinguish between products, opportunities for fraud are significantly reduced, and on the other hand the possibilities for additional revenue through licensing contracts, franchise etc. develop, especially in service trademarks where a strong growth<sup>48</sup> has been noted. The impact of trademark in strengthening of nonprice competition and improving market position in terms of competition makes the investment in creation, launch and promotion of marks a worthwhile investment.

According to the latest processed statistical data available from 58 intellectual property offices, in 2010, 18.1 million trademarks were in force worldwide. China has the highest number of trademarks in force (4.6 million) in 2010, a 35% increase compared to 2009, Japan (1.75 million) and the United States (1.54 million). In terms of average duration of trademarks around 20% of trademarks in force in 2010 were registered in the 1980's, while this percentage is around 40% of the marks that are still in force in 2010, and were registered in the 1990's. It is noticeable that a significant percentage of the trade marks in force and which have been registered before 2000, are subject to continuous renewal, which sometimes lasts for decades. Over half of the trade marks in force, have been registered in the period between 2004-2010. WIPO estimates that only in the 2010, 3,157,824 trademark were registered which is exactly 6 times more than the number of trademarks which were protected 25 years ago.

Such global flood of protected trademarks, gives a big incentive for the economic and legal approach in studying the issue of trademarks and their meaning. Especially if one takes into account the fact that in our country very little has been done regarding this issue which is relatively new and still under-explored for our market, but at the same time with great potential for the development and improvement of the economic situation in the country.

Trademarks alone are not guarantee marks in the strict sense (although in the case of certification marks is different), still greatly assist in evaluating the quality of goods and services. These features ultimately stimulate competitiveness. In longer term it may lead to an increase in the number and type of goods and services in the market and to possible prices decrease. The usage of trademarks stimulate competition between holders in terms of quality also, that in the end leads to the improvement of the overall quality of goods and services. In other words trademarks stimulate investment in the quality of goods and services. This is especially important due to the fact that in developing countries, where the general perception is that the quality of goods and services is lower, preferences toward foreign products which have a recognizable trademark often lead to unreasonably high profits, as well as entry barriers for the domestic companies.

<sup>45</sup> *TRIPS: Agreement on trade-related aspects of intellectual property rights*. World Trade Organization Morocco: Marrakesh, 1994.

<sup>46</sup> *Law on Industrial Property. Official Gazette of the Republic of Macedonia* 21/09.

<sup>47</sup> Exclusivity also implies prohibition of use in the market by third parties without the consent of the right holder, including affixing the sign on products and their packaging, import or export of goods under that sign, usage of the sign in correspondence, publication and advertising

<sup>48</sup> Andrea Mangani, “An economic analysis of the rise of service marks”. University of Pisa, Department of Economics, page 7-12

Therefore, the conclusion that the economic functions of the trade mark are complex and can be exploited in many different ways in order to achieve economic benefits by the business community, and thus economic development in Macedonia is entirely reasonable.

## 2. Trademarks in Republic of Macedonia and protection of trademark rights

In the latest publication of "The Global Competitiveness report 2011-2012" by the World Economic Forum, the Republic of Macedonia according to the Global Competitiveness index (GCI) is on 79th place out of 142 countries analyzed in the world (ranked as in the previous report for 2010-2011). As an indicator in the survey, the issue of the protection of intellectual property rights has been treated, the capacity for innovation, companies investment in R & D, etc..Although the protection of Intellectual Property rights (and thus trademark) is not categorized in the group of 15 most problematic factors for doing business, still the fact that we are ranked at 89th place regarding protection of intellectual property, 109th place on the list regarding companies spending in R & D, and even 113th-place regarding foreign direct investment and technology transfer, is sufficiently illustrative for the condition in the Macedonian economy.

All this leaves a large area for research as to where is the Republic of Macedonia in the field of protection of intellectual property, and thus the trademark rights as its significant part, in which direction should the amendments to the legislation be oriented, but also the necessary changes that need to happen in respect of the way of perception of the trademark institute, considering the huge potential that it has in the economic development of the business community, and thus of the national economy.

For these reasons, the analysis of the structure of trade marks in Macedonia is unavoidable (in terms of the class in which they are registered, their number, the origin of the holders, the number of holders, etc.) which in the end will give a fairly objective image of the economic relations and the situation in the country.

Statistic data show that in the period from 2003 to 2011 the State Office of Industrial Property received a total of 40,892 applications for recognition of the trademark right. Of these, even 74.5% are under the Madrid Agreement, and only 25.4% were filed before the Office. In terms of the structure of the total number of applications, the number of applications filed from abroad is dominant - 86.3%, versus only 13.7% submitted from domestic applicants. Regarding the division in terms of residency or no residency of trademark applicants, an increase in the number of domestic trademark applications which are submitted directly in the State Office of Industrial Property is obvious. For example, the ratio of 1.5 in favor of foreign trademarks in 2006, where out of a total of 1243 applications 749 were foreign and only 494 were domestic, in 2011 the situation was quite the opposite in favor of domestic trademarks and from 1391 registered applications, 917 were domestic, while 474 were foreign applications or a ratio of 1.9 in favor of domestic trademarks. Of course, this indicator indicates that domestic trademark holders have become quite active in the last period and have understood the benefits and the importance of trademark registration. Structural analysis of the trademarks applications shows dominance of the Class 35 applications (trademark in the wholesale and retail trade and advertising, doing things, and office management work) according to the international classification of goods and commodities (Nice Agreement) with its share of 33.3%. About 29% of the applications refer to class 30 (trademark in the field of food products of plant origin for consumption or conservation, as well as additives designed to enhance the taste of food), Class 29 and Class 43. Especially significant is the participation of trademarks from class 05 - protection of pharmaceutical products and other products for medical use (15.6%), due to the developed Pharmaceutical industry in the Republic of Macedonia.

Despite the positive trend in the number of recognized trademarks and the particularly significant continued growth of domestic trademarks (from 80 in 1994 to 1,012 in 2011)<sup>49</sup>, still the situation with internationally registered trademarks from the Republic of Macedonia indicates that macedonian companies have not yet understood the importance of the international protection of trade marks and the fact that the Madrid system offers convenience as a lower cost, a single application for multiple states etc..

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<sup>49</sup>. The newly adopted tariff of the State Office of Industrial Property of the Republic of Macedonia no.03-674/8 of 20.09.2007 also contributed to this, which halved all current fees related to the procedure for the acquisition of industrial property rights and costs providing information services, making the procedure for registration of a trademark more accessible with no serious financial burden on companies

So in 2011, through the State Office of Industrial Property in the World Organization only 17 trademarks were internationally registered, which leaves plenty of room to investigate this situation and the reasons for this passivity of domestic companies (whether it is due to the lack of information among domestic companies, high fees for international trademark registration<sup>50</sup>, weak export orientation of companies, flaws in the conduct of strategic management, etc.).

In 2010, according to data published by WIPO for the Macedonian trademarks that are either directly registered abroad or through Madrid, even 111 were in class 5<sup>51</sup>, 31 trademarks in Class 30<sup>52</sup>, 18 in Class 32<sup>53</sup>, 46 in Class 33<sup>54</sup>, 15 in Class 35<sup>55</sup>, and 7 in class 39<sup>56</sup>. Thereby the protection primarily in the surrounding region countries is dominating, 76 trademarks are protected in Croatia, 28 in Bosnia and Herzegovina, Serbia 27, 11 in Albania, Bulgaria, 14 in Montenegro, while only 10 in Ukraine 14 OHIM, 9 in Romania, Turkey, Russia 8, 7 Slovenia etc<sup>57</sup>. This is a strong illustration of which part of our economy is export-oriented and who pays attention to the the protection of the rights of the trade mark in order to build and ensure a secure position in the domestic and foreign market. The dominance of trademarks in Class 5 speaks about the developed pharmaceutical industry in Macedonia<sup>58</sup> (also in 2010 even 111 Macedonian trademarks were directly or through the Madrid Agreement registered abroad, and in the same 2010 172 applications for registration of trade marks of class 5 were filed, almost half of them for the territory of Ukraine, the Russian Federation and Serbia), while the rest were in the area of food and beverages (mainly wine).

Legal protection of the rights of the trade mark must be capable of quickly and effectively preventing any kind of violence directed towards the rights of the trademark, damage prevention, and an adequate compensation for those already created. Only in that way an area for the full realization of the rights of the trademark on economic plan will be provided. In order to improve the civil law, criminal law and administrative law protection and warranty of the rights of the trademark, the Republic of Macedonia has made solid progress in the last period, and of course there is still plenty of space for improving mainly the protection by using the comparative experiences.

Thus, according to the prestigious “Doing business”, in the “Enforcing contracts” part,<sup>59</sup> the Republic of Macedonia is better ranked in 2012 compared to the 2011 analysis and is located at 60 th place.

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<sup>50</sup> The basic fee for filing an international application is CHF 653 or CHF 903 when the mark is in color. The website of the World Intellectual Property Organization offers a calculator for easy calculation of the compensation for trademark protection under the Madrid system <http://www.wipo.int/madrid/en/fees/>

<sup>51</sup> Class 5 - Pharmaceutical, veterinary and sanitary preparations; dietetic substances adapted for medical use, food for babies; plasters, materials for dressings; material for stopping teeth, dental wax; disinfectants; preparations for destroying vermin; fungicides, herbicides.

<sup>52</sup> Class 30 - Coffee, tea, cocoa, sugar, rice, tapioca, sago, artificial coffee; flour and preparations made from cereals, bread, pastry and confectionery, ices; honey, treacle; yeast, baking-powder; salt, mustard; vinegar, sauces (condiments); spices; ice.

<sup>53</sup> Class 32: Beers; mineral and aerated waters and other non-alcoholic drinks; fruit drinks and fruit juices; syrups and other preparations for making beverages

<sup>54</sup> Class 33: Alcoholic beverages (except beers)

<sup>55</sup> Class 35 - Advertising; business management; business administration; office functions.

<sup>56</sup> Class 39: Transport; packaging and storage of goods; travel arrangement

<sup>57</sup> Trademark registrations by Origin, Office and Class (2010): WIPO Statistics Database, <http://www.wipo.int/ipstats/en/statistics/marks/>

<sup>58</sup> only Alkaloid AD Skopje, the famous pharmaceutical company is the holder of approximately 460 brands <http://ippi.ukim.edu.mk/predavaci.php>

<sup>59</sup> The enforcing contracts topic assesses the efficiency of the judicial system by following the evolution of a commercial sale dispute over the quality of goods and tracking the time, cost and number of procedures involved from the moment the plaintiff files the lawsuit until payment is received



The time needed for filling and service, trial and judgement and enforcement of judgement is 370 days<sup>60</sup> which is better compared with the average in Eastern Europe and Central Asia of 412 days and compared to the OECD average of 518 days<sup>61</sup>.

The section ECONOMY CASE STUDIES: FYR MACEDONIA, Judicial reforms of the report says „A comprehensive information technology system was introduced in 2007 as part of the government’s 2007–10 information technology strategy. This provided a foundation for reforms in judicial processes, especially through the introduction of electronic case management. Before reforms, the judicial system was plagued by inefficiencies. Procedures were slow, delaying access to justice. Getting final decisions enforced was a long and difficult process. Courts were overburdened with minor cases, and case management was unorganized. There was too little use of information technology—and qualified human resources were scarce. FYR Macedonia tackled these inefficiencies through several reform initiatives for which EU legislation provided a framework.“<sup>62</sup>

The efficiency in the legal protection of intellectual property rights and therefore trademark rights was part of the Commission Staff working paper, The Former Yugoslav Republic of Macedonia 2011 Progress Report, Part 4, Chapter 7, Intellectual property law. In the report it was concluded that the methodology for collecting statistical data has not been developed yet and there is still no reliable enforcement record. However in the report as a positive example were highlighted 23 undertaken coordinated actions throughout the country to combat piracy and counterfeiting, and the increased number of misdemeanour, civil and criminal proceedings, 10 individuals were sentenced to 6 months imprisonment, 34 fines of between €200 and €1,600 were imposed on legal entities, 91 out of 152 cases were completed in 2010 by the specialised IPR departments of the 13 basic courts. But despite the obvious progress in the protection of intellectual property rights, the European Commission in the conclusion points out the great need for a series of activities in the future in the field of effective protection of intellectual property rights.<sup>63</sup> In this respect, R. Macedonia should use the positive experiences of Croatia due to the fact that alignment with the *acquis* in the field of intellectual property law has reached a very high level.<sup>64</sup> In contrast to the Croatian example, the situation in the Republic of Macedonia is better evaluated by Albania<sup>65</sup>, Turkey<sup>66</sup>, Bosnia and Herzegovina<sup>67</sup>.

The dedication and commitment of the Republic of Macedonia to promote protection of trademark rights and the recognition of the economic dimension of intellectual property rights, which according to global processes is one of the supporting pillars of the economic development of the country, resulted in the adoption of the Strategy for Intellectual Property of the Republic of Macedonia 2009-2012.<sup>68</sup> The strategy defined *inter alia* measures for strengthening the legal framework in the field of intellectual property, measures to strengthen effective and efficient implementation of the protection of intellectual property rights, measures to enhance the capacity of individual holders and the business community for the protection and enforcement of intellectual property rights and the measures to strengthen public awareness and benefits of intellectual property.

<sup>60</sup> „The time to enforce a contract fell from 509 days in 2004 to 370 days in 2009, as measured by Doing Business. A 2011 amendment to the law on civil procedure, the result of an analysis of court cases by the Ministry of Justice, is aimed at further reducing the cost and duration of court proceedings. The law sets deadlines for the different steps in a court case. One tool helping to meet those deadlines is software supporting electronic case management. The world bank, IFC, Doing Business 2012, page 30

<sup>61</sup> Unlike Macedonia, the time required for filling and service, trial and judgement and enforcement of judgement in Bulgaria is 564 days, in Albania 390 days, in Serbia 635 days, in Croatia 561 days, in Turkey 420 days etc.

<sup>62</sup> The world bank, IFC, Doing Business 2012, page 29

<sup>63</sup> „Although the actions of the Coordination Body for Intellectual Property CBIP continued on a regular basis, counterfeiting and piracy remains widespread. The track record on investigation, prosecution and judicial handling of piracy and counterfeit is not satisfactory. Counterfeit and piracy are not addressed as an aspect of organised crime. The level of awareness of intellectual property rights among the public remains low. Overall, preparations in the area of Intellectual property law are advancing.“ Commission staff working paper, The former Yugoslav Republic of Macedonia 2011 Progress Report, European Commission, page 38 Brussels, 12.10.2011

<sup>64</sup> Commission staff working paper, Croatia 2011 Progress Report, European Commission, page 30 Brussels, 12.10.2011

<sup>65</sup> Commission staff working paper, Albania 2011 Progress Report, European Commission, page 35 Brussels, 12.10.2011

<sup>66</sup> Commission staff working paper, Turkey 2011 Progress Report, European Commission, page 62 Brussels, 12.10.2011

<sup>67</sup> Commission staff working paper, Bosnia and Herzegovina 2011 Progress Report, European Commission, page 38 Brussels, 12.10.2011

<sup>68</sup> Adopted at the session of the Government 07.09.2009.

In that direction is also the information of the State Office for Industrial Property and the Coordinating Body for Intellectual Property in the Annual Report<sup>69</sup> under the Operational Programme for piracy and counterfeiting combat. According to a statement of the Coordination Body for Intellectual Property on the official website of the State Office of Industrial Property as of November 2011, 269021 items that have been used in a violation of copyright and related rights were seized and 132620 items that have been used in a violation of industrial property rights or a total of 401641 items.

All these measures are taken in order to ensure the rule of law and secure free, undisturbed and full realization of the rights of trademark in the social relations built on the principles of market economy. Reasonably in today's conditions the perception of investors towards the risk of protection of industrial property rights (and thus of trademark rights)<sup>70</sup> consistently increases. It is hard to expect direct foreign investments, and through them a transfer of knowledge and technology also, creating new jobs and thus higher economic growth and poverty reduction in a country that shows tolerance and passive attitude towards infringements of industrial property rights. Therefore investments in research and development are primarily focused on countries that consistently respect holders' rights of industrial property. While analyzing the chronological FDI in Macedonia since its independence, it is evident that they had a drastic increase during the privatization of the state capital of the most important monopolies<sup>71</sup>. But of course as a positive and successful examples for greenfield foreign investments which also meant transfer of knowledge and technology in the last period, are those of the companies "Johnson Controls" and "Johnson Matthey".

Therefore, the attraction of foreign direct investment to whom the transfer of technology, know-how etc.. is immanent, can be done by taking a range of actions by the state, and certainly the warranty of the rights of industrial property, and thus the trademark rights<sup>72</sup> is necessary and indispensable

## CONCLUSIONS.

The business community in Macedonia, although showing an upward trend in the use of economic benefits arising from the registration of the mark, however is still without serious understanding of the advantages of trademark registration. Strong efforts are needed in the continuous introduction of the business community with the potential that the protection of the rights of the trademark bears inside. The legal protection of the rights of the trade mark must be capable of quickly and effectively preventing any kind of violence directed towards the rights of the trademark, damage prevention, and an adequate compensation for those already created. Only in that way an area for the full realization of the rights of the trademark on economic plan will be provided. In order to improve the protection and warranty of the rights of the trademark, the Republic of Macedonia has made a solid progress in the last period, and there is still plenty of space for improving mainly the protection by using the comparative experiences

With great commitment and firm determination to respect the intellectual property rights (and thus the rights of the trademark), one of the very important conditions for attracting foreign direct investment will be fulfilled, and through them an economic growth of the national economy, which is a top priority of the state.

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<sup>69</sup> Report on the work of the State Office of Industrial Property 2011, March 2012, p 20.21

<sup>70</sup> Despite the general (standard) risks of the operations of foreign investors (mainly political risk, the condition of the administrative system, legal certainty, etc.)

<sup>71</sup> the case with telecommunication, energetic and other giants (Macedonian Telecom and EVN as the two largest foreign direct investments in Macedonia in 2001 and 2006) <http://www.nbrm.mk/?ItemID=750FC531FC3D1B49B16440313562D400>

<sup>72</sup> Even in the case of China, as a specific example of a country with strong economic growth that does not show sufficient results in the field of protection of intellectual protection Yu K. Petek "Intellectual property, foreign direct investment and China exception" will say „Today, piracy and counterfeiting problems remain widespread in China, and rights holders continue to be frustrated by the lack of enforcement of intellectual property rights in the country. However, at some point in the near future, China may reach a crossover point at which it will find it in its self-interest to offer stronger intellectual property protection. Indeed, similar transformations occurred in Japan in the 1970s and in Hong Kong, Singapore, South Korea and Taiwan in the 1980s—and even in Germany and the United States many decades ago. It is only a matter of time before China joins its more developed neighbors in championing the cause for stronger intellectual property protection.“

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21. Ñèí ¼áí í äñèè, Ñèí -í, Õðã äñèà ì àðèà – àí ñí èóó í è è ðáèòò èáí è ï ðè-èí è çà í äáèááæá í à ï ðè¼ááàò à í à ò ðã äñèà ì àðèà (ñëó-àè í à ï àèðèèàò à í à Çááí äí ò), Ñèí ï ¼: „Éí ðáððáòò èèà Óí èí í“, 2009.
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## GLOBALIZATION, GROWTH, AND POVERTY

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### **Abstract:**

*For the health community, globalization offers opportunities but also poses important challenges. Dramatic progress has been made in the area of health over the past forty years; however, improvements have been unequally distributed across regions. Developing countries share a disproportionate burden of avoidable mortality and disability, primarily attributable to preventable infectious diseases, malnutrition, and complications of childbirth. Globalization affects global health, which in turn may improve or worsen the health of the poor in developing countries. This paper reviews the different meanings of globalization and indicators for some of its components. Using a simple framework, it examines the channels, which links globalization and health outcomes and identifies among them five main pathways. The first two pathways connect globalization with general outcomes on the economy and the government of developing countries, which affect the global health situation. The last three connect directly globalization with health, through its effect on institutions, nutrition, and the environment. In conclusion, this paper presents some policy and institutional responses that seek to reduce the negative and enhance the positive effects of globalization on health in developing countries.*

**Key words:** growth, poverty, inequality.

**JEL Classification:** O11.

### **Trends in growth, poverty and inequality**

Growth rates are significantly higher in the second half of the 20<sup>th</sup> century than in any other previous period (Table 3). However, growth appears to have been higher in the 1960s and 1970s for Sub-Saharan Africa and Latin America, although it has been up in Asia since the 1980s (Table 4). Volatility in world per capita annual growth rates about tripled in the 1970s compared to the 1960s, and has remained at similar levels since for the world as a whole. But there are important differences across developing countries with the 1980s showing larger volatility in Africa and Latin America, while for Asia the 1960s and 1970s appear more unstable (Table 5). The UNDP's Human Development Indices (HDI), which summarizes education, health, and income indicators, have been improving in developing countries, and are currently significantly higher than when now-developed countries had similar income levels in the 19<sup>th</sup> century (Crafts, 2000). However, life expectancy declined after the 1980s in SSA and some former republics of the Soviet Union (see Table 1). The number and percentage of people in poverty in developing countries decreased drastically during the 1960s and 1970s. Household surveys available for these years showed that the incidence of poverty (i.e. the number of poor people over total population) had declined significantly from an (un-weighted) average of 46% to 24%, and more importantly, the number of poor in the countries covered had declined by almost 60 million during that period (World Bank, 2009).

### **The impact of globalization on growth, poverty, and inequality**

Early works using case studies (Little et al., 1970); Balassa et al., 1971; and Krueger, 1978), and more recent empirical literature on growth using cross-section regressions (Sachs and Warner, 1995; Sala-i-Martin, 1997), suggest that a positive correlation exists between trade and economic openness, as well as between trade and growth (arguments against these findings can be found in Rodrik 1999, and 2009). Vice-versa, closed economies relying on the dynamics of smaller domestic markets (compared to larger opportunities in world markets) have tended to show slower and halting growth rates. In turn, high and stable growth rates have been commonly associated with reductions in poverty rates. Yet, higher growth rates are not enough if globalization is, at the same time, worsening income distribution.

Empirical analysis of the relationship between openness and income distribution show mixed results (Kohl and O'Rourke, 2000). Some find that openness worsens income distribution at least initially in a Kuznets fashion (Lundberg and Squire, 1999; Barro, 2000); some find little evidence of Kuznets effects (Deininger and Squire, 1998); finally, others find that openness may improve income distribution (after controlling for literacy, and income per capita (which in principle is unbounded), it is in fact truncated in the HDI at some level considered insufficient for human development; income levels above that are not included in the index.

### Summing up

The relationship between globalization, growth, income distribution and poverty, is a complex one. It has to be analyzed in a specific setting: national, regional, or at the household and individual level. In general, higher incomes and poverty reduction are obviously associated with better health indicators. Globalization appears linked also to higher average growth rates, but more recently, world economic volatility seems to have increased, mostly linked to swings in world capital markets influenced by changes in macroeconomic policies in industrialized countries. Even though growth is higher, if, at the same time, the probability of economic financial crises increases with globalization, the poor will face additional risks.

As already mentioned, besides the level and variability of growth it is important to look at its distribution. How globalization affects incomes across different countries and groups in society is not that clear and much depends on the nature and components of developing countries' patterns of integration in the world economy. Two other aspects may affect outcomes even more than the degree of globalization. First, it is important to consider the behavior of the international economy in which developing countries are getting increasingly immersed; these conditions are mostly defined by the policies of industrialized countries. Second, the type of domestic complementary policies, institutions and conditions may ultimately determine the impact on the poor. An important source of discrepancies in the assessments regarding the links between globalization and poverty is the failure to distinguish between those three distinct focus of analysis: first, the degree of integration in the world system; second, the role of domestic conditions, institutions and policies interacting with globalization; and, third, the functioning of the world economy functioning. To use an analogy, the impact of opening up the windows of a house on the well being of those living there, will depend on their own health conditions, but also on the weather outside.

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## THE RIGHT OF ESTABLISHMENT FOR THE COMPANIES UNDER THE EUROPEAN AND ALBANIAN LEGISLATION

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### *Abstract:*

*The right of establishment for the companies is a fundamental right guaranteed by the European legislation. The principle of freedom of establishment which is set in article 49 it refers to a person or a company which is able to carry on an economic activity in a stable and continuous way in one or more Member State. This right is strongly connect with the freedom of companies to provide cross border services which is set out in article 56 of the Treaty. In particular, an economic operator of a Member State is able to offer services in another Member State without having to be established. The Services Directive 2006/123/EC of 12 December aims to create a legal framework for ensuring that both, service providers and recipients benefit more easily from the fundamental freedoms guaranteed in Articles 49 and 56 of the Treaty. The principles of freedom of establishment and free movement of services have been clarified and developed over the years through the case law of the European Court of Justice. These provisions have direct effect that means that Member States must modify national laws that restrict freedom of establishment or the freedom to provide services maintaining only the restrictions justified by overriding reasons of general interest. Due the fact that Albania has apply to obtain the status of candidate member of EU the aim of this paper is the study of the most important aspects of the right of establishment and the comparison between the Albanian and European legislation.*

**Key words:** *companies, establishment, legislation, cross-border, services.*

**JEL Classification:** *K19.*

### • **The Connecting Criteria In Companies Law: The Real Seat And The Incorporation Doctrine**

The delocalization of commercial companies from one country to another is a phenomenon that is strongly correlate with the requirements of companies for competitive markets, that provide not only raw materials or cheaper manpower but also more favorable fiscal systems. The companies have two possibility, they can move from a country to another by establishment a new company abroad in respect with the legal provision of the host country or they can realize a direct transfer of their seat. In this second case the delocalization can create conflicts between the different legal systems of the countries involved. The legal continuity of the transferred company, its recognition in the destination state and also in the origin state, the applicable regulations of the transfer company (so-called *lex societatis*), are all question that depend on the legal regulation in the countries involved the transfer (state of origin and country of destination), and in particular the type of connection and recognition of the companies that has been adopted. The possibility or not that a commercial company can transfer the seat in another country is subject to the principle of territorial connection of the host country. On this connection it depends the recognition of the transfer company under the legal system of the host country than the relative applicable law.

In different international jurisdiction, this question is characterized by a deep division between the *Real Seat doctrine (Sitztheorie)* and the *Incorporation doctrine (Gründungstheorie)*. Different historical contexts and political needs gave rise to these rules of international private law. The *Incorporation doctrine* was born in England in the nineteenth century, where the judges had the intend to extend the application of English law even to distant countries where the incorporated society operate. Instead, the *Real Seat doctrine* was born in France in the mid-nineteenth century with the principal reason to prevent the escape of the French companies towards Britain and Belgium. In Europe, the *Incorporation doctrine* is adopted in England, Ireland, Denmark, Finland Sweden etc. While the *Real Seat doctrine* is adopted in Germany, Austria, France, Belgium, Greece etc. Other jurisdictions, like the Italian, Portuguese, Spanish and Dutch adopt a mixed criterion.

According to the *Incorporation doctrine*, companies are exclusively connected with the legal system in which they are established. That means that the companies established under a specific legal system will any time refer to this system independently from any subsequent territorial event, the law governing companies will be increasingly that of the state constitution. In these countries, also the foreign companies should be recognized under the rules of the State of origin. In jurisdictions that adhere to the *Incorporation doctrine* the transfer of the registered society is not a problem and the companies established under this kind of legal system are free to transfer their seats to another system without incurring the dissolution. Consequently, in these countries, the phenomenon of seat transfer must be considered a merely statutory change. Therefore, the transfer companies are always subject to the law of the establishment state and so in any event that can happen in time, the company will always act according to their original legal system, even when the company operates exclusively in a foreign country.

According to the *Real Seat doctrine*, companies are connected to where their effective seat is located. This doctrine is based on the idea that companies must have a real connection with the legal system of state in which they pretend for application. If the connection is over, because the companies transfer their real seat, or not exists *ab origine* (foreign companies), the companies must be subject of the redevelopment process in the State in which lie the real seat. The countries that adopt this doctrine do not recognize companies without territorial connection and the consequence is that they deny recognition of companies that belong to different jurisdiction than one in which the real seat is stabilized. So in these countries, the transfer company involves a dissolution and a subsequent establishment adapting the rules in force in the host state.

The adherence to the *Incorporation doctrine* expresses a more open system that implies full acceptance of a competition between legal systems, considering that the company will be formed in states that offer a more favorable legislation. Conversely, the adherence to the *Real Seat doctrine* tends to suppress the possibility of setting up the company on the basis of the discipline more convenient because the state in which the company it operates in principle may refuse to apply the law of other jurisdictions in which the companies have constituted their seats.

The *Incorporation Doctrine* seems to be most able to support the right of companies to move anywhere and this one prevailed in the U.S.A, where companies that are established in one of the States of the Union can than transfer their seats in another one remaining formally governed by the law of the establishment state. This situation in the United States has given rise to the so-called '*syndrome of Delaware*', one of the smaller states sought to take advantage issuing more flexible and simpler rules for the constitution and discipline of companies (in particular rules regarding the administrators responsibility). The Delaware syndrome was than counterbalanced by the fact that the *Incorporation Doctrine* in the U.S.A was limited to regulate the relationship between the members or stakeholders and the company. But the discipline of the company at large as a business organization is regulated by the federal rules and in consequence, these rules apply to companies regardless of the state legislation where they belong. Coming to the European, the *Incorporation doctrine* is followed only in some of the EU member states and this situation has contributed to restrain the implementation of the right of establishment.

- **The Right of Establishment For The Companies Under The European**

Since 1967, the Treaty CEE has guaranteed the right of establishment for the companies. In consequence, any limitation of the right to transfer the seat (or the establishment of secondary seat) over the time were valued referring to their compatibility with the obligation of all Member States to ensure to the companies the right of establishment. The principle of freedom of establishment which is set in *article 49* (ex Article 43 TEC) it refers to a person or a company which is able to carry on an economic activity in a stable and continuous way in one or more Member State. This right is strongly connected with the freedom of companies to provide cross border services which is set out in *article 56* (ex Article 49 TEC) of the Treaty.

That freedom is expressed in two ways: the freedom of '*primary establishment*' that means that companies are able to transfer their seats in a different state from the state where they have been created and the freedom of '*secondary establishment*' that refers to the ability of the companies to open in a different state their own branches and subsidiaries or any other organized structure.

The European Commission adopted *the Services Directive 2006/123/EC of 12 December* which aims to create a legal framework for ensuring that both, service providers and recipients benefit more easily from the fundamental freedoms guaranteed in Articles 49 and 56 of the Treaty. These provisions have direct effect. This means, that Member States must modify national laws that restrict freedom of establishment, or the freedom to provide services, and are therefore incompatible with these principles. Member States may only maintain such restrictions in specific circumstances where these are justified by overriding reasons of general interest, for instance on grounds of public policy, public security or public health; and where they are proportionate. The Services Directive obliges Member States to cooperate with each other and give mutual assistance in the supervision of service providers. This will ensure effective supervision of service providers while at the same time providing that such supervision does not lead to additional and unjustified obstacles for service providers.

As has been mentioned above, the Member States have adopted connecting criteria that reported to the *Incorporation* or to the *Real Seat* doctrine and this dichotomy has contributed to restrain the full implementation of the right of establishment. Also there is not in fact any position taken by the Treaty and thereafter from the Directive over the connecting criteria which the Member State have to apply. In absence of a taken position, the principles of freedom of establishment and free movement of services have been clarified and developed over the years through the case law of the European Court of Justice.

- **The case law of the European Court of Justice**

Initially, the European Court of Justice (henceforward the Court) did not recognize effective protection to the right of establishment. Representative of Court orientation is the judgment regarding the case *The Queen c. Daily Mail e General Trust PIC*. The question concerned the compatibility of English law with EU rules regarding the transfer from England to Holland of the seat of Daily Mail company, a enterprise establishment under English law. The British tax authorities did not authorize the transfer of Daily Mail seat reasoning that the main purpose of that seat transfer was to escape paying certain taxes. It was a case which regarded the freedom of '*primary establishment*'. The Court in its reasoning take in consider that companies as juridical person are different from physical persons, because companies are entities created by a specific law, under a national legal system and the Treaty has taken account of these differences. The Court concluded that the diversity of national legislations have to consider the application of the required connecting criteria when a company decide to transfer it seat in another Member States. In subsequent decisions, the Court has taken a more liberal position.

In the case *Centros* (*Centros Ltd. C. Ehrvers-or Selskabsstyrelsen*) the Court stated that "...the fact that a citizen of a Member State decide to establish a company or branches in a Member State in which the commercial rules it seems to be less stringent, that is inherent with the exercise of the right of establishment in the single European market..."

Another relevant case in terms of determining the application of *lex societatis* regards the limited liability *Überseering*. The dispute concerned the compatibility of German law with the Community rules. The German Court, arguing the absence of procedural capacity of the company established in Holland, prevented to the company to assert it rights before them. *Überseering* appealed on German Supreme Court (*Bundesgerichtshof*), which suspended the proceeding and refer the matter to the Court. First of all, the case allowed the Court to clarify that the rules of the State where the company has transfer it real seat are subject of the application of Community provisions on right of establishment, in sense of direct applicability of articles 43 and 48 of the Treaty. The Court has established the right of *Überseering*, as a company correctly established, to transfer it real seat in Germany. Furthermore, reasons of national interest (the right of the state to protect interests of creditors, minority shareholders, employees or taxation collection) can't justify the denial of legal capacity, and consequently the procedural capacity of a duly established company in another Member State.

In the case *Inspire Art*, the Court return to discuss on interpretation of the Treaty provisions concerning freedom of '*secondary establishment*'. The Court stated that for the application of community rules on freedom of establishment is irrelevant that a company is established in a Member State for the sole purpose of settling in another Member State to carry out their main activity. Also, the Court pointed out that any companies established in a Member State has the right to conduct it business in another Member State through a branch, even if the establishment in a given State was made precisely in order to evade the law of the State where the branch is located. With that kind of reasoning and the distinction pronounciation made respect the *Daily Mail* case, the Court held that the rules of Dutch legislation constituted restrictions on Freedom of establishment.

Another important sentence of the Court, concerning the right of establishment of companies that is necessary to analyze is the pronounciation relative to the case *SEVIC*. With this historic decision, the Court has ended a long struggle, legitimizing mergers between companies established in different Member States. The Court has spoken clearly in favor of freedom of establishment making an important step towards the full realization of the Single Market. Summarizing, the Court in this decision has determined the following principles. First of all, the right of establishment finds application also on the mergers and divisions cross border. Secondly, the difference in treatment between domestic mergers (divisions) and cross border mergers (divisions) constitutes a restriction on freedom of establishment. Thirdly, Member States can justified restrictions on this right only in presence of imperative needs, (the interests of creditors, minority shareholders employees and taxation legislation) and their protection may in certain cases and under certain conditions justify a restriction. The Court, once again, has reiterated that the process of harmonization can't in any case affect the right of establishment. The consequence of this decision will be that the cross border mergers may find legitimacy under a dual legal basis, the Merger Directive Cross Border and the freedom of establishment under Article 48 TEC.

In conclusion, having a look to the decision of the Court mentioned above, it seems that the evolutionary interpretation of the Court on the freedom of establishment has reached a significant realization. After a long phase of harmonization aimed at reducing the difference between the company law in different Member States, the European legislation left to the Member States the possibility to choose in their own legislation on private international law to one or the other doctrine the connecting criteria and the law applicable to the companies.



On the other hand, the European legislation seeks to offer solutions that allow economic operator to take full advantage of all the freedoms guaranteed by the UE. The Court has, in the one hand, recognize protection to the reasons behind the ‘real seat’ doctrine (the right of the state to protect interests of creditors, minority shareholders, employees or taxation rules) which may legitimate a restriction of the freedom of establishment without being considered discriminatory, but on the other hand, the refusal from the Member States to recognize the freedom of establishment for foreign companies results in a complete discordance with the principle of single market and full compliance or European directive.

- **The Right of Establishment And The Albanian Legislation**

In the framework of Albania’s integration process into the UE, commercial legislation is considered one of the main priority areas. The objective is to carry out a process of drafting and implementing a commercial legal framework in compliance with the EU standards. All the reforms undertaken by the Albanian legislator are aimed on the reduction of bureaucratic barriers, the simplification and standardization of business practices in line with the best international practices. Pursuant to the obligations stipulated with the Stabilization and Association Agreement, the Albanian legislation has committed itself to approximating commercial companies’ legislation with the *acquis communautaire*. In the last two decades, Albania has undergone a radical structural transformation of its economy through a transition from a country with a centralized and planned economy to a country with a free market. After the changing system, the first regulation of the commercial companies was made in Albania by the Law n. 7638/1992. The article 4 of that Law, entitled, ‘The Seat’ was following the Real Seat doctrine, the law applicable is the one where an company has actually its head office. That provision was in coherence with the provision of other companies law in the region and the aim regarded the possibility for the competent authorities to have more control over the activities of the company. That law was totally changed with the sweeping reforms undertaken from the Albanian legislator on the commercial legal framework.

The new law regulates individual entrepreneurs and commercial companies. In contrast to the previous company law, the law no. 9901 which entered in force on 21 May 2008 includes the definition of branches and representative offices for foreign companies. The Article 8 of the law no. 9901/2008 provides in the first paragraph that ‘*unless the Statute otherwise provides, a company’s head office is the place where the major part of its business is carried out*. This disposition in contrast to the previous forecast of Article 4 of the abrogated commercial law it seems that gives the possibility to the shareholders to choose the seat in a different place from where the economic activity is effectively exercise opening in this manner to the Incorporation doctrine. From the literal interpretation it comes in evidence that the general rule that will find application it’s based on the Real Seat doctrine, however, the company members have the right to choose a different Seat in the Statute. That means that actually both, Incorporation and Real Seat doctrine, can find application in the Albanian legislation, creating this way a mixed system of connecting criteria. In fact, the Albanian judges have not give any interpretation regarding this provision probably because there came not in their attention any dispute related to the application on Article 8.

In conclusion, it is important to underline that the Albanian legislator, in respect of the commitments and the obligations taken with EU, and in respect of the Articles 49 and 56 of SAA, is committed to provide to Community companies and their subsidiaries, treatment no less favorable than that accorded to commercial companies in the country. The same procedures will be adopted also for EU citizens who may carry out economic activities as self-employed in the territory of Albania. The foreign commercial companies which want to transfer or to open their branches in our country are subject of the same rules that find application for Albanian companies.

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**CHALLENGES AND OPPORTUNITIES OF NONPROFIT SECTOR IN ALBANIA**

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**Abstract:**

*This paper marks an important step in the process of analyzing the development of nonprofit sector in Albania since the nineties. It includes a serious attempt to record the historical background of the third sector as well as to qualitatively assess current areas with major interest: mission and goals, human capacities, areas of activity, governance structures, funding availability relationship with the Government etc. The transition to democracy had a huge impact on nonprofit sector in Albania and is associated with emergence of hundreds of NPOs. Albania has a rich history of working with communities, assisting those who are vulnerable, lobbying and performing advocacy and participating in policy debates. The growth of nonprofit sector has been greatly assisted by international donors and development agencies. Although the role played by nonprofit sector in the political, social and economic life of the country has been unique and of vital importance, and there have been ups and downs in recent years. This paper will examine the stages of growth, challenges and achievements of nonprofit sector in Albania. Several methodologies have been used during the analysis of this paper: Secondary data, such as reports and documents focused on nonprofit sector in Albania published during last two decades. These documents include the annual reports and different working documents of NPOs in Albania, the annual reports of international institutions. Websites of international donors and NPOs as well as information from national and international conferences have also been a useful source during the preparation of this paper. A questionnaire, divided in several sections (general information, staff, organization management, areas of activity, relations with the Government and relations with different donors), was prepared to find information for this research.*

**Key words:** nonprofit sector, development, challenges.

**JEL Classification:** I31.

**LITERATURE REVIEW**

The history of development of NPOs is divided into three phases. First phase ends with the end of II World War, the second phase includes the communist period (1945-1990), and the third phase begins after 1991 and until now. History of non-governmental organizations and various Albanian association elements with representatives of civil society, now recognized by naming NPOs begin in the end of XIX century. Albania was under Ottoman rule until the declaration of Independence in 1912. In terms of occupation and denial of national identity elements is inherently have been nor civil institutions nor public debate. Period of (1870-1890) in Albania had about 80<sup>73</sup> organizations, most of which act as humanitarian organizations with support from various religious communities.

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<sup>73</sup> NRO Geschichte, Albania, Bonn 1997

In the first decade of the twentieth century were about 130 associations and organizations, as well as several foundations, religious organizations and other institutions of "civil society". These organizations had political, religious, cultural or nationalist orientation. Some of them were created in the Diaspora, especially in the U.S., England, France, Austria, Romania, Italy<sup>74</sup>.

Communist regime closed all independent associations, intellectual groups, foundations. Social organizations, associations, intellectual clubs representations of various strata of the population as well as other types of groups allowed to act further only under strict control of the government. This centralization process occurred earlier and more complete than Eastern European countries. Being particular and extreme model of Stalinism Albanian dictatorship model based on the concepts and attitudes unimaginable by the human mind.

The culmination of these attitudes came in 1967 where the regime closed all facilities and religious communities.

Transition to democracy period had a great impact on the Albanian society and was followed by the creation of hundreds of NPOs and other civil society groups. Civil society has a rich history of work in the community, helping people in need, government lobbying, advocacy and participation in public debate. The growth of civil society in Albania is assisted by international donors and development agencies.

Increasing the non-profit sector and the role he played in the transition to a market economy has changed over time, influenced by factors such as the current needs of the country, political, economic, and social, as well as the level of donor support. There are four stages of development of the third sector: the transition period (1991-1996); crisis period (1997-2001); period after the crisis and maturity of NPOs (2002-2005); and periods of decline after 2005.

First NPO in Albania has been the Forum for the Protection of Human Rights and was founded in January of 1991. The Forum was apolitical, independent of the state and without any economic and political purpose. His initial activities helped the democratic changes in Albania and increased public sensitivity to the most important issues of human rights, the treatment of political prisoners during the communist regime. In 1992, the Forum was recognized as a full member of the Federation for the Protection of Human Rights in Helsinki, and was named the Albanian Helsinki Committee (AHC), which exists today.

After AHC other organizations of human rights were created such as the Albanian Center of Human Rights (ACHR), the Albanian Human Rights Group (AHRG), and the Society for Democratic Culture (SDC).

First organization of women in Albania was the Independent Forum of Albanian Women, established in 1991. Its main mission was to protect the rights of women to achieve equality between men and women to encourage women to participate in development issues.

Many NPOs were included in human rights issues, while others focused on other areas such as, environment, private sector development, in the field of youth, media. Albania was faced with a financial crisis in 1997 due to the collapse of pyramid schemes. This had a negative impact on economic, political and social conditions. The financial crisis was influenced by the events of 1999, due to the crisis in Kosovo. These events increase the need for assistance from the third sector and influenced the development of the sector in several directions in the number, missions, volunteer involvement, fundraising, advocacy, public image and methods of governance. Aggravation of the political and economic conditions in Albania after 1997 encouraged the development of NPOs in Albania. NPOs which were directed by women's rights became more active<sup>75</sup>. Some organizations were very active in raising the awareness especially in urban and rural areas consequences of trafficking. They provide support, advice, and assistance to victims of trafficking and abuse. After 1998 Albanian Government designed a program to fight corruption as a result new NPOs focused on advocacy for anti-corruption, transparency and government issues. The Kosovo war was the decisive moment of establishment of more than 200 NPOs<sup>76</sup> mainly in the field of assistance to refugees.

During the years 2002 -2005 Albanian civil society was oriented from the civil rights, economic, political, social, cultural protection to improvement the quality of governance and revenue growth.

The role of the third sector increased in the process of strategy formulation, social services, advocacy, and lobbying on specific issues (anticorruption, government, and consumer protection). Third sector participated in advocacy at local and municipal level they were involved in the drafting of the strategy of regional and local development, local budget and community-based services.

The period 2002-2005 represented a higher stage of development of the third sector in Albania. This improvement is attributed to the improvement of the organization of NPOs, in strategic planning, fundraising techniques, financial management, governance of NPOs.

Civil society activities after 2005 was accompanied by several developments: The most important supporters of NPOs reduced their funding. As a result the third sector was reduced in size, purpose, activities and geographical coverage. NPOs in all areas of activity were faced with a decline in funding. Many of them became inactive, while the role of those who stayed was limited.

<sup>74</sup> USAID Report, Issues of NPOs Development, 2002

<sup>75</sup> Human Rights Watch, HRW World Report, 1999

<sup>76</sup> Albania Human Development Report 2000 UNDP

One of the hardest things in the context of the analysis of NPOs has been the difficulty in determining the size and density of the NPO sector due to the lack of a central unit that can collect and disseminate information on the nonprofit sector. Changes in registration procedures over the years have also contributed to the difficulties of measuring the number of NPOs.

Before 1994, the registration of NPOs was the responsibility of the Ministry of Justice and each ministry covering the sector of NPO activities. According to the Civil Code of 1994 responsibility for registration passed the first level courts in the districts for NPOs that were under their jurisdiction. According to the new law on NPOs adopted in May 2001, the registration of NGOs is the responsibility of the Tirana District Court. Currently, the registration of nonprofit organizations is concentrated in Tirana, where information on the registration of NPOs involved in the Commercial Register of the Commercial Association established under the Law on Commercial Association and registered under the Law on the Commercial Register.

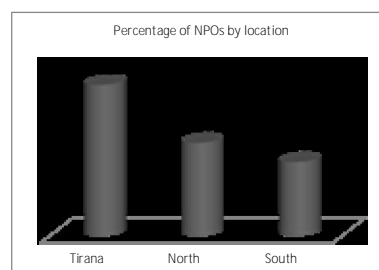
In the District Court of Tirana are registered 5002 NPOs, information from the Tirana District Court until June 2011. Greater growth of NPOs has been in the field of human rights and social field. The most important achievements of the Albanian NPOs are: the creation of relationships and reciprocal link national and international, aids and continuing efforts to mitigate conflicts and fostering dialogue between different groups, unanimous and active role as an advocate of the process integration, their assistance in several laws in the interests of vulnerable groups.

## DATA ANALYSES AND FINDING PRESENTATIONS

Are taken in the study 200 non-profit organizations, their choice is made randomly from the database of non-profit organizations. From this selection results that in Tirana are located 47.6% of NPOs, 29.3% in north of the country and 23.2% are located in south (fig 1). This choice is representative given by the fact that approximately half of non-profit organizations are concentrated in Tirana. Some of the reasons for the high percentage of NPOs located in North compared to south are:

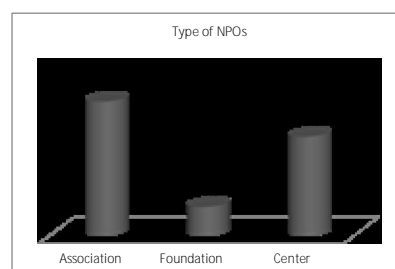
- The Kosovo crisis in 1999.
- In the last five year priority of international donors has been the north of Albania through projects aimed environmental protection, tourism development, and cross-border relations with countrie

**Figure 1: Percentage of NPOs by location**



From the total of NPOs in Albania 51.2% are associations, 11% are foundations and 37.8% centers (fig 2). These facts correspond with the number of NPOs registered in Tirana District Court. This is related to the fact that associations and foundations have existed since 1991, while the centers were used as a designation in 2001.

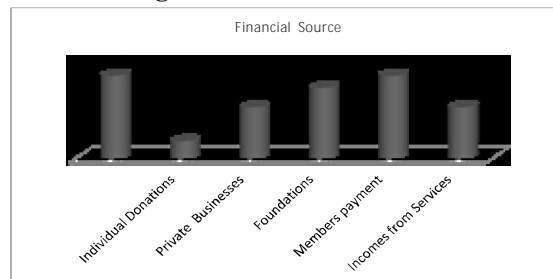
**Figure 2: The type of NPOs**



Findings show that 96.3% of NPOs funded by foreign donors, and a very small number of 8.5% is funded by individual donations.

NPOs provide funding from other donors, 41.5% of NPOs declare that provide funds from government (central and local government). 35.4% of NPOs funded by foundations, as well as by private businesses and income from services at 25.6%. (Fig 3)

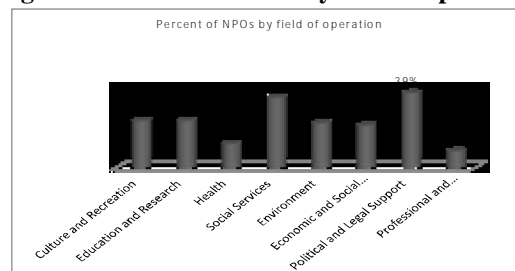
**Figure 3: Financial Sources**



39% of NPOs in Albania operate in the field of legal and political support, 36.6% of them operate in the field of social services, 24.4% in the field of culture and education. Organizations that operate in the environmental field are 23.2% of NPOs (fig 4). Organizations that have a small percentage are those that operate in health field, business and professional associations. NPOs operating in the field of legal support are more numerous than the NPOs operating in other areas for several reasons:

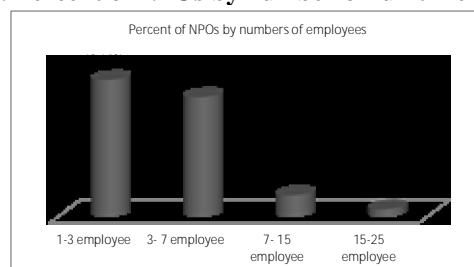
- Were the missing rights in the communist era to which the Albanian people had more need, and this is related to the creation of the first NPO in the field of human rights
- Democracy has in its self human rights
- There are donors who support more the field of human rights.

**Figure 4: Percent of NPOs by field of operation.**



The majority of non-profit organizations (48.1%) have 1 to 3 employees, and only 2.5% have 15-25 employees. The reason is that non-profit organizations rather are not involved all the year in the project. In the moment that they have 1 or no project number of full-time employees is low. (Fig 5)

**Figure 5: Percent of NPOs by number of full time employees**



In conclusion, approximately 90% of NPOs have employed a full-time staff from 1 -7 employees, and a low percentage of them have employed more than 15 full-time employees. If we look at the statistical significance of the relationship between the number of full-time staff and NPO type, the chi square test is 0.0346, which means that there is a relationship between these variables. Associations have the highest percentage of full-time employees by 1-3, while foundations and centers have a higher percentage of full-time employees over 3. As the number of workers employed full-time displays and activities of NPOs, foundations and centers are engaged in a greater number of projects than associations.

**Table 1: percentage of NPOs by full time employees and type of NPOs.**

	Full time Employees				Total
	1-3 Employees	3-7 Employees	7- 15 Employees	15-25 Employees	
Association					
	61,9%	31,0%	2,4%	4,8%	100,0%
	66,7%	38,2%	16,7%	100,0%	51,9%
Foundation					
	11,1%	77,8%	11,1%	,0%	100,0%
	2,6%	20,6%	16,7%	,0%	11,1%
Center					
	40,0%	46,7%	13,3%	,0%	100,0%
	30,8%	41,2%	66,7%	,0%	37,0%
Total	39	34	6	2	81
	48,1%	42,0%	7,4%	2,5%	100,0%
	100,0%	100,0%	100,0%	100,0%	100,0%

**CONCLUSIONS.**

Approximately 50 percent of NGOs in the study belong to the Tirana District, and the rest of the NPOs belongs other areas. One of the reasons is that approximately 50 percent of NPOs exercise their activity in the district of Tirana. North area has a higher number of NPOs than South area. Some of the reasons are:

- NPOs that operate at north are increase in number during the Kosovo crisis in 1999.
- In the last five year North Albania was one of the priorities of donors for the development of tourism, environmental protection and the creation of maintaining relationships with border countries.

If we look at the percentage of NPOs according the type dominate associations that have the highest percentage of NPOs then centers and foundations. One of the reasons is that the associations and foundations have existed since 1991, while centers began to be used in 2001. These figures correspond with the number of registered NPOs in Tirana District Court

The areas of activity in which NPOs operate are: legal and policy support, which is the field that dominates in the sector, some of the reasons are:

- The transition from dictatorial to a democratic system requires the assistance of NPOs and the creation of the first NPO were in that field.
- The community itself lacked fundamental rights
- This area of activity was one of the priorities of donors.

Is the field of social services which dominates the second according to the level of importance and involvement of NPOs. Some of the reasons for the dominance of this field of activity were:

- Year 1997 oriented NPOs in providing services, counseling, assistance, to child victims of trafficking and abuse.
- And the Kosovo crisis of 1999, enabled establishment of NPOs operating in social services.

Other fields in which NPOs operate are: Education and Research, Culture and Recreation, Environment, Economic and Social Development, Health, Business and Professional Associations.

50% of the NPOs interviewed have 1-3 number of personnel employed full time, and the rest 3 -7. A low percentage of NPOs has employed over 7 full-time employees. From these data we conclude that approximately half of the active NPOs are not involved during the year with projects, and the rest of which has a higher number of full-time personnel is involved in more than one project. Associations have a higher percentage of the number of full-time employees from 1 to 3, while foundations and centers have a higher percentage of full-time employees from 3 to 7. This means that the centers and foundations are engaged in projects during the year than associations.

Funding sources are numerous, but international donors have been the primary support of NPOs in Albania. Government and foundations have contributed partly, and other sources of funding have been minimal. Fundraising in the last five years has been decreased by declaration of NPOs. One of the reasons is the fact that Albania is not a priority of international donors, and fields of activity in which the NPOs operates influences in attracting donors. International donors finance about 90% of NPOs, regardless of their type or location. Most of NPO projects are a reflection of the priorities of donors. These priorities generally address the needs of communities in Albania. But dependence on these priorities, restrains organizations create coherent strategies and programs based on real needs identified in the community.

Since NPOs funding comes from international donors, NPOs remain dependent on them. NPOs are aware of the difficulties arising from this fact, but they themselves did not take into account the existence of other opportunities, their orientation towards alternative sources of funds. A new window of opportunity has been opened with the emergence of the new law on NPOs. Currently, NPOs have the opportunity to develop activities generating income, but lack the experience and capacity to manage this situation effectively.

Taken in consideration the image of nonprofit sector it is necessary the sector mechanisms development to enhance transparency in the local and national governance, public and other beneficiaries of services. The first step in this direction would be promotion of activities and financial situation by NPOs.

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## DEPOSIT OR INVESTMENT IN VOLUNTARY PENSION FUND – CASE STUDY IN THE REPUBLIC OF MACEDONIA

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### **Abstract:**

*Purpose of this paper is the comparison for investments. The cases of small economies which are including in developing countries usually bring the question about the most effective investment. The main purpose is the display method of operation that applies to countries with lower financial market. Method of operation is a theoretical approach and understanding of the management structure in banking institutions and the outcome is to show that working in banks has competitions from the other kinds of financial institutions. The paper has consistent form. The significance of this paper is great for countries where financial markets are less developed. Meaning is important because in these economies shocks to the global financial markets have affected to them but they are small countries and they have small opportunities to avoid the imbalances.*

**Keywords:** Voluntary pension funds, deposits, assets management, investments.

**JEL Classification:** G11, G21, G23, G24, G32

### **1. Introduction.**

Managing private resources, especially when they represent future gains has a great significance in countries such as Macedonia, as to say countries where the financial structure is relatively simple, and the choice of financial instruments relatively tight. Not that are prohibited investments in foreign countries, but this paper analyzes the domestic voluntary investment between two alternatives: deposit and voluntary pension investment. The analysis is made direction whether it is investment that is more payable in the third voluntary fund or in the banks and their offers for time deposits. If we consider the data from the next table:

Table 1: Income of voluntary pension funds on an annual level per period:

Period	NLB ä	ÉÁĪ ä
31.12.2009 – 31.12.2010	4,40%	6,67%
31.03.2010 – 31.03.2011	4,28%	8,08%
30.06.2010 – 30.06. 2011	6,38%	9,46%
30.09.2009 – 30.09.2011	4,25%	
30.09.2010 – 30.09.2011		9,83%
31.12.2009 – 31.12.2011	4,18%	6,02%
Beginning 31.12.2011	4,65%	6,05%

Source: Agency for supervision of capital financed pension insurance

And the fact that these funds are young in Macedonia (2009) and on the other side are under strict supervision makes this paper attractive for the citizens that want to manage with their resources and to have a turnover of the money they should receive in the future (after fulfilling certain conditions such as age limits, period of gain upon) as well as dynamic managing with them.

### **2. Investment in the voluntary pension fund or time deposit of the resources.**

Since longer time, in the western countries there are different instruments through which the citizens can affect increasing or improving the conditions for retirement. Improving the conditions means that the citizens can directly influence the height of the pension they would receive after they are retired.

In order to provide the Macedonian citizens to have influence on the height of their income, since 2009<sup>1</sup> in Republic of Macedonia started the voluntary pension fund.

Primary goal of the voluntary pension fund is to insure a higher income after retirement of the insured that are already insured in the first and second pillar of the social insurance pension system (mandatory pension and social insurance), and want and are able to separate additional resources for bigger material security or maintaining a higher living standard after the retirement; insuring pension for people not covered by the mandatory pension insurance personally for themselves or from other person (unemployed for a long period, projects or foreign missions employees, unemployed spouses and other people whether if they are working or no); insuring preconditions for establishing professional pension schemes in the process of accordance of the system of social insurance in Macedonia with the system in the European Union.

The inscription in the pension fund is by signing individual contract for membership in the voluntary pension fund or by signing a collective contract through an employer/president of citizens association that will make so-called scheme for individuals. Every insured person can be included in one voluntary pension fund according to the individual and one voluntary fund according to the professional scheme.

In order to become a member or to get to the information for the pension fund, you have the bank branch offices, head offices of the insurance associations or access of information through phone. Signing the contract and opening the voluntary account means beginning of the membership in some of the associations.

The fund, according to the Law on voluntary capital financed pension insurance invests the resources in order to make profit. Most of the resources are invested in securities guaranteed by the Republic of Macedonia or the National Bank of the Republic of Macedonia, then bank deposits, deposit certificates, commercial recordings, bonds, securities based on mortgage from domestic banks as well as from stock associations (smaller scale) and they can be invested in documents for participation and shares of Macedonian investment funds.

The Voluntary fund can legally charge provision of 7 % on the money paid-in, and plus 1,8% on the fecundated money. The first voluntary fund in Republic of Macedonia started with a provision of 6,5% of the money paid-in by the members. The income compensation is 5,25% for every paid income, and the monthly compensation which is charges once a month, is 0,15%. The insured people can use the resources invested in the Fund at least 10 years before they fulfill the right of age pension (52 years for women and 54 years for men). After that period the payment can be a redundancy pay or multiple pay, it can be through buying pension annuity, as well as through programmed withdraw from the pension fund. The fund is giving the opportunity if the insured wants to make a combination of the three alternatives for payment of the resources.

Behind the payment of the resources as guaranty stands the Agency for supervision of capital financed pension insurance that takes care of the rights and interests of around 170 000 members. The Agency is founded in 2002, it has the role of a legal party that answers for its work to the government of the Republic of Macedonia. It is founded for supervision of the work of the associations for managing with the pension funds for protection of the insured.

The Agency performs its activity through the work of the Sector for control, the Sector for research, Legal sector and Sector for administrative issues and IT (<sup>1</sup>Decision for issuing permit to found voluntary pension association (02-470/3) is adopted on the 30.03.2005, and the date for giving approval for managing with a voluntary pension fund is the 30.06.2009, decision number 02-1025/7. (Source: Agency for supervision of capital financed pension insurance).

Under the sector for control are included a department for financial control, department for institutional control and department for pension control. The sector for research includes the department for macroeconomic research and the department for analysis of the pension system. The legal sector includes the department of for normative questions and department for representing the Agency, and the department for administrative issues and the IT department answer before the Sector for administrative issues. Vice director, director and executive board are above all sectors.

The work of the Agency according to the Law for mandatory capital financed pension insurance is financed by compensations that the Agency charges from the associations for managing the pension funds. In Macedonia, the pension and social insurance is performed not only by the solidarity between generations in the frames of the pension and social insurance, but through introducing a so-called second pillar that means introduction of private pension funds. From the total 21,2% paid as income, 7,42% are paid into the private funds, and the rest 13,78% in the Fund for pension insurance. Regarding the voluntary pillar, the national laws should have an operative independence, adequate resources and authorizations to do their function in order to decrease the biggest potential risks for the pension system. The supervisory bodies should be consistent, reliable, transparent and responsible, to consult with the entities that supervise and cooperate with other supervisory bodies. (The Agency pension funds supervision, "Principles of IOPS for supervision of private pension funds", Skopje, 2007, page 3-7).

Up to a certain point, we can say that the paid-in resources in the voluntary pension fund represent a saving for the citizens, especially when they have an institution behind them that guaranties a certain degree of payment. From that reasons we should make a comparison with the most basic and most obvious alternative that the citizens have, or the possibility to deposit their resources in the business banks as time deposits (the possibility to trade securities is not taken in consideration).

Depositing resources in some of the many business banks is a simple process, same as paying in the same resources in the voluntary pension fund. There is a difference in the way of using of these resources by the fund or the bank, the height of income and the mode (possibility) to withdraw resources.

The resources paid in the voluntary pension fund are invested into different securities, bank deposits, bonds and inscriptions, etc. on the other side, the business banks use most of the collected deposits to place credit lines, where part of the resources can be used for buying bonds and inscriptions with a higher income.

The mode of withdraw and income rate are maybe the most important conditions that would influence the decision of the citizens whether to pay-in their resources in the voluntary pension fund or to deposit them in some business bank. If the citizens make a time deposit of their money in a bank, they will be available after the deposits' timeline (ex. Time deposit of three years with a interest payment). In case when the user needs the resources before the completion of the timeline for deposit, the bank offers a possibility for temporary breaking of the contract (in some banks there is a "penalty" for early breaking of the contract).

The citizens that decided to invest their resources in the voluntary pension fund should fulfill a certain age limit in order to use them. Now, with the voluntary pension fund there is no possibility for early withdraw of the paid-in resources that can be considered as a big disadvantage (there are different reasons that justify the condition for the age limit).

Another factor that should be taken in consideration when making decision where to invest the resources is the income offered by the alternatives. Now, the voluntary pension fund offers an average income of around 5%. We should mention that because of the working mode of the pension fund, the income rate could vary up or down line. On the other side, the interest rate that is paid by the banks on the basic deposit of one year (interest payment) can be from 6,8% to 8,5% depending on the business bank. In addition, the height of the interest rate could vary depending on the market conditions, but depositing resources since the beginning offers a higher income compared with the income from the voluntary pension fund.

We should consider that the business banks have a range of deposit products where the citizens can choose the mode of withdraw the interest, the period of depositing the resources and the currency of saving, and to consider the fact that behind their work, there is an institution guaranteeing payments.

The deposit insurance fund is founded in 1997 according to the prevailing Law on banks and savings banks as Joint Stock Company. Since March 2001 this Fund is a state institution and is legal follower of the Fund for insurance of savings deposit AD Skopje. The Fund insures deposits in banks and Joint Stock Companies for physical entities. Members of the Fund are 17 Macedonian commercial banks and 11 Macedonian Joint Stock Companies.

Table 2: Indemnifies and payments performed by the Fund for deposit insurance

Name of the commercial bank/ savings bank	Calculated indemnify	Paid indemnify	Number of paid customers	% of payment (3/2)
1	2	3	4	5
Àèì àèì áàí èà ÀÄ Ñèì í Ì	1785,0	381,2	10	21,36
Áèñ í ðò-Èì í ðò ÀÄ áàí èà Ñèì í Ì	95608,5	91332,7	573	95,53
Ðàáí áàí é ÀÄ Ñèì í Ì	76005,6	71506,6	780	94,08
<b>Ì àè áàí í ñè à áàí èà ÀÄ Ñèì í Ì</b>	<b>1304585,2</b>	<b>1220344,2</b>	<b>18845</b>	<b>93,54</b>
Ø ðàäèéí èòà "Óí è ï ðí èí ì " - Ñèì í Ì	5118,3	4919,5	79	96,12
Ì èò ø ðàäèéí èòà Äí Í Êóí áí í áí	6769,3	6767,6	33	99,97
Ø ðàäèéí èòà "Èèðí • ó:óé" - Áàèãñ	3318,6	3239,5	186	97,62
<b>Sum:</b>	<b>1493190,5</b>	<b>1398491,3</b>	<b>20506</b>	<b>93,66</b>

The fund insures the denars and currency deposits and the current accounts of physical entities in the banks and the Joint Stock Companies in Republic of Macedonia, the deposits bonded to the cash cards issued by banks founded in Republic of Macedonia, the currency influx of the physical entities in the banks of Republic of Macedonia, while the deposits such as the example above that are given with privileged interest rates or under some other circumstances, such as owners of over 5% of the bank are not insured. Since the foundation of this Fund until today, several payments have been executed. See Table 2 Source: Fund for insurance of deposits Skopje, Republic of Macedonia (in thousand denars – currency 61.5).

Since the 30.09.2008 from overall of 121594 savers of all seven members of the fund where there is a risky event, indemnify are 16,86% of savers, but from the total value of savers in all of the seven members of the funds where happened risk event, indemnify are 16,86% of the savers, but from all the obligations realized are 93,66%. Residual till the hole value is usually made from small savers with small accounts (100-1000 denars), and from small groups of savers of Makedonska banka in liquidation with bigger accounts. This is the position: Maybe because of the stability of the banking sector from the independence of Macedonia and the traditionalism in the working and investment of the financial institutions, as well as the households at the end of the third quarter of 2011, regarding June 2011, the financial mediation measured through the ratio of deposits with GDP has increased for 1,3 percentage points. However, in the third quarter of 2011, the short term deposits stayed the most present in the structure of the total deposits increased for the price of the decreasing of the participation of the deposits. This only shows that the feeling for saving is starting to appear in the Macedonian citizens, but there is still the fear of long term play with the finances and earning from different sources.

## Conclusions.

You could say that every alternative for investment of its resources (in deposits or voluntary pension fund) has its advantages and disadvantages. Therefore, every citizen should evaluate which alternative in responding his needs. If there is security that there is no need for the resources until his retirement (or 10 years before the age limit for retirement) and the height of the income does not have a big influence, then he could choose the voluntary pension fund. If the user is not sure for the period when he could need the resources or wants a higher income of its resources, then the user should decide to deposit the resources in some of the business banks.

Managing personal resources, especially when they represent future gains has a big importance in countries such as Macedonia, or in countries where the financial structure is relatively simple, and the choice of financial instruments relatively tight. Not that are prohibited investments in foreign countries, but this paper analyzes the domestic voluntary investment between two alternatives: deposit and voluntary pension investment. The analysis is made direction whether it is investment that is more payable in the third voluntary fund or in the banks and their offers for time deposits. We could say that any alternative for investing of personal resources (in deposits or voluntary pension fund) has its own advantages and disadvantages. You could say that every alternative for investment of its resources (in deposits or voluntary pension fund) has its advantages and disadvantages. Therefore, every citizen should evaluate which alternative in responding his needs. If there is security that there is no need for the resources until his retirement (or 10 years before the age limit for retirement) and the height of the income does not have a big influence, then he could choose the voluntary pension fund. If the user is not sure for the period when he could need the resources or wants a higher income of its resources, then the user should decide to deposit the resources in some of the business banks.

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## FISCAL SUSTAINABILITY AND MACROECONOMIC STABILITY IN AN ENLARGED EUROPIAN UNION

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### **Abstract:**

*This paper is about the fiscal rules that govern countries in the European Union (EU) and their implications for the countries which are candidates for early EU accession. There are likely to be persistent and significant differences among EU members in the growth rates of real GDP and in the rates of inflation, because enlargement will substantially increase the structural diversity of the economies inside the European Union. In this paper is argued that existing fiscal rules are ill equipped to deal with the increasing economic diversity of EU member countries. All new EU members will automatically, upon entry in the EU, be bound by the rules of the Stability and Growth Pact (the Pact) and the Broad Economic Policy Guidelines (BEPGs). In this paper are suggested ways of amending and improving fiscal-financial rules of the Stability and Growth Pact so as to enhance fiscal-financial sustainability and macroeconomic stability. The likely early addition to EU membership roll of eight EBRD countries of operation, and a-fortiori the later accession of Bulgaria and Romania and the eventual accession of the remaining South East European countries will, however, increase the importance of addressing the problems that will be encountered when the one-size-fits-all fiscal-financial criteria of the Stability and Growth Pact and the Maastricht Treaty are confronted with the heterogeneous real economic structures of an enlarged EU. We do not argue that countries with markedly distinct real economic structures cannot all prosper in the European Union. They will prosper, provided proper allowance is made in the design of fiscal-financial rules for marked differences in economic structure. We also do not argue that countries with very difference real economic structures should not join together in a monetary union or that there should be any protracted delay between EU accession and EMU membership for the leading cohort of current accession candidates.*

**Keywords:** Fiscal Sustainability Macroeconomic Stability

**JEL Classification:** E0, E19.

### **1.Fiscal Sustainability and Macroeconomic Stability in EU**

#### 1.1. Framework for fiscal policies.

The purpose of the framework for fiscal policies of the Member States is to fulfil the Treaty objective of securing sound public finances in the context of deeper economic integration, in particular within Economic and Monetary Union (EMU). Rules outlining a common framework for national fiscal policies were introduced into EU Law in the Treaty of Maastricht as an essential element of the preparations for the completion of EMU. Although national sovereignty in the field of fiscal policy was maintained, the autonomy of Member States was reduced by the convergence criteria, with which they had to comply in order to be allowed to adopt the euro.

European Union has settled on an original framework to manage public finances, called the Stability and Growth Pact (SGP). It defines two sets of fiscal rules:

The first one is the Excessive deficit procedure (EDP). The purpose of the procedure is to ensure that excessive deficits are promptly corrected. In normal circumstances, a general government deficit exceeding the reference value of 3% of gross domestic product (GDP) at market prices is considered excessive.

It also formulates the softer constraint of a debt/GDP ratio below 60 percent, which may be overshoot, provided it subsequently is “sufficiently diminishing and approaching the reference value at a satisfactory pace”<sup>77</sup>. This deficit limit is not applicable in a severe recession. Before the reform of the pact in June 2005 a severe recession was defined as an annual drop in real GDP of at least 2%. After the reform, a negative rate of GDP growth or a prolonged period of low growth suffices. The EDP may also be set aside in exceptional circumstances, and the scope of these circumstances was increased in the reform in June 2005.

The second one is the Stability and Growth Pact. The Stability and Growth Pact consists of:

1. The resolutions of the Amsterdam European Council of June 1997 on Stability, Growth and Employment;
2. Council Regulation No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, as amended by Council Regulation No 1055/2005 of 27 June 2005; and
3. Council Regulation No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, as amended by Council Regulation No 1056/2005 of 27 June 2005.

These set out how the treaty rules – in particular the excessive deficit procedure – should be implemented. The pact is applicable to all Member States, both those that have already adopted the euro, and those still in the waiting room or opting out.

With regard to the soundness of budgetary positions, the rules are the same as the convergence criteria. They limit: The deficit in general government finances to 3% of GDP in any year, and The public debt to GDP ratio to 60%.

In recent years policy makers have become increasingly concerned with the consequences of aging and the issue of long-term fiscal. A low debt ratio should provide the European Union with a sufficient “buffer” against the pressures that population aging will put on government budgets. The Stability and Growth Pact was revised in 2005 to include sustainability concerns into the definition of medium-term budget objectives.

The questions, whether the SGP contributes to fiscal sustainability is, therefore, not only of academic interest. With respect to the stipulated fiscal rules, the actual implementation of the SGP has been doubtfully successful.

## 1.2. Evolution of deficits and debts.

The overall conclusion with regard to the fiscal rules remains positive: deficits and debt levels have decreased significantly since the rules were introduced in the Maastricht Treaty. After an initial clear decline in deficits in the run up to EMU, many member States entered EMU with a slightly excessive deficit, which led to time being set for achieving a budgetary position close to balance or in surplus.

The purpose was to avoid the medium term objective becoming a moving target which would never be reached. However, most Member States used the economic upturn of the late 1990s to balance their budgets also notably driven by the motivation to qualify for the Euro, the result being a significant reduction in public deficits.

By the end of 2001, seven of the then twelve EMU Member States had achieved the target of close to balance or in surplus. Following the reform of the stability pact, however, a slight improvement in average budgetary positions has in fact been observed since 2006, although this should by no means be taken to indicate that the Pact is working perfectly.

## 1.3. Concept of Fiscal Sustainability.

What is a sustainable fiscal policy? No universally accepted definition exists, but scholars agree that an exploding debt is not sustainable. An ever-rising ratio of debt to income would require governments to increase taxes and/or reduce expenditure to service the debt. Such policy cannot go on for ever. So what is an optimal policy? A good starting point for the analysis is the funding constraint:

$$G_t + i_t D_{t-1} = T_t + \Delta D_t + \Delta M_t$$

where  $G$  is the level of government spending net of interest payments,  $T$  is tax revenue,  $i$  is the interest rate on government debt and  $D$  is the stock of public debt. The difference between government spending net of interest and tax revenue is called the primary budget position. Government expenditure on public goods and interest payment to bond holders are financed by taxes, increases in debt held by the private sector and monetized debt held by the central bank.  $\Delta M$  is the increase in base money. We will assume that the central bank will not monetize government debt, so that  $\Delta M = 0$ . Relating these arguments to GDP the funding constraint can be written as:

$$(2) \quad \frac{\Delta d_t}{d_{t-1}} = (r_t - y_t) \frac{d_{t-1}}{st}$$

The increase in the debt/GDP ratio depends on the balance between the growth adjusted debt service and the primary surplus. Equation (2) says that the debt ratio will be increasing indefinitely if the real interest rate  $r$  exceeds the growth rate  $y$ , unless the primary budget yields a sufficient surplus. We will call the relation of real interest rates to growth the economic environment and the level of the primary surplus the fiscal policy stance.

<sup>77</sup> Treaty of European Union, art. 104c.

If, but only if, the environment is exogenously given, stability of debt hinges exclusively on the fiscal policy stance. Otherwise, the policy mix may affect long term fiscal sustainability. However, for the sake of simplicity, we will mostly ignore the interdependencies between policy and environment, although we will not assume, as the literature usually does, that the economic environment is stable. Note also that the absolute debt level  $D_t$  grows by the amount of the current deficit, which consists of the primary deficit plus nominal interest charges<sup>78</sup>. As a consequence, the deficit/GDP ratio is

$$(3) \quad \text{def}_{t+1} = \Delta d_{t+1} + (y + \delta)dt = (r + \delta)dt - s_{t+1}$$

with  $\delta$  for inflation rate. If a government borrowed to service the debt, a behavior also known as Ponzi-scheme, the debt ratio would increase until tax payers and bondholders become unwilling to pay. The repudiation of debt may then take the form of outright annulation, monetisation (Sargent and Wallace, 1981) and/or inflation. The sustainability literature has focused on two conditions: a weak solvency constraint whereby the debt-GDP ratio will “eventually converge back to its initial level”<sup>79</sup>. This implies that the debt-GDP ratio is first difference stationary. It fluctuates around a long term constant mean. A solvency constraint defines sustainability by the maximum level of debt, which governments can sell to bondholders without ever having to repudiate debt. Strong solvency therefore requires weak solvency together with a stationary primary-surplus/GDP ratio.

In other words, weak solvency guarantees a stable debt/GDP ratio in the long run (steady state), while strong solvency also requires long-term stability of the policy stance. A well developed literature has sought to assess the time series properties of fiscal variables, including their co-integration. Another way of formulating the concept of sustainability is to say that the public funding arrangements should allow the continuation of a given policy stance into the infinite future without violating solvency constraints.

By rewriting the debt dynamics as:

$$(4) \quad \frac{dt}{dt} = (1 + r_t - y_t) \frac{d_{t-1}}{d_{t-1}} - s$$

The government can then run a primary deficit in the following year. A surplus is only needed when growth falls below the rate of return on government bonds and the government pursues a debt target. Thus, whether fiscal policy is sustainable or not depends on the sign of the fiscal policy reaction with respect to the target: if an increase in debt is followed by an increase in primary surpluses, debt is sustainable. Bohn (1998) has estimated the US reaction function for the primary surplus in response to a marginal increase in government debt. He finds significant reaction coefficients of the order of 2.8 and 5.4 percent and he concludes that “this provides reliable information about sustainability, regardless of how interest rates and growth rates compared”. He recognizes that “permanent primary deficits will lead to excessive debt accumulation in at least some ‘bad’ states of nature”, noting, however, that “a strictly positive and at least linear response of primary surpluses to the debt ratio is sufficient for sustainability”.

The question then is what drives the accumulation of debt and how long does it take to revert? Thus, the key is the fiscal policy reaction function. The excessive deficit procedure of the Maastricht Treaty formulates a fiscal policy rule. Does it assure European public finances of sustainability?

### 1.3.1. Achieving Fiscal Sustainability

A well designed system for fiscal decentralization promises many benefits, including enhanced economic growth and macroeconomic stability. Fiscal sustainability means that a subnational government covers its expenditures out of its own revenues, reducing its dependence on borrowing and transfers from the center. To determine whether a subnational government’s plans are fiscally sustainable, analysts need accurate information on revenues and expenditures at the central, regional and local levels. Analysts also need to understand the interplay between intergovernmental grants and government borrowing – that is how hard the subnational budget constraint truly is. Careful analysis of country specific intergovernmental relations, and the resulting incentive framework, should accompany any analysis of fiscal sustainability.

Fiscal, political and financial institutions that strengthen competition at local level, especially for capital can promote hard budget constraints. If institutions directly or indirectly suggest that the central government will step in to cover subnational liabilities in the case of default, they may encourage subnational governments to “overspend” or “undertax”. The Latin American experience suggests that subnational governments that are subject to hard budget constraints are more likely to tax and spend prudently. Fiscal sustainability is also a forward looking concept, in that it requires accurate assumptions about revenues and expenditures and key economic variables.

## 1. Conditions for Sustainable Fiscal Policy.

<sup>78</sup> In reality the debt level varies also because of stock-flow adjustments which encompass factors outside the government budget, such as revaluation of debt issued in foreign currency, proceeds from privatisations or debt take-overs from other sectors of the economy, accumulation of financial assets and statistical errors

<sup>79</sup> Blanchard et al., 1990: 12.

By using (2), (3) and we can formulate a system of two simultaneous linear difference equations, rewritten in continuous time form as

$$(5) \quad \begin{cases} d' = (r-y)d - s \\ s' = (\hat{a}(r+\delta) + \hat{a})d - \hat{a}s - z \end{cases}$$

Where the prime indicates the time derivative and the constant  $z = \hat{a}z_1 + \hat{a}z_2$ . Solving the difference equations for  $d(t)$  and  $s(t)$  will give us the time path of the debt ratio and the primary budget position. If these two time paths converge to a pair of inter-temporal equilibrium values, the fiscal policy is strongly sustainable, regardless of the intermediary adjustment dynamics. These equilibrium values are given by the solution for the particular integrals:

$$(6) \quad d = \frac{z}{\hat{a}(y+\delta) + \hat{a}}$$

$$(7) \quad s = \frac{(r-y)z}{\hat{a}(y-\delta) + \hat{a}}$$

If public finances are (strongly) sustainable, the debt-GDP ratio converges to a stationary position that is determined by the nominal growth rate, the reference values and the adjustment parameters. The steady state primary surplus equals the growth adjusted debt service on the steady state debt. We assume that the reference values and the reaction coefficients are structural values determined by the political system.

Yet, given that interest and growth rates vary over time, the steady state debt ratio is not constant. As European nominal growth rates have fallen in the 1980s, 90s and early 2000, the implicit steady state debt ratios have risen. Note that this effect is independent of actual budget policies, as the reaction coefficients  $\hat{a}$  and  $\hat{a}$  reflect medium to long term behaviour. The rise in the steady state level reflects the transversality condition in a time-varying macroeconomic environment. If we drop the ad hoc assumption of a stable economic environment, a change in the equilibrium debt level is required to compensate for the change in the discount factor (see equation 3). Equation (6) reveals another interesting fact. If we set  $\hat{a}=0$  and only focus on the debt response factor  $\hat{a}>0$ , the equilibrium debt ratio becomes identical with the debt target.

Thus, the sustainable debt ratio is arbitrary, like the Maastricht 60 percent, but if one took the reaction function responding to changes in debt, as estimated by Bohn for the USA, the steady state would always be the debt ratio realized in the previous period. Such a rule would turn sustainable debt into a random walk. It is of course, possible that U.S. authorities have an implicit debt target to which they respond. In the European case, the target was made more explicit by the Maastricht provisions. Second, if  $\hat{a}=0$ , the steady state for debt reflects the ratio of the deficit target to the nominal growth rate, which is 60% under the assumptions of the "Maastricht numerology". But if  $\hat{a}>0$ , the steady state for the debt is lower. Note also, that if  $1-z=0$ , as implied in the medium term rule of the SGP, and if  $\hat{a}=0$ , the steady state debt ratio and primary surplus are both zero.

## 2.2. Stability Conditions.

Next, we need to determine the conditions for the debt and primary surplus ratios to converge to the steady state. This convergence is more rapid if it proceeds in a monotonic fashion; it is slower, if the time path oscillates periodically in its convergence to equilibrium. This distinction may be politically relevant. In the periodic case, the debt ratio may temporarily rise without reflecting a lack of sustainability. For example, we observed that the debt ratio in France and Portugal has risen above the steady state. Does that mean that fiscal policy in these countries is unsustainable? To judge this, we need to establish the conditions under which convergence occurs either periodically or monotonically. If it were periodic, fiscal policy may still be sustainable, as it will return to equilibrium in the future. Solving the dynamic system (5) for the homogenous part yields the following condition for sustainable financial policies (for the formal proof, see Annex):

**Proposition 1.** *Given the policy system (5) and assuming  $\hat{a}=0$ , a sufficient condition for the debt ratio's convergence to the steady state is  $\hat{a} > (r-y)^2$ .*

**Proposition 2.** *Given the policy system (5), and assuming  $\hat{a}=0$ , a sufficient condition for public finances to be strongly sustainable is*

$$\hat{a} > \max \{ r-y, (r+\delta-y+\delta)^2 = \hat{a}_{\min} \}$$

*This implies:*

(i)  $\hat{a}_{\min} = r-y$  is the sufficient condition if  $r > y$

(ii)  $\hat{a}_{\min} = (r+\delta-y+\delta)^2$  is the sufficient condition if  $r < y$

**Proposition 3.** *The time path of convergence to the steady state can take three forms given the value of  $\hat{a}$ :*

(i) Periodic case: Damped convergence is obtained if:

$$\min \hat{a} < \hat{a} < r+\delta+y+\delta$$



(ii) *Critical or aperiodic case:* The critical condition for switching between cyclical (pseudoperiodic) and monotonic convergence of the debt ratio's path to the intertemporal equilibrium is  $\hat{a} = r + \delta + y + \delta$ .

(iii) *Monotonic case:* The necessary and sufficient conditions for rapid convergence are:  $\hat{a} > r + \delta + y + \delta$ <sup>80</sup>.

These are important results. They prove, first, that the short term fiscal policy reaction function is sufficient to ensure long term debt sustainability. No need for simplifying ad hoc assumptions, long-term forecasts of all future net liabilities, intergenerational accounting, etc. Long term sustainable fiscal policy is always made in the here-now.

Second, sustainability requires fiscal policy to adjust to changes in the timevarying economic environment. If the growth-adjusted real interest rate increases, higher primary surpluses are necessary to meet the minimal constraints and fiscal policy may have to tighten unless the reaction function coefficient  $\hat{a}$  is already larger than the minimum. This could create a pro-cyclical bias when the growth slow-down is caused by a negative demand shock. But if there is a significant safety margin by which  $\hat{a}$  exceeds  $\min \hat{a}$ , the year-by-year fiscal policy can accommodate shocks without having to sacrifice sustainability. Third, it matters what interest rate we use. Because the government collects taxes from bond holders, one should use the after-tax interest rate. Because tax rate data are notoriously unreliable and only with difficulty comparable, I have mostly used pre-tax interest rates in the empirical part of this paper, although I have also calculated an after-tax growth adjusted real interest rate, based on average tax rates over the last 5 years. This gives a conservative bias to our assessment of sustainability. However, with respect to after-tax rates it is also apparent that fiscal consolidation is more efficient for sustainability if it is tax-driven. An increase in the tax rate will simultaneously increase revenue and lower the post-tax interest rate, while a cut in government spending will only affect the primary surplus.

### 2.3. Fiscal Sustainability and Macroeconomic Stability. Case of Albania

Fiscal sustainability has drawn increased attention in transition countries, recently. Indeed, almost all transition economies as like as Albania, have experienced large deficits in both balances since the start of the transition process. On one hand Albanian economy collapsed, prompting the government to adopt an expansionary fiscal policy in the form of increased expenditures (to build up social and physical infrastructure) and extended tax incentives to encourage investment. Moreover, fiscal deficits expanded as government tried to absorb the revenue and expenditure pressure associated with the sharp falls in GDP and fiscal restructuring.

Consequently, a substantial increase in the public debt/GDP ratio has emerged in the region. Moreover, a stable public finance is an explicit criterion for many transition economies' eligibility for Economic and Monetary Union (EMU). The most common way of assessing a given economy's fiscal position is to analyse fiscal sustainability, where the 'sustainable' level of the fiscal imbalance was that level consistent with solvency, i.e. satisfies the criterion that the total public debt to GDP ratio should not increase.

For this reason a similar, though slightly reduced, exercise was started in 2007 with the potential candidate countries, with the submission and assessment of annual EFPs as important element. The EFPs have two objectives: first, to outline a medium-term policy framework, including public finance objectives and structural reform priorities needed for EU accession; and, second, to offer an opportunity to develop the institutional and analytical capacity necessary to participate in the Pre-Accession Fiscal Surveillance Procedure and eventually, in the long-term, in EMU with a derogation in regards to the adoption of the euro upon accession, particularly in the areas of multilateral surveillance and co-ordination of economic policies.

The development of the institutional capacity to co-ordinate between the various ministries, government agencies and the central bank is a particularly important aspect ensuring the success of the Economic and Fiscal Programmes. The Economic and Fiscal Programme (the EFP 2007) covers the period 2007–2010 presenting the medium-term framework of economic and fiscal policies in Albania.

Recent macroeconomic developments have been broadly favourable, with relatively strong economic growth of 5.5% annually in 2006, and fairly moderate inflation at around 3%. The general government deficit was kept below 4% of GDP in 2006; the public debt ratio has decreased. In 2009–2011 the fiscal balance is projected to improve only gradually, the deficit amounting to close to 4% of GDP. The structural and institutional reform agenda of the programme is adequate, corresponding to the criteria listed in the European Partnership with Albania.

The fiscal framework of the programme is well integrated in the overall policy objectives and soundly based on the presented medium-term economic framework. The programme does not mention possible relations of its objectives with the Progress Report assessment or European Partnership priorities.

The presented framework is coherent, consistent and relatively comprehensive, and to a large extent also influenced by the current IMF programme. The key measures on the revenues and expenditure side are well explained but not supported by quantitative estimates.

<sup>80</sup> Wilcox, D. (1989), The Sustainability of Democratic Deficits: Implications of the Present-Value Borrowing Constraint, *Journal of Money, Credit and Banking*, XXI, 291-306.

General government expenditure is projected to remain at the level of 31% of GDP except for 2008 when a large-scale one-off infrastructure project is planned. The general government budget deficit is projected to increase to 7.9% of GDP (recently revised to 5.2%) in 2008 and thereafter to decrease to below 4% of GDP in the following years. Public debt is projected to reach 56% of GDP in 2008, decreasing to 52% in 2010.

The budget expenditures are projected to increase somewhat less than the revenues, the main increasing components being higher expenses on personnel and on social and health insurance compared to the 2006 EFP. The capital expenditures are also projected to increase modestly, affected by the newly introduced procedures of public investment. Changes in the public debt management are projected to decrease expenditures on interests of domestic debt in 2007. The impact of a large one-off government subsidy to the national power utility is not discussed in the programme; the effect is expected to remain below one percentage of GDP. Overall, the programme lacks ambition as the margin of manoeuvre gained from increases in revenue is being used mainly to increase expenditure and only marginally to reduce the deficit. For 2008, a further sharp deterioration of the fiscal balance is projected. Policy changes of reducing subsidies and increasing expenses of the local government, as a result of continuous decentralisation process, are expected to have relatively low impact on the consolidated budget. Infrastructure projects are planned to be financed partly by loans. The government budget for 2008 is consistent with the planned one-off surge in capital expenditures. Increasing financing needs are foreseen to be covered mainly by foreign borrowing (public debt increasing by 2.55% of GDP).

The projected increase in public investments is foreseen to be virtually neutral to domestic demand as large-scale infrastructure projects are being mainly implemented by foreign companies. In 2009–2010, the government expects to reap the benefits from a number of policy measures. After the expansionary stance of 2007–2008, the government will need to come back to a more conservative fiscal policy and continue with structural reforms in order to promote a favourable business climate. The above-listed risks apply also in 2009–2010. Fiscal risks are only briefly discussed in the submitted programme. The revenue risks of non collection of taxes and the uncertainty of the recovery of profit tax revenues are considered to be low. Regarding the uncertainty of success of the respective reforms, the risks may be underestimated. Risks on the expenditure are not discussed.

This declining trend is due to a lower increase in net borrowing compared to the foreseen GDP growth. Privatisation revenues are expected to decrease considerably after a peak in 2007, lowering to below 1% of GDP in 2009–2010, therefore the deficit will have to be mainly financed through public borrowing. Exchange rate risks to the public debt management are relatively low as 70% of the debt is denominated in domestic currency and 30% in foreign currency. The 2007 EFP foresees an increase of the share of the external debt compared to domestic debt, which may increase exchange rate risks, although it may reduce interest rate risk, as mentioned in the programme. Interest rate volatility risks are also foreseen to be reduced by increasing the share of long-term domestic debt (from the current 30% to 67% in 2010, relative to total domestic public debt).

## Conclusions.

European Union has settled on an original framework to manage public finances, called the Stability and Growth Pact (SGP). There is a need for the EU and ECB to present to the public a clear conceptual framework to motivate and explain the concepts of fiscal sustainability and excessive deficits, and to relate these fundamental notions to concrete quantitative fiscal-financial objectives (which could be time- or state-contingent) and to specific policy actions or rules.

In recent years policy makers have become increasingly concerned with the consequences of aging and the issue of long-term fiscal.

The Stability and Growth Pact was revised in 2005 to include sustainability concerns into the definition of medium-term budget objectives.

In sub-optimal currency area, fiscal policy needs more flexibility across countries. Yet, since the Maastricht Treaty was signed, fiscal policy has become more homogenous.

Fiscal policy should stimulate economic activity for the whole Eurozone if resources are underemployed, and it should impose fiscal restraint when production is above potential. Thus, the issue of debt sustainability in Europe is crucial for the long term evolution of economic growth and possibly even for the sustainability of European monetary union itself.

Fiscal sustainability has drawn increased attention in transition countries, recently. Indeed, almost all transition economies as like as Albania, have experienced large deficits in both balances since the start of the transition process.

In 2001 a regular economic fiscal surveillance procedure was established for the candidate countries. It aims at preparing countries for the participation in the multilateral surveillance and economic policy co-ordination procedures currently in place in the EU as part of the Economic and Monetary Union. The Pre-Accession Economic Programmes (PEPs) are part of this procedure.

The Economic and Fiscal Programme (the EFP 2007) covers the period 2007–2010 presenting the medium-term framework of economic and fiscal policies in Albania.

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## BENEFITS OF IMPROVING THE FINANCIAL REPORTING IN REPUBLIC OF MACEDONIA

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### **Abstract:**

*High-quality financial reporting is the foundation of a functioning market economy and the basis of a healthy financial system. Quality financial reporting in Republic of Macedonia depends on the adoption and application of a variety of benchmarks, standards, codes and practices. Improving the quality of financial reporting will have a significant and positive impact on the economy by: 1) reducing the risk of crisis in the financial market and related adverse economic impacts by strengthening the domestic financial architecture; 2) contributing to foreign direct and portfolio investment and helping to mobilize domestic savings; 3) helping the access of small enterprises to loans from the financial sector by reducing the high costs of information and borrowing; 4) enabling investors to properly assess business perspectives by informed investment and voting decisions, resulting in lower cost of capital and better allocation of resources; 5) allowing shareholders and public to assess the success of the management of enterprises, which promote active development of capital markets, and 6) supporting economic integration regionally and globally.*

*The priority goals of this paper are to mark the activities and actions necessary to achieve the previously mention benefits, such as: 1) improving the framework for financial reporting; 2) strengthening the key stakeholders in the framework for financial reporting; 3) supporting the auditing profession; and 4) supporting education, training and public awareness.*

**Keywords:** financial reporting, accounting, auditing, standards, framework,

**JEL Classification:** G19.

### **1. Improving the framework for financial reporting**

Achieving a consistent, predictable and practical framework for financial reporting is one of the key benchmarks for a healthy financial system. In developing the framework for financial reporting, primary goal is to provide a balanced approach between the financial reporting and audit requirements, that will meet the needs of the various users of financial information, will be consistent and predictable, and, what is more important, will not imposes unnecessary burdens on the corporate sector. Creating high quality regulatory and institutional framework for accounting and auditing, requires reform in Macedonian legal framework, institutions and accounting profession, as well as changes in its accounting, auditing and business culture. Strengthening the legal and institutional framework for financial reporting is guided by a primary benchmark, i.e. *acquis communautaire* of EU complemented with International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA) and international good practice.

Alignment of current financial reporting requirements in laws and regulations with those of the *acquis communautaire* will encourage the development of a significantly improved financial reporting framework in Macedonia. The relevance of the *acquis communautaire* for Macedonia is bilayer. First, it is a high quality model for the regulation of accounting and auditing, which can be applied in countries with different characteristics. Second, the adoption of the *acquis communautaire* related to accounting and auditing, supports the strategy of Macedonia to become part of the European Union. This is of even greater importance after the EU granted Macedonia candidate status.<sup>81</sup>

<sup>81</sup> <http://ec.europa.eu/enlargement/candidate-countries>, accessed on August 2012

Chapter 6 of *acquis communautaire*, "Commercial Law", is particularly relevant for setting a solid framework for financial reporting.<sup>82</sup> Here we can distinguish between "hard law" and "soft law". Regulations (obligatory in all EU Member States without the need for national implementation legislation) and Directives (binding in terms of the objectives to be achieved and the terms of it; however, they leave to the national authorities the choice of form and means to achieve such goals) are considered as "hard laws". Recommendations and Communications are considered "soft law". Soft laws are "rules of conduct which, in principle, are not legally binding, but which nevertheless may have practical effects". Taken together, these regulations, directives, recommendations and communications can be considered as a substantial body of the *acquis communautaire*, which is relevant to corporate accounting.

Environment for effective financial reporting is based on appropriate standards for financial reporting (Accounting Standards). Making financial standards that lead to transparent financial reporting will help preparers and users of financial statements. Relevant financial reporting standards should address the needs of different types of entities, such as public interest entities and small and medium enterprises. According to the Company Law<sup>83</sup> and the Law on accounting matters<sup>84</sup>, business entities are required to prepare and submit annual and consolidated accounts in accordance with the adopted International Accounting Standards, published in the Official Gazette. Macedonia has accepted International Financial Reporting Standards and published interpretations of IFRS. International Accounting Standards and International Financial Reporting Standards are updated on an annual basis, to be harmonized with current standards, as revised, amended or adopted by the International Accounting Standards Board (IASB). Regard to the fact that in application of standards there are two stages, i.e. their preparation and implementation, is inevitably activities to be directed to their application or implementation (training of employees in practice for their ease understanding, as well as preparation and issuing guidelines for accounting in accordance with the legislation) of technical assistance in financial reporting issues not specifically addressed by IFRS.

The accounting in Macedonia is regulated by the Companies Act, Law on accounting matters, the Law on Accounting of budget and budget users and Accounting Guide. Companies Act determines that the following companies have to prepare annual / consolidated accounts in accordance with IFRS which is published in the "Official Gazette": large enterprises; medium-sized enterprises; banks; insurance companies; companies listed on the stock exchange; companies that are part of the consolidated accounts of some of the above types of companies. Provisions of this law determine bookkeeping, classifying traders, trade books, annual accounts and financial statements. The Law on accounting matters regulates the conditions of doing accounting work, subjects who perform accounting work, the conditions for acquiring the status of a bookkeeper and accountant, organization and operation of the Institute of Accountants and Certified Accountants of the Republic of Macedonia, as well as other issues concerning performing accounting work. Law on Accounting of budget and budget users<sup>85</sup> regulates the performing of accounting, business books, accounting documents and data processing, recognition income and expenditure, balance sheet items assessing, revaluation, financial statements, delivery and financial reports and other matters related to accounting budget of Republic of Macedonia, the budgets of local government units, budgets and funds, consumers and individual users of funds, and other legal entities for which funds to perform operating activities are primarily provided from the budgets. Accounting Guide contains directions of conducting accounting in accordance with international accounting standards, which are published in the "Official Gazette".<sup>86</sup>

## 2. Strengthening the key stakeholders in the framework for financial reporting

Successful financial reporting should be implemented and enforced in practice by institutions with adequate resources. The purpose of this activity is to introduce a system that works together with appropriate financial reporting framework and which result will be a high quality financial reporting.

Banking sector as a whole represents a significant segment for preparers and users of financial reporting and, therefore, is a key area for the establishment of expectation and preparation of financial reporting quality. National Bank of the Republic of Macedonia<sup>87</sup> shall ensure the harmonization of the legal framework with the relevant parts of the *acquis communautaire* in order to provide consistency of banking legislation with other relevant domestic legislation. This determines the role of the Supervision Department of the Bank in strengthening the institutional capacity to supervise, monitor and enforce the implementation of IFRS in the banking financial reporting. Resources which are used to build capacity in the Association for commercial banking in the long run will allow its development in the direction of a key partner for the Central Bank, which will create a culture of compliance and, ultimately, better financial reporting in the sector.

<sup>82</sup> [www.eurofound.europa.eu/areas/.../acquiscommunautaire.htm](http://www.eurofound.europa.eu/areas/.../acquiscommunautaire.htm), accessed on August 2012.

<sup>83</sup> Company Law, Official Gazette of the Republic of Macedonia, No. 28/2004.

<sup>84</sup> Law on accounting matters, Official Gazette of the Republic of Macedonia, No. 95/2012

<sup>85</sup> Law on Accounting of budget and budget users, Official Gazette of the Republic of Macedonia, No. 81/2005

<sup>86</sup> Accounting Guide, Official Gazette of the Republic of Macedonia, No. 28/2004

<sup>87</sup> [www.nbrm.gov.mk](http://www.nbrm.gov.mk), accessed on August 2012.

Tax reporting in Macedonia currently absorbs a significant portion of the country's accounting facilities. Resources which are used for clarification and coordination of the environment for tax reporting on one hand and financial reporting on the other hand will contribute significantly to the overall significance of financial reporting in Macedonia, and in the long run this will lead to better quality financial reporting. Public Revenue Office (PRO)<sup>88</sup> should support the establishment of a legal framework that provides predictable tax base, as well as the construction of an efficient process for determining taxes which would reduce compliance costs imposed on companies. Moreover, they should encourage the establishment of institutional framework to implement an effective process for determining income tax, which would result in effective assessment and collection of taxes.

Development of key specialized financial sectors in the areas, which also cover the insurance and pensions, is a strategic goal for any country that seeks to develop a healthy and growing economy. This specialize areas require specialized financial reporting and supervision. For this, there is a need to develop a consistent legislative and regulatory framework that supports the modernized reporting environment for the insurance companies in line with the *acquis communautaire*. Moreover, it should support the development of capacity for monitoring and ensuring compliance with financial reporting legislation and regulations for insurance companies in Macedonia.

The establishment of a strong, effective and sophisticated capital market is the foundation of a successful economy in any part of the world. Strong, effective and sophisticated capital markets require appropriate regulations (including financial reporting requirements) and institutionalized mechanisms for their implementation in practice. This includes responsibility for Securities Commission<sup>89</sup> to support the development of legislative and regulatory framework for the listed entities.

Institutional and legal strengthening programs should assist in the preparation of high quality financial reporting that will meet the needs of a wide range of users, such as investors, lenders and other creditors. Such high quality financial reporting is a prerequisite for raising funds in the capital markets and the banking sector, which are essential for economic growth. This high quality annual accounts and consolidated accounts are useful only if the public can get them quickly and easily. Central Registry shall ensure the harmonization of national legislation and regulations with the relevant parts of the *acquis communautaire* related to: the publication and submission of financial information, including the principle of mandatory disclosure, minimum requirements for transparency, and their consistency with other relevant domestic legislation; significantly improve public access to quality financial information through a program of operational hardware and software support. These activities will enable stakeholders for fast and easy access to electronic annual accounts and consolidated accounts of the relevant companies.

Accountants and certificated accountants in the territory of the Republic of Macedonia, according to the Law on accounting matters adopted in June 2012, should be organized in the Institute of Accountants and Certified Accountants of the Republic of Macedonia. The Institute should perform the following tasks: 1) maintain a register of accountants; 2) control the operation of accounting workers; 3) organize and conduct exam for accountant or certified public accountant; 4) issue a certificate for accountant and certified public accountant; 5) issue and revoke licenses of sole proprietors - accountants, sole proprietors - chartered Accountants and companies performing accounting work; 6) determine applications for approval of the accountant or public accountant qualification acquired abroad; 7) organize and conduct exam for accountant or public accountant qualification acquired abroad; 8) organizes and conducts training for continuous professional development; 9) monitors the application of the Code of Ethics for Professional Accountants brought by IFAC; 10) translates IFRS and IFRS for IAS; 11) cooperate with other relevant professional bodies in the Republic of Macedonia and abroad and 12) perform other duties stipulated by this law.

### 3. Supporting the auditing profession

Adoption of improved financial reporting framework will be effective only if the companies comply with it. Strengthening key actors responsible for regulation is one of the methods to ensure companies comply with financial reporting requirements. Statutory audit of selected annual accounts and consolidated accounts (e.g. annual accounts of company of public interest) is another effective method to encourage compliance with the financial reporting standards. Essential pillar for ensuring quality and consistency in financial reporting is the presence of a reliable and independent auditing profession loyal to the creditors, shareholders and other stakeholders of the company.

Support and development of the auditing profession in Macedonia have been identified as essential goals, so there is a need to develop internal regulations and procedures for conducting it. This become especially important after the international accounting scandals ("Enron", "Parmalat" etc.), and taking into account legislation of the European Union (Eighth Directive in the field of commercial law on statutory audit). Macedonia should implement a system to an external and independent public oversight of the audit profession. In addition, effective public oversight of the audit profession is a vital element in maintaining and increasing the confidence in the audit function.

<sup>88</sup> [www.ujp.gov.mk](http://www.ujp.gov.mk), accessed on August 2012

<sup>89</sup> [www.sec.gov.mk](http://www.sec.gov.mk), accessed on August 2012

Audit Act<sup>90</sup> supports the creation and development of the Council for advancement and audit oversight to help assuring regulators, investors and the public that the audited annual accounts and consolidated accounts give a realistic picture of the financial condition of the revised companies. Council is required to be developed into effective and efficient professional body that will be able to fulfill its legal duty to fortify the regulatory structure of the auditing profession in Macedonia in the long run. Preparation of structured processes and procedures, as well as the construction of sufficient capacity for efficient and effective implementation of the same is one of the basic tasks of the Institute of Certified Auditors<sup>91</sup>, as a professional body which brings together the statutory auditors in the Republic of Macedonia. Effective audit procedures are implemented through adherence to relevant international benchmarks, in particular International Standards on Auditing (ISA). Continuous availability and implementation of these standards is essential. Translation of ISA and the constant updating of the translated text are under the control of the ICA.

Fully functional audit profession requires the development of accounting education and training program that will create competent auditors capable during their working life to make a positive contribution to the profession in which they operate and the country in which they exist. Preparation, implementation and continued development of such an educational program are also under the control of the ICA. It also means ensuring the continuing competence of statutory auditors and their permanently acquiring new skills and experience to remain effective in the workplace and career. Such an approach will improve the qualitative attributes of the members of ICA and their reputation among employers, clients and the public. ICA is responsible for preparation, implementation and permanent development program for continuous professional development. Transparent display to the public that the activities of statutory audit follow, check (quality assurance) and implement appropriate measures (sanctions and discipline) is a key method in building public confidence in statutory audit. Acquisition of public confidence in the auditing profession in turn will increase the use and credibility of the audited annual accounts and consolidated accounts. Quality assurance is a major asset of the audit profession to show the public and regulators that auditors work at a level that meets the established auditing standards and ethical rules.

The ICA also perform the following tasks: 1) maintain a register of certificate auditors and firms; 2) control the operation of auditors; 3) organize and conduct exam for auditors; 4) issue a certificate for auditor; 5) issue and revoke licenses; 6) determine applications for approval of the audit qualification acquired abroad; 7) cooperate with other relevant professional bodies in the Republic of Macedonia and abroad and 8) perform other duties stipulated by the Audit Act.

The Law on Internal Audit in the Public Sector<sup>92</sup> regulates internal audit system based in accordance with international internal audit standards, objectives, principles, organization, functioning and responsibilities of the internal audit in public sector entities in the Republic of Macedonia. The aim is to help public entities to meet their objectives by bringing a systematic, discipline approach to evaluate and improve the effectiveness of management with risk, control and governance. The provisions of this law shall apply to the following entities in the public: users of funds from the State Budget, the Pension and Disability Insurance Fund, Health Insurance, Fund for National and Regional roads, the Employment Agency, municipalities, agencies and other institutions established by law, public enterprises, as well as legal entities in which the state is the dominant shareholder. Performance of public enterprises in meeting these goals determined by internal audit is controlled by external state audit. The Law on State Audit<sup>93</sup> regulates the conditions and manner of performance of the audit of Budget of the Republic of Macedonia, the budgets of local government, the budget of the social security funds, users and individual users of the budgets, public enterprises, the National Bank, legal entities in which the state is the dominant shareholder, political parties financed by the budget, agencies and other institutions established by law, other institutions financed by public funds and users of funds from European Union and other international institutions. The state audit represents conducting test procedures of the financial transactions with government expenditures in terms of legal and authorized use of funds. State audit also include the provision of an assessment of the use of funds in terms of achieved economy, efficiency and effectiveness. State audit is performed by the State Audit Office.<sup>94</sup>

#### **4. Supporting education, training and public awareness**

Financial reporting plays a key role in the functioning modern economy. Clear understanding of the important role which high-quality financial reporting plays in a successful economy, by future generations of Macedonian entrepreneurs, lawyers, bankers, creditors and, of course, statutory auditors, will greatly increase the opportunities for further development of Macedonian economy. Such understanding can be gained through a good curriculum in the area of accounting and auditing at university level education in Macedonia.

<sup>90</sup> Audit Act, Official Gazette of the Republic of Macedonia, No. 135/2011

<sup>91</sup> [www.iorm.org.mk](http://www.iorm.org.mk), accessed on August 2012

<sup>92</sup> Law on Internal Audit in the Public Sector, Official Gazette of the Republic of Macedonia, No. 22/2007

<sup>93</sup> Law on State Audit, Official Gazette of the Republic of Macedonia, No. 145/2010

<sup>94</sup> [www.dzr.mk](http://www.dzr.mk), accessed on August 2012

It is significant not only directly to students at accounting and auditing, but also for other disciplines (e.g. business administration, law, economics) to provide potential experts engaged in all sectors of the functional economy to bring the appropriate decision based on confidential financial information. For example, future entrepreneurs should appreciate the potential benefits that come with the quality of the annual accounts and consolidated accounts, the leaders of the listed entities should recognize that the cost of capital will be reduced by the improvement of financial reporting and the general public should be aware of importance to have a trust in annual accounts and consolidated accounts of companies who have substantial pension investments. Provision of necessary resources to initiate programs of activities that will lead to innovation of the curriculum of accounting and auditing departments at the universities in Macedonia will result with better knowledge of potential candidates for training of certificated auditors. Also it is significant that improved knowledge of all university students studying at accounting and auditing departments will increase the overall knowledge base for quality financial reporting.

Understanding the requirements for quality of financial reporting is important for protection of key stakeholders. National economies can't be developed without investors. Investors in the company should have some protection if the directors or management cheats or ignore trusted duties. The judicial process is a key component in the overall financial transaction between the involved parties - shareholders, directors, management and the state government (legislative, executive and judicial). Investors have certain expectations about the role of the courts in implementing trusted duties. There is a need for well prepared and implemented training program that will improve understanding of the judges on the importance of high-quality financial reporting and the rights and obligations of stakeholders. Encouraging awareness of good financial disclosure and transparency of financial reporting in long term will lead to increased confidence in financial reporting in Macedonia, will increase public demand for good financial disclosure and transparency, will reduce the risk from major frauds, will increase people awareness of the rights and responsibilities and will increase knowledge of financial reporting at the local level, and all these will maximize the potential base for investment in Macedonia.

### Conclusions

Achieving a consistent, predictable and practical framework for financial reporting is one of the key benchmarks for a healthy financial system. Creating high quality regulatory and institutional framework for accounting and auditing, requires reform in Macedonian legal framework, institutions and accounting profession, as well as changes in its accounting, auditing and business culture. Strengthening the legal and institutional framework for financial reporting is guided by a primary benchmark, i.e. *acquis communautaire* of EU complemented with International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA) and international good practice. Successful financial reporting should be implemented and enforced in practice by institutions with adequate resources. The major stakeholders in this process are: Banking sector and other financial institutions, Tax authorities, Securities commission, Central Registry, and Institute of Accountants and Certified Accountants of the Republic of Macedonia. Strengthening key actors responsible for regulation is one of the methods to ensure companies comply with financial reporting requirements. Statutory audit of selected annual accounts and consolidated accounts (e.g. annual accounts of company of public interest) is another effective method to encourage compliance with the financial reporting standards. Essential pillar for ensuring quality and consistency in financial reporting is the presence of a reliable and independent auditing profession loyal to the creditors, shareholders and other stakeholders of the company. Effective audit procedures are implemented through adherence to relevant international benchmarks, in particular International Standards on Auditing (ISA). Continuous availability and implementation of these standards is essential. Translation of ISA and the constant updating of the translated text are under the control of the Institute of Certified Auditors, as a professional body which brings together the statutory auditors in the Republic of Macedonia. Provision of necessary resources to initiate programs of activities that will lead to innovation of the curriculum of accounting and auditing departments at the universities in Macedonia will result with better knowledge of potential candidates for training of certificated auditors. Also it is significant that improved knowledge of all university students studying at accounting and auditing departments will increase the overall knowledge base for quality financial reporting. The judicial process is a key component in the overall financial transaction between the involved parties - shareholders, directors, management and the state government (legislative, executive and judicial). Investors have certain expectations about the role of the courts in implementing trusted duties. There is a need for well prepared and implemented training program that will improve understanding of the judges on the importance of high-quality financial reporting and the rights and obligations of stakeholders. Encouraging awareness of good financial disclosure and transparency of financial reporting in long term will lead to increased confidence in financial reporting in Macedonia.

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## PROFESSIONAL ETHICS IN THE AUDITING PROFESSION

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### **Abstract:**

*The word revision comes from the Latin word audire - to listen. The auditor is defined as a listener: one who reviewed the bills. Internal audit is a systematic, objective evaluation by the internal auditors of various activities and controls within an organization to determine whether: the financial and operating information is accurate and reliable; risks for the enterprise are identified and minimized; follow external regulations and generally accepted internal policies and procedures; satisfied the relevant criteria of performance; resources used in an efficient and economical manner and purpose of the organization are met in an effective manner - all in order to ensure consultation with management and to help members the organization in relation to the effective fulfillment of their management responsibilities. This definition not only indicate the role and objectives of internal auditors, but it identifies the opportunities and responsibilities. Internal audit must have professional guidance and be technically competent. Given that the review does not work in a vacuum, senior management of the audit must well know the working environment of the organization. Ideally staff audit should have previous experience of management and should not spend their entire career in internal audit because without such experience would not have a realistic idea of what is actually managing the organization. Internal audit may well not function if there are stable systems of governance and accountability. Therefore, in these circumstances that the reports to top management should focus on providing and implementing recommendations that will seek to ensure: the separation of managerial and political roles, a high level of integrity and ethical standards, quality planning and assessment risks and building a strong and reliable financial systems and internal controls that management becomes aware that it is responsible for the operation of internal controls. This paper deals with precisely the issue of professional ethics in the auditing profession.*

**Keywords:** *audit, ethics, behavior.*

**JEL Classification:** *M42.*

### **1. Theoretical overview of the importance of professional ethics in the auditing profession**

The word audit comes from the Latin word audire - to listen. The auditor is defined as a listener: one who reviews bills. Increased trade during the 19th century demanded a growing funding provided by multiple investors. Thus began the practice of jointly owned companies and the formation of limited liability companies. Owners employed managers to manage their enterprises and managers gave a report on their work, normally once a year. Investors usually do not know nothing or very little about the business you invested and therefore could not know anything about the reliability of financial reporting who tolerated managers.

Therefore, they nominate a third independent person to review the accounts, you will explore and perform checks when necessary, in order to give its opinion on the admissibility. The financial statements were submitted after the oral route, and after Honourable listener tell his opinion. These students later became known as auditors. With the expansion of business activities, lips financial reports passed in writing, but the name of auditor, listener has not changed.

Internal Audit in the book Sawyer stated the following definition to describe the wide, unlimited range of modern internal audit:

Internal audit is a systematic, objective assessment by the internal auditors of the various activities and controls within an organization in order to determine whether:

- (1) financial and operating information is accurate and reliable;
- (2) the risks of the company are identified and minimized;
- (3) monitor the external regulations and generally accepted internal policies and procedures;
- (4) the appropriate criteria are met performance;
- (5) resources are used in an efficient and economical way
- (6) The organization's objectives are met in an effective manner - all in order to ensure consultation with management and to assist members of the organization in relation to the effective fulfillment of their managerial responsibilities.

This definition not only cite the role and objectives of the internal auditors, but it identifies the opportunities and responsibilities. Further definition embedded important requirements stated in standards and it contains modern extended activities of internal auditors and the emphasis being placed on value added and all other issues related to risk management and control. Many characteristics any profession, can be applied and internal audit: the common general knowledge, Certificate Program, a program of continuing professional development, code of ethics, statement of responsibility, a set of standards, professional magazine and an increasing flow of literature .

Internal audit must have professional leadership and be technically competent. Given that the review does not work in a vacuum, audit senior management have a good knowledge of the working environment of the organization. Ideally the audit staff should have previous experience of managing and should not spend their entire career in internal audit because without such experience would not have a real idea of which is the management of the organization. Necessary quality of audit activities and reports because otherwise the reports and recommendations of the auditors will be ignored. This involves a thorough knowledge of technical standards and independent quality audits.

Internal audit must function within the organization, that is not to rely on external assistance to achieve their goals (except in extreme cases). Auditors must have a personal and technical management skills and higher managerial nivo. Internal revision may well function if there are no stable management systems and accountability. Therefore, in such conditions that the reports to senior management needs to focus on providing and implementing recommendations that will aim to provide: separation of managerial and political roles, a high level of integrity and ethical standards, quality planning and assessment risks and build strong and relevant financial and internal control systems that guide you become aware that it is responsible for the operation of internal controls.

Internal auditing is an independent giving objective assurance and consulting activity, established in order to contribute to increase the value and improve the operations of the entity. It helps the entity to meet its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance. The internal audit activity in the public sector in the Republic of Macedonia started in 2000, when it established the Internal Audit Unit of the Ministry of Finance (central model). In 2004 begins the establishment of internal audit units in public sector institutions (decentralized model). Due to the need for development and support of internal audit in the Republic of Macedonia, in April 2004 the Ministry of Finance set up a Central Internal Audit Department with two units, and in December 2006 transformed into the Department of Public Internal Financial Control with four divisions. internal audit conducted internal audit units in public sector entities.

The Internal Audit Unit conducts internal audit: the public sector, individual users, all structures, programs, activities and processes, including those of beneficiaries of EU funds, as well as natural and legal persons with which the entity with whom perform internal audit has business relationships and using public funds. The Internal Audit Unit in the entity that is responsible for managing the intergovernmental programs / projects, coordinate the work of internal audit units of the public sector entities involved in the implementation of programs / projects.

The scope of internal audit defines the IIA in the codification of standards for the professional practice of internal auditing as follows:

The scope of internal audit should include a review and assessment of the adequacy and effectiveness of the organizational system of internal control and the quality of performance in carrying out the prescribed responsibilities. " Internal auditors review the existing systems or suggest new systems, if necessary, through proper controls provide reasonable assurance that management objectives are achieved. Internal auditors perform the following main activities:

organization's mission;

stems that exist to ensure compliance with policies, plans, procedures, laws and regulations that could have a significant impact on operations and reports, and should determine whether the organization adheres to them;

egrity of financial and operating information and the means used to identify the method of measurement, classification and reporting of such information.

Internal auditors examine, evaluate and report on the adequacy of internal control systems in relation to the proper, economic, efficient and effective use of budgetary resources. The new concept also emphasizes that internal auditors bringing a systematic, disciplined approach to evaluating, consulting and performance improvement in the risk management, control and process management. Additionally, in 1994, CIPFA published ethical guidelines for members of the institute. " Members of the Institute are advised to take ethical requirements as basic principles to be followed in the performance of their work.

Guidelines sets standards of conduct for members of the Institute and sets out the basic principles to be respected members in order to achieve common goals. Manual is valid for all members, whether from the public sphere, industry, commerce, public sector or education. It covers the following areas em states that the purpose of the accounting profession is to meet the following four basic requirements:

Reliability of the information and information systems;

Professionalism - that CIPFA members can accurately identify as professionals;  
Quality of service - need assurance that all services meet the highest standards;  
Confidentiality - the users of the services of professional accountants should be confident that there is a framework of professional ethics that governs such services.

## 2. Principles of professional conduct

The fundamental principles of professional ethics, which include:

- Integrity;
- Objectivity;
- Professional competence and due care;
- Confidentiality;
- Professional conduct.

The integrity of internal auditors creates trust and thus provides the basis for the reliability of their assessment. Internal auditors perform their work with honesty, diligence and responsibility. Law-abiding and publish information is expected to be disclosed under the law and the profession. Not aware of the illegal activity or are not engaged in activities that are inappropriate for the profession of internal auditing or to the organization. Respect and contribute to the legitimate and ethical objectives of the organization.

Internal auditors should exhibit the highest level of professional objectivity in the collection, evaluation and presentation of information about the activity or process which is an overview of the control.

Internal auditors make a balanced assessment of all relevant circumstances and based their decisions should not affect their own interests or the interests of third parties. Internal auditors do not participate in any activity or relationship that could not harm or be considered damaging realistic assessment. This participation includes activities or relationships that might be in conflict with the interests of the organization.

Do not accept anything that might hurt or be deemed that injures their professional opinion. Disclose all material facts known to them, and which, if not detected, could impair the notice of the activities reviewed.

Internal auditors are engaged only for those services for which they possess the necessary knowledge, skills and experience. Perform internal auditing services in accordance with the International Standards for the Professional Practice of Internal Auditing. Continuously improve their readiness and effectiveness and improve the quality of their services.

Internal auditors make wise use and protection of information acquired in the performance of their duties. Do not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization. Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

Internal auditors apply the knowledge, skills and experience required for the implementation of internal audit services.

Code of business ethics and conduct of employees of the State Audit Office, unequivocally and clearly express the values and principles that should guide employees in their daily work. Independence and responsibility is delegated to employees of the State Audit Office, set high ethical criteria that employees must meet.

Code of Business Ethics and Conduct is based on the generally accepted codified values and principles of the audit profession contained in the Lima Declaration of Guidelines on Auditing Precepts and the INTOSAI Code of Ethics as a complement and strengthen the INTOSAI auditing standards issued by the Auditing Committee INTOSAI standards. SAO staff have an obligation to abide by the provisions of this code. Code of Ethics State Audit Law and the bylaws. Employees perform their tasks in accordance with the law and are subject to regular legal procedures and sanctions. Employees subject to the legislation that applies to all citizens of the Republic of Macedonia.

**COOPERATION WITH COMPETENT AUTHORITIES** - In the process of carrying out its responsibilities, the State Audit Office establishes functional cooperation with the competent authorities in the field of legislative, executive and judicial powers. When performing work from employees in the course of the entire work process cooperate with entities subject to audit. With the realization of cooperation need to disable, remove or limit opportunities for abuse of office or position of public office holders responsible officials and responsible persons in entities that have state funds. Mode of operation to provide a functional system of communication and exchange of information with domestic and international legal entities and informing the public about the operation of the State Audit Office. In the framework of cooperation with relevant institutions employees are obliged to respect the constitution, the legislation of the Republic of Macedonia, the INTOSAI auditing standards and INTOSAI Code of Ethics. Employees develop a high degree of professionalism in accordance with the principles of civil society.

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**PUBLIC ADMINISTRATION REFORM IN THE CONTEXT OF EUROPEAN INTEGRATION**

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**Abstract:**

*The status of public administration, and its adjustment to rapidly changing needs of society and government, is currently a universal debate in European countries. The Albanian government has committed itself to walk into the path of European integration. With its aim of EU membership, the Government and the EU have identified public administration reform as a basic priority to achieve this membership.*

**Purposes or objectives:** *The paper analyzes main aspects of public administration reform in Albania during the last decade, focusing especially on trends and restructuring strategies to achieve European standards and requirements. At the beginning of this study, we are going to describe briefly the principal issues of this sector, a general view of the past and the critical moments to be rebuilt. A narrative approach is employed to analyze essential characteristics of the new law on "Status of the Civil Servants" and on "Organization and Functioning of Public Administration". An important moment of our study will be to highlight the main rules on modernizing the process of a "Good Administration" as an inclusive concept.*

**Methodology & Conclusions**

*Primary search in the form of interviews and close contacts to the managers/directors of central and local public institutions and secondary search reviewing of recent reports, previous statistics, papers and articles of the field.*

*Finally the paper concludes by emphasizing the necessity of the reform through the strategy with a series of changes not only in law, procedures or policies, but also recommending a strict attention to the human resources management as the most substantial asset of the implementation.*

**Key Words:** *Public Administration Reform, Good Administration, EU integration, Modernizing Standards, Law on CSS*

**JEL Classification:** *H190; H830*

**ABBREVIATIONS**

<b>CSR</b>	-Civil Service Reform
<b>CSS</b>	-Civil Servant Status
<b>CSC</b>	-Civil Service Commission
<b>DoPA</b>	-Department of Public Administration
<b>HRM</b>	-Human Resources Management
<b>PAR</b>	-Public Administration Reform

**1. Principal Issues and Areas for Support**

An efficient, responsive, transparent and accountable public administration is not only of paramount importance for the proper functioning of a nation, it is a central part of democratic governance and also the basic means through which government strategies to achieve the integration goals can be implemented. But, most important of all, an established non-partisan civil service is vital to democracy as it makes peaceful and orderly political succession possible, and thus genuine pluralism. Also, because the public administration is one of the main vehicles through which the relationship between the state and civil society and the private sector is realized, supporting Public Administration Reform (PAR) is a means towards achieving higher-order development goals, particularly equitable growth, poverty reduction, peace and stability. Capacity development in the public administration needs to be addressed at three levels: the individual level, the institutional level, and the societal level. *At the individual level* it involves establishing the conditions under which civil servants are able to embark on a continuous process of learning and adapting to change – building on existing knowledge and skills and enhancing and using them in new directions.

This requires a new approach to human resource management (HRM) and also points to the importance of knowledge management, as the new vehicle for increased learning. *At the institutional level*, a similar approach needs to be applied. Finally, capacity development at the *societal level* is required to support the paradigm of a more interactive public administration that equally learns from its actions and from the feedback it receives from the population. Based on this, PAR can be divided into three main areas<sup>95</sup>:

- (a) Civil service reform (CSR), which is concerned with human resources in the public sector such as capacity, wages and conditions.
- (b) Increasing the efficiency and responsiveness of the policy-making system.
- (c) Reforming the machinery of government, which is concerned with the rules, institutions, and structure of the administration necessary to carry out government policy, including new tools for public administration, notably e-governance and e-government.

### 1.1 What do we mean by Public Administration Reform (PAR)?

Public administration refers to:<sup>96</sup>

- The *aggregate machinery* (policies, rules, procedures, systems, organizational structures, personnel, etc.) funded by the state budget and in charge of the management and direction of the affairs of the executive government, and its interaction with other stakeholders in the state, society and external environment.
- The *management and implementation* of the whole set of government activities dealing with the implementation of laws, regulations and decisions of the government and the management related to the provision of public services.

Public Administration Reform can be very comprehensive and include process changes in areas such as organisational structures, decentralisation, personnel management, public finance, results-based management, regulatory reforms etc. It can also refer to targeted reforms such as the revision of the civil service statute. Meanwhile, the reform in public administration sector actually includes:

- a) Functional and structural reform
- b) Extension of scope of legislation related to civil service
- c) Wage system reform

## 2. PAR in Albania: General Overview and Trends

The Albanian transition clearly demonstrates how development achieved without paying attention to public administration and management can be hardly sustainable. In its National Strategy for socio-economic development the Albanian government recognized PAR as fundamental for the attainment of the medium-term objectives for growth and poverty reduction.<sup>97</sup> During the 1990s, government efforts focused on maintaining aggregate fiscal discipline, and less on establishing institutional arrangements to bring a more strategic focus to budgetary processes. Management of people and programs in a fiscally responsible way, based on sound technical data and modern administrative principles, has been a forgotten area of action. Public administration has, during its brief democratic trial period, been one of the weakest links in the Albanian government system. Leadership into the modern world, of which Albanians dreamt in 1992, had devolved to a series of embarrassing measures of social control.<sup>98</sup> An important milestone in modernizing Albanian Public Administration has been the foundation of DoPA in 1994, based on a government decision to create a governing unit in charge for formulation and implementation of the public administration reform. The DoPA is responsible for formulating HRM strategies, while an independent authority, the Civil Service Commission (CSC) monitors DoPA's activity. The most important next step has been the approbation by Albanian Parliament of Law on Civil Servant Status (CSS) in 1999. Law no. 8549 dated 11.11. 1999, "Public Official Status" created a mixed civil service system, mainly a position based model, combining it with elements of a career system. The prevalent character of the positions system can be distinguished by elements such as: recruiting criteria, promotion, horizontal movement etc. The law mentioned above aims to create a relatively open system of the CS, providing at the same time premises for internal and career mobility. In 2005, for the first time DoPA initiated a general organizational and functional review of public administration institutions. This movement aimed the rationalization of public administration structure, through identification of abundant positions in every institution, and increase of efficiency of the whole structure. The baselines defined by the EU were such minimum standards of performance in areas of budgeting and financial management like public expenditure management, financial control, public procurement and external audit. However, reforms were addressed mainly by drafting laws and formally establishing new agencies, revealing donor pressure more than a serious commitment of the Albanian government, still unable of implementing much of the reforms. As is confirmed in some

<sup>95</sup> Public Administration Reform, Practice note (UNDP)

<sup>96</sup> Public Administration Reform and EU Accession in CEE, Technical Paper (World Bank)

<sup>97</sup> Public Administration Reforms in Transition Countries-Albania, Working Paper (D.Cepiku,2010)

<sup>98</sup> Aspects of PAR in Albania (Blerta Selenica)

UNDP and WB studies, base salaries for public servants are at or below poverty rates; for top functionaries, they are only slightly above. This situation leads to several destructive effects: corruption; grade inflation, salary compression, low quality and low motivation.

Recently, important steps are undertaken in reforming the wage system by drafting a new legislation, which aims to regulate the wage system of independent institutions and extend the civil servants wage system to other state institutions. Finally, DoPA has been involved in several projects aiming to increase the use of computer technologies in day-to-day operations in public administration and e-governance.<sup>99</sup> However, the current implementation of PA reforms continues to focus on mechanical and formal alterations of the structure of the civil service rather than procedural operations and effectiveness and a change in behaviour within the civil service and its citizens-orientation. We move toward integration which is the most intensive process of negotiations in the country's history. There are hundreds and thousands of issues to be negotiated with the European Commission, with member countries in the coming years. The truth is that nothing determines the pace of integration more than the country's administration, its reforming strength and ability<sup>100</sup>. The service of CS has made its progress, has been expanded, but we should not forget that civil service is not the product of a long evolution, but the product of a decision and a law, which makes necessary the continuous training and qualification of this administration. Just to be more concrete, we want to emphasize the crucial directions of this process to be addressed through the table below:

**Table 1: The scope and contents of PAR in Albania**<sup>101</sup>

<b>Areas of PA modernization</b>	<b>PAR in Albania</b>
Public employment	Law on CS and creation of the CSC
Open government, transparency and accountability	Law on the rules of ethics in PA, anti-corruption plans and measures controlling conflict of interest, law on administrative procedures and law on freedom of information
The use of market-type mechanisms	First privatisation was pursued, but other market mechanisms have not been introduced because of the absence of well developed market and private enterprises
Reforming organisational structure	This lever of change has been widely used, but without a coherent strategy
Public expenditure and budgeting	Introduction of the Medium-Term Budget Program (MTBP), a tax administration modernization project, enactment of a new organic budget law
Enhancing public sector performance	Performance evaluation has been introduced more at the individual than at the organizational level
Control systems	Emphasis is on external control legislation and institutions
Use of ICTs (Information Communication Technology) and E-government	ICTs have been used in a fragmented, its use for service delivery is still very limited. Several projects on e-proc, e-accounting and e-population registry are undertaken.

### 3. "Good Administration" -the key of Public Administration

The concept of Good Administration has emerged within the European Union and its Member States as a system of values stemming from the principles of rule of law, democracy and human rights. It comprises a set of procedural rules which translate these principles into concrete standards for administrative operation.<sup>102</sup>

#### 3.1 Principles and their importance

The status of public administration, and its adjustment to rapidly changing needs of society and government, is currently a universal debate in European countries. In this political and social context, "Good Administration" has emerged as an inclusive concept, indicating the overall objective of the modernization process. The Charter of Fundamental Rights of the European Union proclaims that every person has the right to Good Administration.

<sup>99</sup> An overview of PA in Albania (Dhurata Thanasi)

<sup>100</sup> Intersectoral Strategy of PAR 2009-2013 (DoPA)

<sup>101</sup> Public administration reform in transition, Public Management Review (Mussari, R., Cepiku, D.,2007)

<sup>102</sup> Good Administration through General Administrative Procedures, Wolfgang Rusch (Annual Conference ReSPA,2012)



Some key elements of this fundamental right are stated in the Charter itself, while other principles and standards of good administration derive from other EU legislation and judicature as well as from good administrative practice of EU Member States. These principles and standards have become part of modern administrative systems. Good administration principles need to respond to old and new challenges.

Currently, they include the following elements:

- Good Administration is *reliable and predictable*. It guarantees legal certainty by respecting the rule of law. Administrative bodies exercise the powers and responsibilities vested in them in accordance with the laws and regulations applying to them. They implement general rules and principles impartially to anyone who fulfils the required conditions taking into account the interpretative criteria elaborated by the courts. When exercising their discretion they remain within the boundaries set by the law, in good faith and in a reasonable and proportionate way, upholding the requirement of equal treatment.
- Good Administration is *open and transparent*; administrative bodies keep matters secret or confidential only in order to protect a legitimate superior interest, e.g. national security or personal data of third parties etc. They even facilitate access in various ways, e.g. by electronic means, where feasible, and through points of single contact. Administrative bodies communicate actively about their tasks, duties and responsibilities. All public authorities identify the responsible civil servant and take care of improper or impolite behavior vis-à-vis citizens. They encourage participation of everyone affected by its decisions. Accepting citizens as partners in the decision making process is the first step towards the "horizontalisation" of the relationship.
- Good Administration is *accountable*. Administrative bodies, their work and its outcome are open to scrutiny and review by other administrative and legislative authorities as well as the courts. Accountable administration further requires the possibility of legal remedies for a decision and the provision of information about them by indicating any preconditions. Accountability involves the possibility for each individual citizen to lodge a complaint to an independent body. Such is the role of an Ombudsman who acts as an external mechanism of control, investigates complaints about maladministration and recommends corrective action where necessary.
- Good administration requires *an accessible and comprehensive system* of judicial control of administrative acts and other actions of the administration. This completes the mechanism for the defense of citizens' rights. Courts are provided with adequate power to fully scrutinize the legality of the administrative acts/actions in order to pronounce a final decision on the dispute.
- Good Administration is *effective and efficient*. Public authorities need to be successful in achieving the goals and handling the public problems set for them by law and government. They need to use public resources in a way proportional to the results attained, set clear objectives, evaluating past experience as well as the future impact of their action. Administrative procedures constitute a crucial part of the quality of public administration, which in turn is a prerequisite for political and economic performance.

### 3.2 Benefits of Good Administration

Good Administration presents multiple advantages and benefits: (a) it enhances democratic governance and political efficiency; (b) it fosters economic development and (c) – for EU candidates' countries and potential like us – prepares accession and future membership.

#### 3.2.1 Impact on political efficiency and democratic governance

Reliable, fair, open, accountable and efficient administration means proper implementation of political decisions and legal rules. The public interest is properly and efficiently pursued and the rights and interests of the citizens are respected. This is to the benefit of government, the citizens and more generally, democratic governance. Furthermore, by creating predictability, enhancing political legitimacy and promoting democratic governance, Good administration principles promote political efficiency. Predictability is important for government in order to make sure its decisions will be implemented. It is also important for citizens, who are able to know their rights and obligations act accordingly and know what to expect from public administration when deploying their activities.<sup>103</sup> Good Administration fosters trust in institutions, a vital precondition for low compliance costs, social peace and political stability. On the contrary, the lack of such conditions results in weak administration, weak state institutions and, in the end, a low capacity of a society to promote its well being. Delays, inefficiency, partiality, arbitrariness, corruption, nepotism, patronage, and other forms of maladministration lead to citizens' resentment, resistance and protest against the state and its institutions. All this is important at the international level as well. Cross border cooperation needs to be based on clear and predictable rules and on efficient domestic institutions. These conditions promote the political and economic position of our country in the EU and the globalised markets.

<sup>103</sup> Effectiveness of Good Governance and Ethics-evaluating reform outcomes in the context of the financial crisis (Ch Demmke & T Moilanen) June 2011.

### 3.2.2 Impact on economic development

The administrative, legal and court systems of a country form the most important part of its institutional infrastructure. Their importance for the development of the economy is universally acknowledged. They constitute the basis for the operation of the market and the encouragement of the most dynamic parts of society to contribute to its general welfare. Economic success requires institutions that encourage individuals to engage in productive and innovative activities, to look for opportunities and take up challenges. Foreign investors assess the risk by the chief criterion of predictability and stability of the political and institutional environment. It is a primary role of the State to define and follow up the respect of the rules of the game ensuring predictability for the deployment of economic activities. Maladministration in the form of administrative deficiencies and obscure, lengthy and unnecessary complex administrative procedures yield the field to partiality and corruption. Good Administration principles aim at balancing the needs of society and economic actors in view of the common good. Efforts to facilitate this encounter and communication with public bodies include the use of IT-based communication means, the introduction of single contact points (“one-stop-shops”) etc.

### 3.2.3 Impact on European integration: the non formalized *acquis communautaire*

It is not a coincidence that the principles of Good Administration form an integral part of the value system of the European Union. The EU constitutes a complex political and economic environment in which predictability is of utmost importance either for joint decision making or for achieving its economic and social goals. This is why these principles are common to all member states of the European Union, and to the institutions of the European Union itself. They represent part of the “non-formalized *acquis communautaire*” that has to be adopted by candidate countries. In terms of European integration Good Administration serves first and foremost the national interest of each member state. It allows coping with the pressure of economic competition and the forces at work on the common market. Accession states that wish to contribute to and benefit from the common market can do so for their own benefit only if they possess a functioning market economy as well as corresponding state institutions supporting it. A degree of compatibility of their administrative systems with the other EU countries is required for administrative cooperation, which in turn reduces transaction costs for cross-border business and investments. The European Commission is more and more interested to ensure that accession countries fulfill the Copenhagen and Madrid criteria. This includes the readiness and the ability to follow the principles of Good Administration in all its aspects, including administrative and judicial reform, the rule of law, and the fight against corruption.

## 4. PAR through modernizing administrative procedures, meeting EU standards

The Albanian government has committed itself to walk into the path of European integration. With its aim of EU membership, the Government and the EU have identified public administration reform as a basic priority to achieve this membership. Under this reform, especially under the objectives mentioned above and also in view of the necessity of establishing Administrative Courts, a whole set of new laws like the Code of Administrative Procedure, the draft law "On Organization and Functioning of Administrative Courts and Judgment of the Administrative Disputes ", the new law on "Status of the Civil Servants ", the new law "On Organization and Functioning of Public Administration", have gone through a series of important changes to fit as much EU requirements. In our study we want to stop on the most important moments regarding below:

### 4.1 The new Code on Administrative Procedure

The new Administrative Procedure Code project, aims to address the existing shortcomings. The new code tries to maintain the same overall structure (establishing/correcting the existing structural problems) and the same legal terms with the current code, trying to have a generation of entire professionals trained under the current code. However it is important to underline that some necessary changes were done in the reversal of new concepts and arrangements. Some of the accomplishments and updates of this Code achieved until now may be mentioned briefly as follows:

- Structural clarity on grouping dispositions
- Introduction of new legal regulations on electronic communications, and service centers with a ONE Stop
- Better regulation of principles of administrative proceedings
- Introduction of the principle of non-formalism and efficiency
- Regulation of the procedural delegation
- Regulation of the parties and their representation
- Strengthening the principle of inquisitorial and of cooperation in administrative proceedings
- Full adjustment of the concept of administrative acts and its forms
- Complete adjustment of the concept of legality and validity of administrative acts
- Regulation of a new institution, the one of the administrative arrangements
- Complete adjustment of the notification forms and procedures

#### 4.2 The new law on "Civil Servant Status"<sup>104</sup>

Drafting a new Law on Civil Servants is one of the priorities of the Inter-sectoral Strategy for Public Administration Reform (SPAR) of the Albanian Government and serves the country's ambition to integrate in the European Union (EU). After almost 12 years of actual implementation of civil service law, series of problems are encountered by its application, such as:

- a) recruitment not based on merit mainly due to the use of temporary contracts and lack of transparency and accountability in appointments
- b) politicization and instability reflected in politically motivated movements
- c) poor management and control over the implementation of civil service law.

The Albanian government has explicitly recognized these problems and the importance of civil service reform in terms of the need for an impartial, efficient and professional civil service. The goals of this reform should be to increase the capacity of the state to continue reforms in the country's development and to prepare Albania for association with the EU and beyond for its full membership. In this context, special attention is given to strengthening the role of DoPA as a central policy unit and civil service management, a role which should be clearly differentiated from that of CSC.

#### 4.3 The law for the organization and functioning of public administration

The draft law aims to reinforce the notion of "good-management" in the organization and administrative practice. This notion developed in a number of principles that are distinguished from the principles of the procedure administrative and budgetary management principles. The purpose of this draft is:

1. To create a general legal framework for the organization of state administration that can and should be used for all sectors of state activity, and avoid organizational development solutions on a case by case basis, leading to fragmentation, coordination problems, lack of accountability and abuse of resources
2. To strengthen the overall capacity of the central government to direct the implementation of state functions to resolve and implement national policies and to adjust deviations in the implementation process
3. To strengthen the accountability of senior civil servants through a clear structure that defines the tasks and responsibilities
4. To establish basic principles for the functioning of public administration in order to guide all directors, according to the principles of "good-management" when performing their duties. In the context of the difficulties faced for the application of these reforms it should be mentioned that in order to pass all these draft laws in the Parliament a qualified majority - 3 / 5 of all members of the Assembly is required- which is at the moment difficult to achieve due to political differences existing in the country, but international intervention will probably soon have a new legal package and quality.

### 5. CONCLUSIONS AND RECOMMENDATIONS

The role of civil servants and the concept of a "job" as a continuing, autonomous responsibility within a hierarchical structure are badly understood. Rational organization, personnel management and job definition require cultural understanding of a "western-type" work context which is not always present. The Albanian PA continues to be characterized by rigid hierarchies and a custodial attitude, which government-led reforms have not yet begun to address. Roles and missions of main institutions and their component parts are not established clearly. As we mentioned, capacity to implement HRM reforms has been weak and political interferences have been a threat for their successful implementation. But recent work by the DoPA has increased understanding of the situation in central Ministries and institutions. It has clarified organigrammes and staff numbers and standardized grade nomenclature. Despite some initial fundamental regulatory and institutional achievements, key challenges that threaten the successful implementation of the government's decentralization strategy are the following:

- The impact of external assistance in decentralization reforms
- Weak administrative capacity (both local and central)
- High fragmentation and small size of local units
- A still undefined role of the regions and the interactions between levels of government, which create conflicting authorities, duplications, and inefficiencies
- The poor coordination of decentralization implementation
- The absence of clear service standards and measurement criteria of performance in local service delivery
- An inadequate degree of revenue institutional autonomy and predictability

A more recent challenge for Good administration is to respond to fundamental social, cultural and economic changes that have occurred during the last decades. Investing in and professionalizing the public service must be the top priority. The Government is willing to stabilize public finances and to use the existing institutions and (draft) laws in which there has been considerable international investment. Historically, citizens were regarded as subordinated to public authorities.

<sup>104</sup> Intersectoral Strategy of PAR 2009-2013 (DoPA)

The top-down and unilateral behavior of public authorities dominated legal patterns as well as everyday administrative practice. This type of relationship was thought to serve the principle of the rule of law, while it guaranteed – inter alia – the noninterference by the state unless specifically provided for by the law. However, modern democratic governance transformed both the role of the state and the citizen. The citizen is not passive and a subject to the exercise of state authority but is seen as an asset: the citizen is given space as an active member, a partner who can contribute to the general welfare.

In this new context, administrative decision making and provision of administrative services need to adjust. This involves a new place for values such as transparency, simplicity and clarity, participation, responsiveness and “citizen oriented” performance. They redefine the relationship to citizens as more “horizontal”. Legal provisions and their administrative implementation need to incorporate this redefinition and keep up with these developments.

A professional public service will regain public credibility for government and also provide the creativity, skills and effort to help design and carry out social and economic policies.

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## CHALLENGES IN ACCOUNTING AND MANAGEMENT OF THE INTELLECTUAL PROPERTY IN ALBANIA AND STANDARDIZATION WITH THE EUROPEAN UNION

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### **Abstract:**

*In this study we are going to explain the achievements made in Albania regarding the Intellectual Property in accounting and the developments made to protect this right from the Albanian authorities and respective institutions.*

*We will begin the introduction of the implementation of the intellectual property in Albania with a brief history of the legislation that protect it and respective accounting standards applied in Albania and the difficulties in implementing them.*

*We will consider each institution in detail involved in the management of intellectual property by giving the progress that they have made in reaching the objectives in the field and the goals that they have in the coming years.*

*The informations gathered will be displayed in charts and tables comparable with other years to come to clear conclusions.*

*An important part of our study will be the economical aspect of the Intellectual property and the important role that it has in the Albanian actual economical system .We will give information of the registered trademarks and patents in Albania by each year and the explain by questionnaires the importance of Intellectual Property from the aspect of the Albanian businessmen.*

*Examples will be given to support the ideas and theoretical aspects showed in the study in order to explain the actuality of the Albanian market compared with the global trends of the field.*

*The methodology used in the preparation of this paper will be that of the utilizing the foreign and national literature , and the utilization of the questionnaires .*

*The conclusions and the recommendations for the Albanian market will be the final part of this paper.*

**Key words :** *Intellectual property, ALPTO ,IAS 38 , Albanian IP strategy , trademark value.*

**JEL Classification:** *M49.*

### **Introduction**

The legal regulations concerning the protection of the intellectual property is a key element for the right competition development in every social and economic aspect of a nation. In the universal declaration for the human rights is stated that “Everyone has the right to protect his moral or economic interests that are consequence from every scientific , economic or artistic work , author of whom is him his self”

In today’s economic system we can see that the intellectual property is becoming more valuable then the material products. The rough competition to make better and more efficient products or services has made that each inventor or producer ,not to simply deliver a product but also to find alternative ways to make the product more efficient or wanted from the consumer.

On this purpose the scientific innovations in products the patents , the brand name logo, or special design will distinguish a certain product from those of the competitors and lead through the rough global competition . Once becoming the leader of the competition its obvious that the earning power will increase and the intellectual property holder will satisfy it’s moral and material interest from his/her creation or invention.

Today we can see that the importance of the intellectual property is in the focus of the successful investitures , just checking the most successful companies in the world today , we observe that mostly their earning power comes from their brands, just having a look at the most valuable trademark ranking worldwide we can see that the value of the biggest companies is the brand name value. Below are listed 10 most valuable brands of the world according to FORBES 2012 list :

<i>Name</i>	<i>Value of the brand name (in millions)</i>
• Apple	182.951
• IBM	115.985
• Goggle	107.857
• Mack Donald's	98.188
• Microsoft	76.651
• Coca Cola	74.286
• Marlboro	73.612
• AT&T	68.870
• Verizon	49.151
• China mobile	47.041

In U.S. , according to a study almost 60% of the value of the big companies is made from the intangible assets , and mostly from the brand name.

As the brand name has a vital role in a company's revenue generation , is in the company's interest to protect it from the unauthorized usage , by piracy and from the other hand to value it accordingly to the IAS and to report it in it's financial tables.

The protection of the intellectual property and concretely the brand name from piracy , that is the production , distribution and sales of a product or service with a certain brand name without the authorization of the legal owner of the brand name. Piracy damages the interests of the legal authors or owners of the brand names , by putting them under non favorable economical positions.

For this purpose , and as a condition of Albanian perspective for the stability and association to EU in Albania the intellectual property is guaranteed to the owners by these institutions:

- Albanian patent and trademark office (ALPTO)
- Albanian office for the copyright (AOFC)
- General office of customs
- General office of the state police

Albania is becoming more active in the adoption of intellectual properities by being associated with most important treatment in the world such as Madrid treatment , and nice classification, as well as stating new laws that regulates the intellectual property. By stating these developments in intellectual property protection against piracy , the Albanian state focus to attract the foreign investments and companies.

Actually the laws that protect the intellectual property are :

- Law no.9947 dt. 7.th July 2008 "For the Intellectual property" and
- law no. 9380 dt. 28.th April 2005 "For the copyright and other related rights"

The above mentioned developments are also as a part of the conditions set from the EU in the Albanian prespective of stabilization and association to EU.

In accounting and managment prespective the institute of certified accountants (IEKA) is implementing the IAS 38 for the Intangible assets, that aims to certify and value an intangible assets only if certain criteria are met, and the requirements for extra informations regarding these assets.

In Albania there are companies that are becoming active in the intellectual property regulations , that register their inventions or brand names to the corresponding offices as well as including the value of the intellectual properties such as inventions , patents or brand names in their financial tables.

### **The actuality of Albanian Institutions of Intellectual Property**

In Albania there are two direct institutions that manage the intellectual property in Albania , Albanian Patents and Trademarks office (ALPTO) and Albanian office for the copyright (AOFC). ALPTO is focused in all intellectual property rights such as patents , trade marks , geographic indications etc. Whereas the AOFC is exclusive focused in copyrights issues.

The institution for the registration of the trademarks has operated in Albania since 1957, under authority of Albanian Chamber of Commerce. In 22<sup>nd</sup> of March 1993 the Albanian Chamber of commerce authority passed to Directory of "Albanian Patents and Trademarks office" (ALPTO), that is under the authority of Ministry of Economy, Trade and Energy, dt 22 Mars 1993. Its operations is regulated with law no. 9947 dt. 07/07/2008 of the Industrial Property. It is focused on the Intellectual Property related with patents, industrial designs, trademarks, integrated circuits and geographical indicators.

The mission of ALPTO is to enforce the protection of intellectual property in Albania through the applications and for their registration and the creation of the registers where these IP can be organized and managed within the Albanian regulations. ALPTO can achieve its missions with the aid of below instruments:

- The support of the initial premises that try to improve the legislation in the field of the IP.
- The support of the initial premises that are focused in the association and stabilization of the Albania in international treatment and agreements in the field of IP.
- The support of initial premises that target to establish better cooperation between institutions that are involved in the protection of IP.
- The creation of a effective system for the acceptance and registration of the IP rights according to the actual legislation.
- The support in the field of IP and other rights that are consequences of the IP legislation, in other sectors.
- Finding and supporting the right administrative capacities and applied legislation in the related field.
- Administration of the public registers of the IP and the publication of the related important data of IP in periodic bulletins.
- Creation of the conditions and the bilateral negotiations for the cooperation with homologue authorities involved in the field of IP protection.
- The protection of the ALPTO thoughts and cases in courts and other arbitrage cases involving the court procedures.
- Organization of the exams for the patents lawyers and administration of their list.

From year 2009, ALPTO uses the base system for the intellectual property IPAS (Industrial property automated system) installed by WIPO in year 2006, that the industrial international applications for trademark registration to be registered electronically according to the Madrid treatment and protocol. The appliance of IPAS has improved and made more efficient the operation of appliances and made more exact the database of the IP, that is very important for the ALPTO, and other institutions as well as for the public who can obtain the desired informations through these database.

Till the end of the year 2011 in ALPTO there have been 2.327 patents applications, and 2.208 patent rights were released. Actually 2.604 patent are protected and registered.

Regarding the trademarks, 3.223 trademarks registration applications scored at the end of year 2011, and 3.152 trademarks have been registered.

The main problems for ALPTO are:

- Intensity of law application the abuse with trademarks and patents.
- Lack of qualified personnel with high degrees in Biology, mechanic, engineer etc.
- Ratification of the London agreement.
- Lack of cooperation between government institutions.

In April 2006 , was created The Albanian Office for the Copyright (AOC), where it's focus is the copyright and the protection of copyright and prevention of copyright violations. The office is under the authority of Ministry of Tourism, Culture, Youth and Sports. The office is primarily created for the immediate response against the copyright violations and piracy .

The objectives of AOC are determined according to the decision of council of ministers no.232 . One of the main competences of the AOC is related to the registration and the appliance of the legislative rights of the IP rights.The main objectives are:

- The information of the public about the general cases of the copyrights and other rights related to, in accordance with other governments institutions.
- Observations of the protection of the copyrights and other related rights.
- The creation of a suitable system of the general administration of the copyrights.

Till year 2011 , 1941 applications are registered to certificate copyrights. 196 companies have registered their rights in fields such as publishing, music and television re-transmissions .1034 sale-buy contracts are certificated with object the Intellectual Property and 75 art works (books, tv programs, etc) are registered.

The main problems for AOC is :

- Intensity of law application against piracy and abuse with copyrights.
- The lack of conscience from the economic entities to know and obey the law.
- Lack of cooperation between government institutions
- Main problems remain the piracy of music and art

### **Standartization of the Albanian regulation and accounting issues of IP with EU**

Since 2009, ALPTO uses IPAS (Industrial Property Automated System) , the database of WIPO , for the international patents and trademarks registration online, according to Madrid tractate and protocol. The usage of IPAS has improved the efficiency of the office for the patents registration.

ALPTO have signed most of international conventions such as WIPO , EPO (European Patent Office) , PCT (Patent cooperation treaty ) , Madrid convent , Niche treatment etc.

Today every Albanian business have the chance to protect it's patent or brand name in Albania and not only , but in every specially country that he want the intellectual property to be protected, according to every business need or budget.

Through an application at ALPTO every business can protect the intellectual property in other countries according to their needs and budget. ALPTO can achieve this because it is part of many international treatment like Niche and Madrid treatment , where a business with one single application can protect it's IP in every country that is part of these international treatment according to the specific fees.

This is valid even for the other countries business which through an application to their respective IP institution , through the Madrid treatment can register their patents, inventions and brand names in Albania. Below we can find the registration of last 5 years of foreign businesses IP applications in Albania through Madrid treatment.

AOC has played a significant role in it's adaption to the preparation of Albania entering the EU by signing very international agreement upon copyrights such as BERN convention , TRIPS, Paris Universal convention for the copyright , Rome International convention etc.



## The accounting and valuation of IP

In accounting prospective the accounting institutions for the standards harmonization's has played a significant role in adopting the IAS to NAS . For the intellectual property it's applied IAS38 "Intangible assets" and in Albania it's adopted to NAS 05 for the "Long term tangible and intangible assets" .

The NAS 05 is made according to IAS38 and from the accounting point of view the Albanian standards are compatible with IAS.

Every business entity consists of three basic components: monetary assets, tangible assets and intangible assets. Their aggregate value equals the value of the entity. Monetary assets are defined as current assets less current liabilities. Tangible assets are plants, property and equipments, together with monetary assets they appear on the financial balance sheet of a business .

Valuing IP is important for many purposes including determining business values, capital allocations, taxes, licensing rates, and patent infringement damages. There is a growing interest in valuing patents and trademarks because the world economy is shifting from a tangible assets based economy to an intangible assets based economy. The business world has recognized that the intangible assets of many companies exceed the value of their tangible assets, and that patents and trademarks are part of these intangible assets.

There are several methods and models that can be used to value a brand name , but basically all these models can be derived from three methods:

- Cost Approach
- Market Approach
- Income Approach

**The Cost Approach** indicates the market value of the trademark based on the concept of replacement cost. The premise of the Cost Approach is that a prudent investor would pay no more for the trademark than the amount for which he could replace the trademark with a new one having the same utility to the investor as the existing trademark.

- **The Market Approach** indicates the market value of the trademark based on a comparison of the trademark to comparable trademark transactions in the market.

The market approach provides an indication of value by observing what others have agreed upon as a fair price in arm's – length , open market transactions involving property similar to subject. That is virtual transaction is compared with actual transactions judged to be comparable , based in the principle of substitution

**The Income Approach** indicates the market value of the trademark based on the value of the cash flows that the trademark might reasonably be expected to generate. To calculate the present values of future economic benefits we should take in consideration the following basic inputs:

- The economic benefit that can reasonably be expected from the exploitation of the property
- The pattern by which that economic benefit will be received
- An assumption as to the risk associated with realizing the estimated amount of economic benefit in the expected pattern

The valuation process may be very complex and should be performed by experienced and skilled accountant. The complexity of the IP valuation varies from the method that should be used , as with an improper method the variables can differ in a large scale. Another factor are the external factor, the competitors similar products, marketing efforts, as well as the economical expectation. There are many external factors that can effect the value of an IP, and the complexity of the valuation is not to leave any factor without examine and to examine it objectively . This the last task is very difficult as the valuation its self is based on a persons', concretely experts opinion and thus it has the trend to be subjective.

The difficulties in applying the standards in Albania are various, the first one is the lack of information that the finance department has regarding to the investments made in patent and brand name from the business owner. They generally are treated as expenses and not capitalized as expenses for IP , leaving no historical evidence for later valuation methods like cost approach.

Even if the expenses are capitalized for the brand name or a patent, there is a lack of information for the business owner as well as the accountant in valuation methods for the intellectual property.

Another problem in applying the trademarks valuations is the lack of a competitive and active market, from which it can be taken similar transactions and compared with our trademark in order to evaluate it according to the market value approach.

The lack of the skilled and experienced accountants in the valuation of the trade marks is another key factor that has made that even certain business in Albania have a valuable brand name or intellectual property they cannot take advantage of it by showing it into their financial tables.

### Conclusions and recommendations

In Albania there is made lot of progress in the field of the intellectual property , as it is one of the objective in Albanian's association and stabilization progress towards EU.

In this perspective there are adopted EU legislative regulations and the related IAS of the intellectual property. For the management and administration of the IP in Albania there are two institutions ALPTO and ACO that are part of most important agreement and institutions regarding the intellectual property in the world such as WIPO,ETC , Madrid agreement , Niche agreement etc. where an Albanian business can protect its intellectual property not only in Albania but also in other countries by simply applying in ALPTO and ACO in Albania. Even the progress made in the field yet there is work to do in this field to be in the level of EU standards.

- The improvement of the current legislation to protect the copyrights and the intellectual property in Albania
- Several reforms in the inspections sector , where the field inspectors have to be trained more and to be more responsible in protection of the intellectual property.
- Consolidations of the government institutions' cooperation to reach the common goals regarding the IP protection and management in Albania.
- The improvement of the people responsibility in general in respecting the copyright and IP.
- Training of the accountants and tax officers with the accounting and tax issues regarding the IP .

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## SECTION II: ALBANIAN FINANCIAL AND BANKING SYSTEM

## BANKS PROFITABILITY DURING RECESSION- CASE OF ALBANIA

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*The current economic crisis has highlighted that a well-functioning financial system is significantly important for economic growth. The financial system make possible an economy to be more productive as it permits the investors with less resources to use savings from those with few willingness of investing. Several studies demonstrate the existence of a significant relation between the business cycle and bank profitability. Since the last financial crisis weak balance sheets have increased the risk, thus resulting in an unprecedented rise in non-performing loans and credit-related write-offs in mortgage lending. Based on aggregate data of the banking sector in a our country we will try to evaluate the relation between bank profitability, economic growth and mortgage lending supply. Among the different components which define bank profits, more than one may be responsible for the co-movement with the business cycle.*

**Keywords:** bank profitability, business cycle, economy growth, mortgage lending.

**JEL classification:** G2, E32, O4, G21.

**1. Introduction.**

The current economic crisis has highlighted that a well-functioning financial system is significantly important for economic growth. The financial system enables an economy to be more productive as it allows investors with few resources to use savings from those with few prospects of investing. In this context, it is crucial to know what drives bank profitability. Higher profitability not only allows banks to generate funds to grant more credit to the economy, but is also important for regulators as it guarantees more flexible capital ratios, even in a riskier business environment. In addition, bank profitability must also lead to fair returns for its shareholders. To better understand the underlying mechanisms of bank performance in Albania for research purposes, some additional background information is required. By the end of 2011, the total assets of the Albanian banking system reached the level of 1,120.2 mil ALL which are 84.8% of the GDP.

Tables-1

Year	Total loans to business	In ALL	USD	EUR
2009 / 12	291,214.30	76,734.30	26,832.10	186,942.00
2010 / 12	330,388.10	89,529.30	31,186.80	209,347.50
2011 / 12	389,425.70	118,862.40	36,138.20	234,203.00

Year	Household Loans	In ALL	USD	EUR
2009 / 12	139,779.60	56,239.50	243.00	80,748.30
2010 / 12	142,176.00	59,411.90	236.80	80,001.60
2011 / 12	141,618.30	61,524.90	251.00	77,355.10
Year	Total Loans	In ALL	USD	EUR
2009 / 12	430,993.90	132,973.80	27,075.10	267,690.30
2010 / 12	472,564.10	148,941.20	31,423.60	289,349.10
2011 / 12	531,044.00	180,387.30	36,389.20	311,558.10

\* Data on loans do not include accrued interests.

Source: Bank of Albania

Measuring liquidity is a very important issue, even in the Albania. Although we can not speak for its significant volumes in the money market, the importance and the calculation of liquidity risk and its financing, are the focus of Albanian bankers. In the banking market operates 16 commercial banks, two of which were branches of foreign banks in Albania and this last year due to Bank of Albania regulation are not registered as branches. Developments in 2009 presented a challenge in the management of liquidity in the system in terms of a tense liquidity situation in the global financial markets. In order to manage better the situation, the Bank of Albania asked banks updated reports of a number of elements associated with their liquidity situation, particularly their relationships with non-resident financial institutions and deposits daily performance. The discussion on below section relies on the literature that exists on the Bank profitability in US and Europe.

## 2. Literature review.

According to previous studies, the factors determining the profitability of banks fall into two main groups.

- First, there is a group of determinants of profitability that are specific to each bank and that, in many cases, are the direct result of managerial decisions. They include :  
asset structure, asset quality , capitalization , financial structure ,efficiency, size revenue diversification.
- The second group of determinants includes factors relating profitability to: industry structure and the macroeconomic environment within which the banking system operates, such as industry concentration, economic growth, inflation, and interest rates.

### 2.1. Asset structure.

Most of the banking literature agrees that a bank's profitability is expected to increase as its portfolio of loans grows in relation to other more secure assets. This greater relative proportion of loans in the portfolio of the bank is usually coupled with a greater liquidity risk arising from the inability of banks to accommodate decreases in liabilities or to fund increases on the assets side of the balance sheet.

Consequently, a bank holding a low proportion of liquid assets (with greater liquidity risk) is more likely to earn high profits. Among the recent studies that report a direct relationship between the relative percentage of loans in bank assets and profitability—or, similarly, an inverse relationship between liquidity and profitability—are Barros *et al.* (2007), Chiorazzo *et al.* (2008), DeYoung and Rice (2004), Goddard *et al.* (2004), and Iannotta *et al.* (2007).

### 2.2. Asset quality.

There appears to be a consensus that bank profitability is directly related to the quality of the assets on its balance sheet; which means poor credit quality has a negative effect on bank profitability and vice versa. This relationship exists because an increase in the doubtful assets, which do not accrue income, requires a bank to allocate a significant portion of its gross margin to provisions to cover expected credit losses; thus, profitability will be lower. Among the studies that show a direct relationship between profitability and asset quality are Alexiou and Sofoklis (2009), Athanasoglou *et al.* (2008), Chiorazzo *et al.* (2008), and DeYoung and Rice (2004).

### 2.3. Financial structure.

Over the past decade, against a background of credit growth and favorable conditions in international financial markets, many European banks have financed an increasing portion of their growth by resorting to the medium- and long-term wholesale markets. Although this decision has afforded banks greater flexibility in their financial structure, the cost has been greater than it would have been if the financing had been in the form of bank deposits.

In this context, a higher share of customer deposits in bank liabilities should increase a bank's profitability, considering that deposits constitute a cheap and stable financial resource compared with other financing alternatives (Claeys and Vander Vennet, 2008; García-Herrero *et al.*, 2009).<sup>8</sup> Thus, we examine whether there is a direct relationship between the proportion of customer deposits in a bank's total liabilities and the bank's profitability.

On the other hand, an aggressive commercial policy could lead banks to pay higher rates to attract deposits from competitors (the so-called "deposit war"), thus squeezing bank margins. This "deposit war" may also be caused by the difficulties associated with accessing international funding markets, particularly since the start of the financial crisis in late 2007. We test whether high rates of growth in customer deposits are achieved at the expense of a reduction of the net interest margin.

### 2.4. Size.

There is consensus in the literature that the average cost curve in banking has a relatively flat U-shape, with medium-sized banks being slightly more scale efficient than either large or small banks. In other words, the effect of size could be non-linear, with profitability initially increasing with size and then declining for bureaucratic and other reasons (Athanasoglou *et al.*, 2008).

On the other hand, a larger size may imply economies of scope for the bank resulting from the joint provision of related services. However, Barros *et al.* (2007) find that larger and more diversified banks are more likely to perform poorly, suggesting that smaller and specialized banks can more efficiently reduce asymmetric information problems associated with lending.

The preceding arguments lead us to formulate two hypotheses of different signs. In principle, one would expect that larger banks experience more significant increases in profitability through economies of scale. However, above a certain threshold of size, diseconomies of scale can arise, making the size of the bank detrimental to its profitability. To this situation, we add the (uncertain) effect of bank size on profitability derived from possible economies of scope in addition to a possible “too-big-to-fail” argument in favor of larger size.

### 2.5. Economic growth.

Poor economic conditions can worsen the quality of the loan portfolio, generating credit losses and increasing the provisions that banks need to hold, thereby reducing bank profitability.

In contrast, an improvement in economic conditions, in addition to improving the solvency of borrowers, increases demand for credit by households and firms with positive effects on the profitability of banks (Athanasoglou *et al.*, 2008; Calza *et al.*, 2003; among others).

### 2.6. Inflation.

Revell (1979) introduces the relationship between bank profitability and inflation, stating that the effect of inflation on bank profitability depends on how inflation affects both salaries and the other operating costs of the bank. In this context, Perry (1992) concludes that the extent to which inflation impacts bank profitability depends on whether the extent of inflation is fully anticipated. If the inflation rate is fully anticipated by the bank's management, the bank can adjust interest rates appropriately to increase revenues faster than costs, which should have a positive impact on profitability. Recent studies (see, for example, Alexiou and Sofoklis, 2009) confirm a positive relationship between inflation and profitability. We therefore expect a direct association between the two variables.

### 2.7. Interest rates.

An environment of low interest rates coupled with fierce competition among banks could limit the possibilities for banks to establish appropriate prices for their loans and deposits. It may put pressure on the operating margin and negatively affecting banks' profitability. Among the studies that report a positive relationship between interest rates and bank profitability are Bourke (1989), Claeys and Vander Vennet (2008), Demirgüç-Kunt and Huizinga (1999), García-Herrero *et al.* (2009), and Molyneux and Thornton (1992). Despite this, as Avkiran (2009) points out, when management makes a conscious decision to pursue a high level of interest rate risk (e.g., by maintaining a high proportion of fixed rate assets relative to fixed rate liabilities), an increase in interest rates would lead to a fall in profitability and vice versa. This inverse relationship may also be caused by a time lag to pass changes in interest rates on to customers, particularly when interest rates decline.

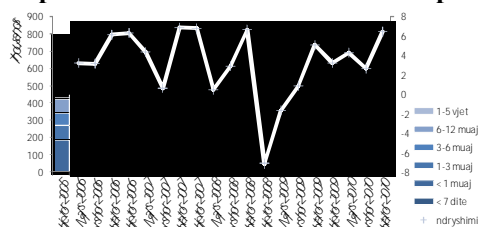
## 3. Performance of liquidity in the Albanian Banking System.

Banking system, introduced in 2009 increased total assets of about 6.25 percent, showing moderate growth rate this year compared with 12.4 per cent growth to introduce during the previous year. At a slower pace of growth has also introduced loan portfolio, which was estimated at 13.4 per cent increase compared to annual growth of 35.67 per cent estimated for 2008 and that of 47.73% calculated for 2007. For 2010, the volume of banking activity appeared more shrunken. The increase the level of deposits largely depends on the rate of return of public confidence in the health of the banking system, while the increase of deposit compensation served as a driving factor to stabilize public finance. The assets of the system are oriented toward assets that are less risky assets, while more conservative rules provided by the banks in terms of lending potentially affecting economic growth negatively, 2010. Even the performance of the exchange rate against foreign currencies, especially the euro, recently is a worrying sign of the deterioration of the terms of the borrowers who have a loan in foreign currency.

Therefore, a deterioration of their capacity to repay obligations related to loans obtained, is an expectation, not far from reality. In the last quarter of 2008, the banking market was faced with the withdrawal of deposits from customers, attracting not contributed to the decline in liquidity indicators and stayed away from critical levels. During this period, higher demand for short-term funds in banking sector and currency rates, is met by reducing liquid investments, loans obtained from parent banks, as well as liquidity to borrow from the Bank of Albania. This high demand for short-term funding has limited the ability of the banking sector to lend to the economy. As a result of the liquidity situation in the foreign currency, increased dependence on foreign financing lines. Despite the downward trend of recent years, the share of liquid assets to total assets of the banking sector continues to show good value. According to data published by the Bank of Albania, at the end of 2008, the value of this indicator was 42.8 percent, compared to 44 percent at the end of 2007.

During the first nine months of 2010, the banking system deposits result increased by about 48.1 billion. The international crisis effected our system during 2008 in the fall of deposits in October 2008 to 28.4 billion, or 4.1 percent compared to the level of deposits at the end of September reducing their weight in the total balance also moderating their annual growth compared to previous years.

**Graphic 1 Performance of customer deposits by maturity**



Source: BoA

Banking system until September 2010 represents a satisfactory liquidity position. The period in question was characterized by an increase in the deposit base in most of the banks of the system, a phenomenon which led to the improvement / stabilization of liquidity, being materialized in increasing the system's liquid assets. Although our banking system deposits are short-term sources, they are seen as more stable funding, which in this quarter there is an improvement to the structure shown with long-term maturities increase weight 6-12 months deposit. The growth rate of total deposits in the third quarter appears on the same line with the deposit of the same quarter of previous years.

Dynamics of deposits up to September 2010 according to the individual banks, shows that the largest increase compared with the end of last year highlight small banks (an increase of 7.74 per cent) while the growth of deposits by individuals has continued to hold the major share in the growth of deposits in the system. On the other hand it is worth to note that the banking system deposits exhibit a high degree of concentration, where the 5 largest banks in the system account for about 74 percent of their total weight which is located on the same level as the end of 2008

Indicators of profitability in the period of global financial crisis are presented in levels as in the following table:

Table2- Profitability levels 2007-2010

Profitability	2007	2008	2009	2010
ROA (%)	1.48	0.91	0.42	0.72
ROE (%)	20.32	11.35	4.58	7.58

Source : BoA

It is noted that the indicator of return on assets is decreasing in 2008. This decrease is evidenced in the coming year marking the lowest level years of recession that we have analyzed. Even the Return on Equity has the same trend.

In our analysis we want to verify the conclusions that have reached different authors and academics in the study that have led to the identification of factors that affect the profitability of the banks. The first indicator that we take in consideration is the level of credit analysis in 2007-2009.

Table 3 - Loans, deposit and loans to deposit ratio

Year	Deposits	Credit	Credit/Deposit ratio
2007	602.7	293.9	48.76%
2008	619.9	396.3	63.93%
2009	662.4	440.4	66.49%
2010	785.2	483.1	61.53%
2011	875.2	541.9	61.92%

Source : BoA

It is noted that the ratio of loans to deposits has increased in 2007-2009, which logically leads to the reasoning that profitability would be increased while this ratio is increased. But if we relate to one other factor, that of the net interest margin, we will understand the effect that has had this indicator profitably is not in the same direction. According to BoA data indicate that the net interest margin in the years of the financial crisis is in decline as a result of increased interest expense to a greater extent than to the interest income.

Column1	2007	2008	2009	2010
Incomes from interest/average assets that brings incomes (1)	7.72	8.06	8.1	8.11
Expenses from interest/average assets that brings incomes (2)	3.37	3.94	4.06	3.78
Net margin (1)- (2)	4.35	4.13	4.04	4.32

Source BoA

Also, if we relate the profitability of banks in the period of crisis with macroeconomic factors will we notice that:

- A low economic growth in the period described as the period of recession accompanied with a low and declining profitability. Albania in recent years although there is an economic growth, change in Gdp is positive, it is at low level compared to other years due to economic crisis. Economic growth 2008-2009 is the lowest level during the period of our analysis, at 3.32%.
- In terms of inflation, we see that this indicator is at constant levels. This has to do with the policy of the Bank of Albania to maintain inflation at constant levels. This is in favor of banks in the country which provide for and take into account inflation level in order to adjust interest rates.

Table 4 - Macroeconomic indicators

Year	2005	2006	2007	2008	2009	2010
GDP change (%)	5.7	5.4	5.9	7.71	3.32	3.6
Gdp level (mio All)	814,797	882,209	967,670	1,088,132	1,143,610	
Inflation rate	2	2.5	3.1	2.2	3.7	3.4

Source BoA

#### 4. Conclusions.

The current banking crisis and the concurrent severe recession revive the interest in the issue of pro-cyclicality of bank profitability. This paper has examined how bank-specific characteristics and macroeconomic variables, factors affect the profitability during recession period. We have taken in consideration different factors that may influence profitability in terms of RoA and Roe. Our study does not confirm that the rate of growth of deposits is related to profitability. In order to analyze the influence in profitability the level of income interest and expenses interest should be taken in consideration. We find evidence for our theoretical prediction that a bank's lending history should also be taken into account when explaining its current net interest income. Also the macroeconomic factor as the economic growth or inflation are considered. The economic growth explains the profitability where as in terms of inflation no evidence of relation is shown.

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## CAPITAL STRUCTURE AND FIRM PERFORMANCE: A REVIEW OF LITERATURE

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### **Abstract:**

*The relationship between capital structure and firm performance has been the subject of debate of earlier and actual studies. This debate consist on whether there is an optimal capital structure for a firm or whether the use of debt is irrelevant to the firm's performance or value as Modigliani-Miller theory of 1958 suggest. Many studies are focused on optimal capital structure and each firm has an optimal (target) capital structure, defined as that mix of debt, preferred and common equity that causes its stock price to be maximized. This paper provides a brief review of literature of the main capital structure theories .The paper also provides review of literature of different studies which have proved the existence of a relationship between capital structure and firm performance.*

**Keywords:** Capital Structure; Modigliani and Miller Theory; Trade off Theory; Pecking Order Theory and Agency Theory; Firm Performance.

**JEL Classification:** G32.

### **1. Introduction.**

According to Brigham and Ehrhardt (2008) capital structure refers to the firm's mixture of debt and equity. Firms may raise funds from external sources or plow back profits rather than distribute them to shareholders. In reality, capital structure may be more complex including different sources.

The Modigliani-Miller theorem in 1958 forms the basis of further studies on capital structure. The theorem states that, in a perfect market, how a firm is financed is irrelevant to its value. For this reason their theorem is called "The Irrelevance Theorem" (Modigliani and Miller , 1958). But in the real world capital structure is relevant, that is, a company's value is affected by the capital structure it employs.

Many studies are focused on optimal capital structure and each firm has an optimal (target) capital structure, defined as that mix of debt, preferred and common equity that causes its stock price to be maximized. Therefore a value-maximizing firm will establish an optimal capital structure and then raise new capital in a manner that will keep the actual capital structure on target over time (Brigham and Ehrhardt 2008).

Myers (1984) takes another position in contrast to earlier studies saying that different capital structure theories don't seem to explain actual financing behavior, and it seems presumptuous to advise firms on optimal capital structure when we are so far from explaining actual decisions. De Wet (2006) proved that at the financial structure that yields the lowest WACC, the value of the firm as a whole is also maximized .So according to his study he identified a correlation between the increase in firm's value and the optimal level of leverage and showing how the value of a firm can be increased with increased levels of debt. According to Rajan and Zingales (1995), profitability is negatively correlated with leverage and the negative influence of profitability on leverage should become stronger as firm size increases.

And Myers (2001) writing on optimal capital structure, concludes that: "There is no universal theory of the debt-equity choice and no reason to expect one (Myers, 2001).

Hovakimian and Opler and Titman (2001) conclude that the different effect of profitability on the debt ratio and the debt-equity issue appear to be consistent with a pecking order behavior in the short-run and revision to the target in the long-run. This leads to the possibility that firms do not view the pecking order and trade-off theories as mutually exclusive and support the existence of "generalized version of the trade-off theory".

The literature on the relationship between firm performance and capital structure has produced different results( Modigliani and Miller ,1958;Myers ,1984;Titman and Wessels, 1988; Harris and Raviv, 1990; Rajan and Zingales ,1995; Frank and Goyal, 2003). The starting point for all the theories on firm's capital structure is the Modigliani and Miller (1958) propositions in a world of perfect capital market and no taxes. Their first 'proposition' was that the value of a company is independent of its capital structure.

Their second 'proposition' stated that the cost of equity for a leveraged firm is equal to the cost of equity for an unleveraged firm, plus an added premium for financial risk.

That is, as leverage increases, while the burden of individual risks is shifted between different investor classes, total risk is conserved and hence no extra value created.

## 2. Trade off Theory.

*By including market imperfections, firms seem to get an optimal, value-maximizing debt-equity ratio by trading off the advantages of debt against the disadvantages. So firms will set a target debt ratio and gradually will move towards achieving it (Myers, 1984).*

One of the main assumptions in the Modigliani and Miller (1958) is that there are no taxes. The trade-off theory is a development of the MM theorem but taking in consideration the effects of taxes and bankruptcy costs. This theory is considered as the first step for the development of many other theories which have studied how firms choose their capital structure. Modigliani and Miller's (1958) theory can be used to describe how firms use taxation to manipulate profitability and to choose an optimum debt level.

Debt level at the other side increases the risk of bankruptcy or as we call it the bankruptcy costs because as the debt to equity ratio increases the debt holders will require higher interest rates but also the shareholders will pretend higher profits for their investments. (Brealey and Myers, 2003) According to Brealey and Myers (2003) financial managers often think of the firm's debt-equity decision as a trade-off between interest tax shields and the costs of financial distress.

Sogorb and López (2003) used a sample of 6482 Spanish SMEs during the five-year period 1994–1998. Using panel data methodology, they found evidence that SMEs attempt to achieve a target or optimum leverage (like that suggested by the trade-off model) which is explained as a function of some specific characteristics of the firm, and they found less support for the view that SMEs adjust their leverage level according to their financing requirements (pecking order model). Also according to their study the coefficient of the effective tax rate is positive and statistically significant, so if SMEs have to pay more taxes they should increase the use of debt to reduce tax bills, but there are other costs like depreciation which are considered non-debt tax shields, that reduces the importance of the fiscal advantage of debt.

At the other side Serrasqueiro and Nunes (2010) study of 39 companies for the period of 1998 to 2006, conclude that the attempt for a trade-off between debt tax shields and bankruptcy costs seems to have little relevance in explaining the capital structure of quoted Portuguese companies. They used financial data from the balance sheets and income statements of the companies selected from Analysis System of Iberian Balance Sheets. Using OLS regressions they found that the firms adjust their actual level of debt towards a target debt ratio, but because of higher transaction costs the adjustment towards a target debt ratio of quoted Portuguese companies is slower than that found in similar studies of German, British, Spanish (Sogorb and Lopez, 2003) and USA companies.

## 3. Pecking Order Theory.

*The pecking order theory contradicts the existence of financial targets, and states that firms follow a financing hierarchy: internal funds are preferred above external financing (Myers, 1984;*

*Myers and Majluf, 1984) When firms need additional funds they follow the below pecking order: First they use internally funds (retained earnings), they adjust their target dividend payout in order to let unaffected the dividend flow (also if a firm has insufficient cash flow from internal sources, it draws down cash and marketable securities), and at last if external finance is required firm prefer (in order of preference): debt, hybrids securities (for example convertible bonds) and issue equity. (Myers, 1984; Myers and Majluf, 1984). So, firms do not have a target debt ratio and the reason for this hierarchy is that internal funds are supposed to be the less costly source of finance not subject to any outside interference. **This theory suggests a negative relationship between profitability and leverage.***

The pecking order theory was first suggested by Donaldson in 1961 and it was modified by Myers and Majluf in 1984 (Sogorb and Lopez, 2003). The pecking order hypothesis is an important theory explaining capital structure decisions of firms (Seifert and Gonenc, 2008).

Pecking order theory advocates that companies in its capital structure decisions do not search for a target debt ratio (Myers, 1984; Myers and Majluf, 1984): "The choice between debt and equity financing should not matter either" (Myers and Majluf, 1984). According to them the level of debt is determined by the need to finance growth opportunities, when internal finance is exhausted. "If managers assume active shareholders, then only the investment decision matters" (Myers and Majluf, 1984). So the only information which is considered important by the decision to issue risk-free debt and invest is that the firm has a positive-NPV project causing a positive price change.

Pecking order theory (Myers, 1984; Myers and Majluf, 1984) describes a hierarchy of financing choice a firm makes due to information asymmetry.

1. Firms prefer internal finance.

2. They adapt their target dividend payout ratios to their investment opportunities, although dividends are sticky and target payout ratios are only gradually adjusted to shifts in the extent of valuable investment opportunities.

3. Sticky dividend policies, plus unpredictable fluctuations in profitability and investment opportunities, mean that internally-generated cash flow may be more or less than investment outlays. If it is less, the firm first draws down its cash balance or marketable securities.

4. If external finance is required, firms issue the safest security first. That is, they start with debt, then possibly hybrid securities such as convertible bonds, then perhaps equity as a last resort. In this story, there is no well-defined target debt-equity mix, because there are two kinds of equity, internal and external, one at the top of the pecking order and one at the bottom. Each firm's observed debt ratio reflects its cumulative requirements for external finance (Myers, 1984).

Internal funds hold no adverse selection risk because the cost is internal and completely controlled by the entrepreneur. (Handcock, 2010) Debt is a higher risk, there is the need to repay it, but the costs are external and therefore are considered to be moderate, or incur minor adverse selection risk. Equity comes with a higher adverse selection risk and information asymmetries between the investor and firm are significant. Therefore, the cost of such finance is much higher with the investor factoring in the higher risk thus looking for a higher return. Therefore, equity is only sourced after the ability to borrow funds is exhausted (Frank and Goyal 2003).

Pecking Order Theory has been supported by a number of studies in various environments. (Shyam-Sunder and Myers, 1999; Swinnen, Voordeckers and Vandemaële, 2005; Aen and Oruc, 2008; Serrasqueiro and Nunes, 2010). Shyam-Sunder and Myers (1999) study tested the pecking order theory for USA quoted companies (a sample of 157 firms from the set of all publicly traded American firms over the period 1971 to 1989) using time series cross sectional tests were to analyze the data. The idea was that the debt financing is used to fill the internal financing gap, which is constructed from an aggregation of dividends, investment, change in working capital and internal cash flows. The attraction of interest tax shields and the threat of financial distress are assumed second-order in the pecking order theory (Shyam-Sunder and Myers, 1999).

Shyam-Sunder and Myers (1999) found strong support for pecking order theory and they conclude their study with the sentence: "Thus our tests have power with respect to the pecking order" (Shyam-Sunder and Myers, 1999). The results showed that changes in debt ratios were driven by the need for external funds, not by any attempt to reach an optimal capital structure. The pecking order model to be tested in the study was:

$$\Gamma \text{Dit} = a + bpo * \text{DEFit} + \epsilon it$$

Where:  $\Gamma \text{Dit}$  = the amount of debt issued,  $\text{DEFit}$  = the funds flow deficit and if it is negative it is expected that  $a = 0$  and  $bpo = 1$ ,  $bpo$  = the pecking order coefficient. They found constant close to zero, and  $bpo = 0.85$

Aen and Oruc (2008) studied the relevance of Pecking Order theory in capital structure formation for manufacture firms processed in ISE-Turkey. They took data from 75 firms which were continuously processed in ISE from 1993 to 2007 and of which financial table information were available. According to the results they obtained, the firms give priority to internal resources for finance as their total asset profitability, liquidity levels and sales amounts increase and prefer a lower level of external resource use. This condition supports the explanations made on the basis of pecking order theory.

Pecking order theory has not been supported by different studies (Frank and Goyal, 2003; Handcock, 2010). Frank and Goyal (2003) analyzed U.S. listed companies from 1971 to 1998 but did not support the pecking order theory. According to them internal financing is not sufficient to cover investment spending on average and external financing is heavily used." Debt financing does not dominate equity financing in magnitude. Net equity issues track the financing deficit quite closely, while net debt does not do so. The current portion of long-term debt is not treated as part of the financing deficit. These facts are surprising from the perspective of the pecking order theory" (Frank and Goyal, 2003).

#### 4. Agency Theory.

*The probability distribution of cash flows provided by the firm is not independent of its ownership structure and that this fact may be used to explain optimal capital structure and also there would be an optimum combination of outside debt and equity to reduce total agency costs (Jensen and Meckling, 1976). Optimal capital structure can be obtained by trading off the agency cost of debt against the benefit of debt (Harris and Raviv, 1991).*

Capital structure is influenced by firm's management because they might be pursue to take personal incentives instead of maximizing shareholder's value (Myers, 2001). An agency cost relates to the cost incurred by an organizations associated with problems such as different objectives between management and shareholder and information asymmetry.

The costs consist of the risk that agents will use organizational resource for their own benefit and the costs of techniques used to identify the problems connected with using an agent. Management, specifically the CEO, has their own objectives to pursue. The classical ones are empire-building, risk-averse investments and manipulating financial figures to optimize bonuses and stock-price-related options. The latter may be fraudulent, but the first two are not.

Michael Jensen and William Meckling in their article in 1976 "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", gave a definition of the agency relationship as: "A contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent" (Jensen and Meckling 1976).

Also according to them the agency costs includes (Jensen and Meckling, 1976):

1. the monitoring expenditures by the principal,
2. the bonding expenditures by the agent,
3. the residual loss,

In the case of small and start-up enterprises, the investor carries the financial risk. Investors will attempt to reduce the extent to which the entrepreneur holds information that is not accessible to the investor. They may provide debt funds and thus repayable in full (plus interest). When friends and family are investors there are other mechanisms that appear to reduce such risks. Within a close community, agency costs are reduced by only dealing within a trusted network (Hancock, 2009). "If the owner-manager sells equity claims on the corporation which are identical to his own (i.e., which share proportionately in the profits of the firm and have limited liability), agency costs will be generated by the divergence between his interest and those of the outside shareholders" (Jensen and Meckling 1976).

But in the cases of greater enterprises the separation of ownership and management gives corporations permanence and the corporation can survive even if managers quit or are dismissed and replaced (Brealey and Myers, 2003). According to Brealey and Myers (2003) the financial managers have to resolve two basic questions: The first is in what real assets should the firm invest in? (The answer is given by the capital budgeting decision), and the second that how should the cash for the investment be raised? (The answer is given by the firm's financing decision) (Brealey and Myers, 2003). Also according to Brealey and Myers (2003) the separation of ownership and management has same advantages:

- 1- It allows share ownership to change without interfering with the operation of the business.
- 2- It allows the firm to hire professional managers.

But if shareholders and managers have different objectives, it can cause the principal-agent problem. In such case managers do not attempt to maximize firm value and shareholders incur costs to monitor and control the managers' actions. In the case when the shareholders and the managers are the same person, the conflicts of interest doesn't exist (Brealey and Myers, 2003).

Jensen and Meckling (1976) was focused on two types of conflicts: between managers and stockholders and between debt holders and equity investors:

*The managers and stockholders conflict, is caused because managers usually try to overspend or take less leverage in order to avoid total risk, which comprises of risk of losing job, reputation and wealth. Mehran (1992) study suggest same ways to reduce the conflict between the managers and stockholders: adding compensation in incentive plan, giving some equity to managers, having investment bankers in the board and having equity owned by large individual investors. All this actions will affect managers to increase the level of debt which will become a disciplinary force for the company.*

*The conflict of shareholders and bondholders is caused because the shareholders have better incentives to maximize their wealth at the expense of the bondholders. They can do this through the increases in dividend rate, claim dilution, asset substitution and underinvestment (Myers, 1977; Myers, 2001) In this case, the bondholder can limit the consequences by drafting a bond covenants, which is an agreement to limit the firm on such actions as: financing, investment, production, dividend payout etc.*

The first conflict occur because managers hold less than one hundred percent of the residual claims. "If a wholly-owned firm is managed by the owner, he will make operating decisions that maximize his utility" (Jensen and Meckling, 1976) "If the owner-manager sells equity claims on the corporation which are identical to his own, agency costs will be generated by the divergence between his interest and those of the outside shareholders, since he will then bear only a fraction of the costs of any non-pecuniary benefits he takes out in maximizing his own utility" (Jensen and Meckling, 1976).

Different other articles have had in focus the problems related with the agency costs (Myers (1977; Ross, 1977; Grossman and Hart, 1982; Bradley et al., 1984; Jensen, 1986; Harris and Raviv, 1990; Stuls, 1990; Harris and Raviv, 1991; Rajan and Winton, 1995; Denis and Milov, 2002).

According to Harris and Raviv (1990) managers tend to prefer to go on with the activities and the operations of the firm even if liquidation is preferred by shareholders. They conclude that the ability of the firm to make its contractual payments to debt-holders provides information and in default management must placate creditors to avoid liquidation, either through informal negotiations or through formal bankruptcy proceedings (Harris and Raviv, 1990). Capital structure theories have focused on the tax advantages of debt (starting with Modigliani and Miller (1963)), the choice of debt level as a signal of firm quality (starting with Ross (1977)), agency costs of debt (Jensen and Meckling (1976) and Myers (1977)), and the advantage of debt in restricting managerial discretion (Jensen (1986)). Harris and Raviv (1990) study conclude that the informational and disciplining role is important and enables us to address issues such as liquidation vs. reorganization (Harris and Raviv, 1990), that were not addressed in the theories just mentioned. According to Stuls (1990) managers will try to invest all available funds in projects because their perquisites increase with investment even if their net present value (NPV) is negative. Consequently, when cash flow is high they invest in negative NPV projects rather than pay out cash.

Debt payments force managers to pay out cash flow and hence reduce investment in all states of the world. The tradeoff between the cost and the benefit of debt implies that there is a debt payment that maximizes firm value.

The optimal debt payment is negative when shareholders benefit by giving management more resources to decrease the probability that a good project will not be undertaken (Stuls, 1990). Jensen (1986) theory of free cash flow suggests that: "The problem is how to motivate managers to disgorge the cash rather than investing it below the cost of capital or wasting it on organizational inefficiencies" (Jensen, 1986). Management has an incentive to destroy firm value through empire building and perks etc. Increasing leverage imposes financial discipline on management, which forces the firm to pay out cash. A high debt ratio can be dangerous, but it can also add value by putting the firm on a diet. Harris and Raviv (1990) assert that debt holders can force liquidation if cash flows are poor.

Grossman and Hart (1982) gives us another point of view about the role of the management in determine the capital structure. As they don't want to lose control over the firm they will try to use as efficient as possible the firm's sources in order to reduce the probability of bankruptcy.

"Clearly the efficacy of bankruptcy as a source of discipline for management will depend on the firm's financial structure—in particular, its debt-equity ratio". "Furthermore, since debt increases the probability of bankruptcy, it would seem never to be in management's interest for there to be debt." (Grossman and Hart 1982). Bradley et al. (1984) study suggests that the volatility in earnings will increase bankruptcy costs, increasing the agency costs, therefore and forcing the companies to use less debt. Rajan and Winton (1995) conclude that short term debt contributes to do an effective monitoring of the firm. "When a bank lends to a firm, some stakeholders, such as other investors, trade creditors, employees, the government, free-ride on the benefits of the bank's control function" (Rajan and Winton 1995). Optimal capital structure can be obtained by trading off the agency cost of debt against the benefit of debt (Harris and Raviv, 1991).

The second type of conflict identified by Jensen and Meckling (1976) was that between debt holders and equity investors. In this case the managers will take actions that transfer value from the firm's creditors to its stockholders. There are several ways to do this and Myers (2001) gives us a brief explanation of them (Myers, 2001):

1-Managers could invest in riskier assets or undertake riskier operating strategies even negative NPV projects. If the results of their actions are positive this means higher profits for the shareholders, but if the results are negative this downside will be absorbed by the firm's creditors. This is called "asset substitution effect".

2-Managers may be able to increase the level of debt still and pay out dividends to stockholders. In this case the overall value of the firm is constant, but the market value of the existing debt declines because of the increase of the number of debt holders.

3-The firm invests up to the point where the expected return just equals the cost of capital. If debt is risky (e.g., in a growth company), the gain from the project will accrue to debt holders rather than shareholders. Thus, management has an incentive to reject positive NPV projects, even though they have the potential to increase firm value.

The greater the risk of default, the greater the benefit to existing debt from additional investment. According to Myers (1977) the gain in the market value of debt acts like a tax on new investment. If that tax is high enough, managers may try to shrink the firm and pay out cash to stockholders. Myers (1977) stressed this "underinvestment" or "debt overhang" problem. Debt overhang is when an organization has existing debt so great that it cannot easily borrow more money, even when that new borrowing is actually a good investment that would earn more than pay for itself.

4-Managers may last the maturity of debt to prevent the debt holders from the request of bankruptcy making debt riskier in benefition of stockholders.

Denis and Milov (2002) conclude that if a firm decides to borrow funds it will be monitored by the debt holders and this will be a strong mechanism discretionally chosen by the firm. "Because of their concentrated holdings and access to information, banks and other private lenders have the ability to exert much greater influence and pressure on management than public debt holders. We hypothesize that managers with low equity ownership stakes will seek to avoid this scrutiny by issuing public debt rather than private debt" (Denis and Milov ,2002).

## Conclusions.

This paper is a review of the literatures on some of the main capital structure theories beginning with Miller and Modigliani "Theory of Irrelevance" of 1958 and continuing with Trade off Theory, Pecking Order Theory and Agency Theory. Also this paper provides same evidence on prior studies done to prove if these theories are supported inside the content of different economy situations. Economists have not yet reached a consensus on how to determine the optimal capital structure (debt to equity ratio) the one that would bring the maximization of firm value in benefition of the stockholders and this study presents a theoretical approach toward understanding same financial issues which are not very much discussed in our country.

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## EFFICIENCY OF THE BANKING INDUSTRY – RELATIONSHIPS AND DEPENDENCIES BULGARIA, ALBANIA - COMPARATIVE STUDY

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### **Abstract:**

*The financial sector has an important role in the process of allocation of financial resources in the economy. Disruption of this movement and its limitation for any reason, its failure would trigger an acute need for resources to invest in the economic system on the one hand and the surplus of free resource accounts, and thus unjust and inefficient growth so-called. "Total savings to society." Thus the efficiency of the banking industry is closely related to the positive development of the economy as a whole. Analysis of international experience defined as determining the application of a number of methods and systems derived from authentic performance level and to explore the causal relationships and connections stochasticity and relativity of the results. As a benchmark used official statistics announced by the central banks of Bulgaria and Albania, as well as databases of European institutions.*

**Keywords:** *global economic crisis, the banking system efficiency, performance factors.*

**JEL Classification:** *G21.*

### **1. Introduction.**

Effective functioning of the financial system and its components play an especially important role for development and orderly functioning of the real sector. One of its main functions is to enable the access to financial resources to business accumulated free circulation of financial resources and community here - realizing the close connection and relationship between the state, "Effective Banking Sector", in additional income for savers - and result - stable state public finances. The level of economic agents ineffective functioning of the banking sector is reflected in the extra cost of financial operations, realizing variation from that formed due to supply and demand. This state of the financial services market can be dismissed economic agents to seek outside financial services national financial system, which would have a very adverse effect on the overall growth rate of aggregate output. The crucial problem in the global financial crisis when the dynamic macroeconomic environment is constantly provoking and orderly functioning of banks and their ability to generate income after a significant portion of their customer base suffers the effects of the crisis and limit the parameters of financial intermediation. Changes in banking regulation designed to limit the risks diverse range of proven complementary effect on the change in philosophy and geography of the banking business. Traditional function of providing liquidity, different times to maturity st receivables and payables is accompanied by measures for risk management and implementation of financial innovation. The process of 'financialisation' of social relations find expression through: 1. Zasilenata financial intermediation role of banks as a major source of resources for expanded reproduction; 2. Increase assets of the financial sector and its relationship with growth in gross domestic product; 3. Improved levels of leverage (measured as debt / GDP ratio). All these features are often multidimensional controversial, influence on the behavior of bank agents. Recapitalization banks provoke them to take more risks than they would traditionally suffered, which strains their assets increased demand for credit in the period before the crisis and competition between banks put in a position to continually innovate its product range with the only goal ascending process of lending to not reduced pace. "Plenty" of resources that banks operate in that period artificially lower the price, without the price to include the effects of the implementation of significant risks. The combined effect of all these factors in varying degrees and at different stages of time proved sufficient for the enhanced role of bank intermediation and changes the model to carry out banking business.

The effects of the interaction of banks in the system has dedicated his research Haldane (2009), reaching the conclusion that several external factors proved decisive influence on changes in systematic interaction between the components of the financial system, in particular between banks - namely increased parameters of derivatives trading, increased links between institutions as a result of globalization processes and the role of banking deregulation. These complex relationships between agents with similar business models operating a motoring their behavior extremely difficult. In the financial area united with crucial question as to the effective operation of commercial banks in a changing environment. Stimulating and limiting the impacts of the specific characteristics of the banking industry, the factors resources and legal and regulatory framework. Effective operation of the banks is a function of the dynamic processes of concentration of bank capital, factor conditions and customer base and subject to examination by the application of various methods and techniques of economic analysis. The results of the monitoring process can be quantified as: - Customer - to improve the quality characteristics of the offered bank products and services; - The bank - improving financial performance; for the audience - the redistribution of financial resources e economic space in search of adequate market returns. Saturated with a significant number of competing with each other financial sector stakeholders pursues eliminate variations in performance and cost of the globalized financial markets, Europe and reach the levels of the first-wave accession to the European Union. The study of the efficiency level of banks stands the attention of researchers, bank managers and investors. Today, for the purposes of economic analysis applied considerable number of concepts for research and evaluation of effectiveness. Experience has formulated two types of efficiency: productive efficiency and allocative efficiency. This classification was first proposed by British economist M.J. Farrell. in 1957, who in his article titled "Measuring productive efficiency", first introduced the concept of "operational effectiveness." same operational efficiency divided into two components: (1) technical or productive efficiency (technical efficiency); (2) efficient allocation (allocative efficiency). The first describes a method to maximize the outcome of the process of circulation for a resource. The second is minimized using a combination of resources for a given level of output. In our study, we examine the technical efficiency and allocative efficiency. As an indicator of inefficiency is the difference between acting and real 100% quality indicator expressed as a percentage. Banking efficiency is a topic worthy of attention, and it is especially valuable and important research in the context of the ongoing processes in emerging markets. In economies where capital and debt markets are still undeveloped, the main channel for economy savings are inflow through the banking system. Efficiency of banks is an indicator of the efficiency of financial intermediation process by combining all stages of movement from savers to investors. Moreover, the banking sector of developing economies is facing strong competition resulting the globalization of the financial system. While the trend in deregulation and global competition is limited for the next few years as a result of the financial crisis requires stabilization of the rate of exit from the economic crisis. Individual banks will be interesting to learn if they are other criteria to pursue or lagging in need of improvement. In general finding is that inefficiency costs down over time and convergence clusters defined by a small set of variables to control. Price inefficiency cost is directly related to the number of branches of the bank. Factors determining the efficiency of the banking system.

### **1. The structure of the financial system.**

The hypothesis of efficient structured financial system claims that more effectively operate high share of the banking market and higher market concentration. In their research Berger (1995) and Berger and Hannan (1997) explore how positive the impact of the market structure of the financial markets of the United States for its effective functioning. Presented their results do not provide conclusive evidence of a direct link between two structural components analyzed, and the financial system.

Research on the relationship between the effective functioning of the 11 countries in Europe in the context of the structure of financial market conditions in which they operate explore Goldberg and Ray (1996) and the efficiency levels vary widely. To study the level of risk due to the distribution of market shares between banks will be used coefficient Herfindel-Hirschman Index (Herfindahl-Hirschman Index) and Simple Concentration Ratio (CR<sub>x</sub>) the meaning of which is that an industry with few competitors will be higher degree of concentration, while a lower degree of market concentration is distributed among many smaller market shares.



Herfindel-Hirschman index (Herfindahl-Hirschman Index) and CRx (Concentration Ratio) is generally accepted measure of market concentration. Is calculated by the formula

$$H = \sum_{i=1}^N S_i^2$$

where  $S_i$  is the market share of the number of  $i$ -banks, and  $N$  is the number of banks.

Demiryuk-Kunt and others (2004) offer a concentration in financial markets is measured as the share of banking assets of the three largest commercial banks in the banking system. Although similar in methodology Harfindel Hirschman index is a widely used in conducting comparative studies due to the possible inclusion of a greater number of banks and more accurate comparative studies.

## 2. Banking regulation and supervision.

There are represented a three system's important variables for the efficiency of the financial system: - Restrictions on inclusion of new entrants - presumably actively working system of restrictive measures against the entry of new market participants will increase the concentration of the banking market. Such restrictions would strengthen the role of effectively functioning banking institutions to those who work at a lower level of efficiency. Measurement of this indicator can be done by the number of rejected applications for a license for banking operations. Such a process has been made in countries under market change in the banking sector where banks took Western Europe with strong positions in international markets. Offering the benefits of global business, they took a dominant position in the supply of bank products packages for economic agents operating in a global market environment. - Restrictions on banking operations performed and provided banking services. As such can be defined insurance operations, transactions securities markets, mortgage operations and ownership of shares by non-financial companies. An analysis of research in this area again produced conflicting results, giving a clear and explicit assessment of whether such operations affect positively or negatively the performance of banks. Klaesens and Liyvan (2004) prove his thesis that banking markets which operate in a highly regulated environment is characterized by a lower level of competitiveness will enable efficient banks earn extra from increased market share and thus reduce market positions less efficient rivals. Can be realized and the alternative scenario - set restrictive conditions to reduce the concentration, which will increase the specialization of banking institutions in the provision of certain services and thus operate at a competitive contest with major banks in the market. - The system of deposit insurance as a factor destabilizing the financial discipline of the market participants. High levels of regulation by the State Deposit Insurance initiated processes of higher risk of abuse because of lack of control, and hence the possibility of insolvent banks and systemic crises. The influence of the system guarantee and deposit insurance is a function of the following conditions: government deposit insurance, guarantee deposits in foreign currency, guaranteeing interbank deposits, mandatory inclusion in the scope of deposit insurance, no ceiling on guaranteed amounts. The combination of these factors initiate the conditions for making decisions on the brink of moral and involvement in criminal schemes. The place of supervision as a factor for the effective functioning of the banking system is in direct relation to the powers of the authorized state authority to influence banks to mitigate the risks borne by them. Basel 2 - in terms of external supervision of banks and Basel 3 - in terms of self-monitoring (independent internal) supervision of banks regulations regarding policy stable behavior of banks. The complementarity of the two surveillance - increased external oversight to promote effective behavior and increased self-surveillance - where little regulation of the market environment is a prerequisite for functioning markets offering different conditions.

## 3. Institutional infrastructure.

For effective functioning of the banking system is an important contribution and institutional infrastructure. Effective institutions working right system to ensure compliance with contractual discipline, while conversely preventing the development of effective market relationships between banks and their customers.

La Porta (1998) share the findings of his study that the real market relations in January exist in terms of the financial market, which has a system for ensuring the rights of the holders of minority shareholdings. The lack of safeguards to protect the rights of owners of shares dysfunctional judiciary and unstable control institutions to further delay the development of market positioning principles of financial systems of the countries in transition.

## 4. Ownership Structure.

Determining the level of efficiency of the banking system is the ownership structure of banks' capital. State, foreign or domestic capitals with different levels of representation are subject to restrictions or liberalized entry into the banking system. Free entry of capital contributes to the concentration of resources and hence resource advantage to the effects. Banking systems in Bulgaria and Albania to the global financial crisis. The way that the two countries - Bulgaria and Albania, choosing the path of democratic development, we had to walk the last two decades was never easy .. Complex and difficult evolution was carried out both in the organization and in the development of the social structure of society. The limited size Balkans area was the scene of ethnic, economic and social processes, subject to the processes of development and democratization and market economy. Different degrees of openness of the economies of the peninsula differentiate to some extent the effects of the financial and economic crisis. The effects of the global economic crisis on the economies of the region are expressed primarily in reducing the inflow of foreign capital so necessary for modernization of the real sector. Financial stability policies conducted by governments are segmented to ensure central bank independence and financial discipline on the use of limited public resources for the issuance of debt. These policies are targeted to improve the investment climate, to provide certainty to investors, which will allow the other countries to finance its trade deficit, caused by the growth of domestic demand.

Table 1. 1 Current Balance Account ( % from GDP)

Year/ Country	2005	2006	2007	2008	2009	2010
Albania	-6,1	-5,644	-10,371	-15,206	-14,03-	10,11
Bulgaria	-11,666	-17,573	-30,275	-23,262	-9,97	-2,273

Sources: [www.economywatch.com](http://www.economywatch.com)

Although economic growth was greatly reduced and funded exclusively by the national capital - savings and loan bank. (Table 1. 1).

Table 1. 2 Gross National savings ( % from GDP)

Year/ Country	2005	2006	2007	2008	2009	2010
Albania	22,829	23,566	19,059	17,121	15,059	15,048
Bulgaria	16,054	14,586	16,658	13,548	15,236	24,139

Sources: [www.economywatch.com](http://www.economywatch.com)

Banking systems in Bulgaria and Albania have made significant growth in 2008. Time after this period is marked by a decline in the price of securities the banks - investors major banking systems in both countries. Movement of foreign investments between national banking systems play a stabilizing role in the local banking system and promote efficient investment of available resources in the global economic system. Effects of movement in the banking sector cannot be assessed only through credit - they can affect the improvement of regulatory discipline, stimulate investment and hence - economic growth and prosperity of the nation of the host country. Investment in the banking sectors of Bulgaria and Albania are reflected by increased foreign banks national capital to total bank capital in the following table. 1. 3.

Table 1. 3: Share of international banking capital as a % from gross banking capital.

Year/ Country	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Bulgaria	46	44	48	54	54	54	61	70	67	67	67	67	67
Albania	63	75	75	75	70	73	82	77	85	83	83	83	83

Sources: [www.bis.org](http://www.bis.org)

Tables 4 and 5 shows a dynamics to the most important indexes of efficiency of both banking systems.

Table 1. 4 ROA

Year/ Country	2004	2005	2006	2007	2008	2009	2010	2011
Bulgaria	2,12	2,05	2,88	2,35	2,14	1,12	0,86	0,78
Albania	1,28	1,41	1,36	1,48	0,91	0,42	0,72	-

Sources: [www.bis.org](http://www.bis.org)

Tabl. 1 5 ROE

Year/ Country	2004	2005	2006	2007	2008	2009	2010	2011
Bulgaria	20,63	22,07	23,25	23,75	20,5	9,29	6,73	6,10
Albania	21,1	22,43	20,17	20,32	11,35	4,58	7,58	

Sources: [www.bis.org](http://www.bis.org)

Indicators of both banking systems, measured by return on assets and return on equity are influenced by the global crisis, both systems showed a slight increase at the end of recovery period.

## CONCLUSIONS.

After a period of strong economic growth, the economies of Eastern Europe, including Bulgaria and Albania, seems to achieve a kind of economic stability that is not characteristic of its western neighbors. Alas, the crisis showed that Eastern European economies remain vulnerable and more exposed to external shocks than western economies, as seen in the recent surge in credit default swap (CDS) prices and volatility in foreign currency. Companies and households, who earn their income in local currencies (now less) may not be able to repay the loans taken out in foreign currencies. These loans will be very difficult to reverse, hurting borrowers as well as balance sheets and earnings. In light of this, banks will have to be more circumspect in credit for certain companies and sectors and all stakeholders will have much more carefully managing their currency exposure. But prudent risk management alternatives and will not depend on geographical location.

## OPTIMUM CURRENCY AREA THEORY: AN APPROACH FOR ALBANIA CASE

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### **Abstract:**

*Regional currency areas originated from various roots such as historical, economic and especially political reasons. The optimum currency area (OCA) theory tries to answer one of the most difficult question : what is the optimal number of currencies to be used in one region. The OCA theory provides an explanation for monetary integration process in Europe such as the ability to explain exchange rate. Estimateing costs and benefits of adopting a common currency would argue Albania's access to the common currency area? In this difficulty Economic situation, the actions to adhere in International Organizations should follow the individual interests of the state or must reconsider against to repeal of the state's most powerful. Use of joint reserves offers to soften the impact by losses in foreign exchange rates, but once the depreciation of domestic currency even though the adjustment are proportionally distributed for a long period of time. Statistical methods will show the strength of the country supporting the use of a common currency or the birth of a new regional device. Which way supports monetary integration and how is it acceptable measures, are questions to be answered in the paper development.*

**Keywords:** *Optimum Currency Area, Monetary Integration, International Organizations, Exchange rate, Regional Currency and Statistic method.*

**JEL Classification:** *B4, B5.*

### **1. History and Development of OCA Theory in the 1960s.**

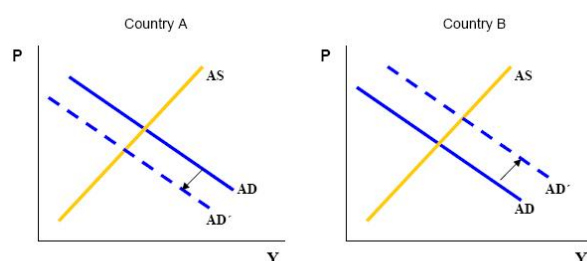
#### **1.1. To Fix or to Float: Friedman's Influence.**

Theory of the optimum currency areas was fully developed during the debates of the benefits and the costs of the particular exchange rates regimes after the World War II. That time, most of the countries fixed their currency to the US Dollar which was convertible at a fixed rate into gold. Friedman (1953b) favored flexible exchange rates, because they serve as a better mean to absorb exogenous shocks.

His argumentation of the adjustment to the shock was as follows: As it is commonly observed, the country's prices and wages are relatively rigid and factors are immobile among the countries. As a result, under the negative demand or supply shock the only instrument to avoid higher inflation or unemployment is the change in the flexible exchange rate (that means appreciation or depreciation of the currency). This brings the economy back to the initial external and internal equilibrium. Under the fixed exchange rate regime there would always be the unpleasant impact on unemployment or inflation. that Friedman did not discourage using the fixed exchange rate regime

#### **1.2. Mundell's Model of Shifts in Demand.**

*"There is an irony, then, that the variables identified by Mundell, McKinnon, and Kenen have the least explanatory power for the decade in which these authors wrote".* Mundell published the article on the optimum currency area (OCA) defining optimum currency area as an area with internal factor mobility (including both interregional and inter-industrial mobility) and external factor immobility.

Figure 1-Asymmetric Shifts in Demand<sup>11</sup>

Source: De Grauwe (1997)

Mundell (1961) challenges Friedman's (1953b) arguments about the means of cushioning shocks in a more general way. In assuming two countries A and B, which are initially in their equilibrium defined as full employment and balanced trade. Both countries maintain own currencies; thus each country can alter its monetary policy if necessary. Now consider the shift in demand away from the products of country A to country B as depicted in Figure 1. If no policy is used, the result of such a shift for country A is the decline in output and the price level and likely unemployment. If domestic spending does not decline at the level of output declines, a current account deficit will occur and possibly a budget deficit, too. The opposite is valid for country B. If country B prices rise at higher speed than prices in country A, then B takes partially the burden of adjustment from country A, because price increase will deteriorate its competitiveness. If country B tightens its monetary policy in order to fight inflation, then the whole burden is thrown onto country A. In the case that countries use flexible exchange rate regimes, the whole adjustment can be solved through the depreciation of the country A's currency. But what if the national currency area (the area where the currency is actually used) does not geographically equal to the optimum currency area (let's say the area where could be the highest welfare of using the currency)? Let us discuss briefly the consequence. Consider that the countries consist of western and eastern parts. If the aggregate demand falls only in the western parts of the countries and the opposite happens in the eastern parts, flexible exchange rate regime does not bring countries back to the equilibrium. Countries would be able to get rid of either inflation or unemployment, but not both problems. Thus, why should a country use flexible exchange rates?

*First*, there is wage flexibility. Wage claims in the western parts are reduced and the opposite is valid for eastern parts.

*Second*, there is labor mobility. Workers can move from west to east in their countries. They do this in order to eliminate the excess labor demand occurring in the eastern parts of the countries. Wages remain constant. Unemployment and inflation vanish.

*Third*, there is a fiscal policy. In the surplus east regions authorities can raise taxes in order to decrease eastern aggregate demand and transfer the surplus to the western parts of each country. Western parts still have a current account deficit, but transfers finance it.

Empirically, many countries have regional redistribution systems through a federal budget because of the centralization of the government budget. As a result, when output in western region declines, the tax revenue of federal government declines. At the same time, the social security system will increase transfers to this region. Transfer do not solve adjustment problems, but make it easier to live with.

### 1.3. Are There 2 Mundell's Models?

One may criticize the means of adjustment. Economic subjects face strong information barriers such as on the length of the crisis. One other is that Mundell implicitly assumed downward sloping and a stable Phillips curve in the long run. And other is that adjustment is often costly. For example the devaluation of the currency is not effective in dealing with the shifts in demand between the countries in the long run and will likely lead to higher inflation.

Devaluation increases the cost of imports and trade unions can bargain for a higher real wage, because the rise in the cost of imports lowers the real wage of workers (price level increases). His global monetarist view on the subject was as follows: If two countries can adopt a common currency (that needs a common central bank and foreign reserves) without substantial change in their purchasing parities, they gain better allocation of capital. The more the country is open to the world the lower the benefits of flexible exchange rates.

## 2. Costs and benefits of Joining the Monetary Union.

An interesting aspect of the second stream literature of identifying costs and benefits of joining the monetary union is that the relevant benefits are usually at microeconomic level, while costs at macroeconomic level. There are several issues to be discussed.

### 2.1. Costs and benefits – Static View.

**First**, the loss of power to affect a national money supply is legitimately feared, since, in an integrated market, all member countries will jointly control their monetary policy. Typically, the loss of a country's ability to use the exchange rate and monetary policy for stabilization was considered to be the most important cost of joining a currency area. However, this is surely not the case for small open economies, because it is impossible to maintain free capital mobility and an independent monetary policy together. Such countries link their currencies to their main trading partners in order to gain higher exchange rate stability. This lowers the independence of monetary policy. The argument about the loss of monetary and exchange rate policy was especially emphasized in the early 1970s when lots of authors believed in a negatively sloped Phillips curve. In that case, the common currency could imply that a country with a higher unemployment rate, relative to other members of the currency area, would no longer have the option of using a monetary policy. As a result, country would not achieve the desired mix of inflation and unemployment.

**Second**, there are concerns about fiscal policy. It is not clear what the implication of the membership is in the currency area for an independent fiscal policy. It does not need to be expected that monetary union mean the end of the independent fiscal policy for its member states. It is likely that even in the complete monetary union countries keep their fiscal policies independent, however some centralization of fiscal policy could serve as one of the mechanisms in adjusting to the asymmetric shock. On the other hand, the centralization of budgets often leads to an increase in spending.

**Third**, another cost of joining a currency area is the loss of seigniorage. Seigniorage is the revenue the government obtains by financing its budget deficit through printing money rather than selling debt. That's why at full employment printing money would lead to inflation or 'inflation tax'. In Western Europe only in some southern countries seigniorage was estimated to be more than one percent of GDP and the ratio is rapidly decreasing in time.

**Fourth**, in an uncertain world risk-averse households and firms would gain welfare (after the elimination of adjustment costs) if one of the sources of uncertainty in exchange rates were eliminated. This argument implicitly assumes that exchange rates volatility has a negative effect on economic calculation. If the exchange rate reflects the movements in fundamentals, then volatility does not matter. On the other hand, if the movements of exchange rates reflect feelings, speculation etc., then high volatility could lead to misallocation of resources. But the decrease in the uncertainty of the evolution of exchange rates lowers the expected profit of investment, which could subsequently influence output; therefore the critical outcome is ambiguous.

**Fifth**, the elimination of exchanging one currency for another is the most visible benefit of monetary union. It is only an empirical question how much the economic agents gain in the long run (after the adjustment of all agents to the new environment). However, there are also indirect benefits from the elimination of the national currencies, such as a decrease in price discrimination.

### 3. OCA Theory and EMU.

Mundell's theory of optimal currency areas establishes that a group of countries will benefit from a common currency if three conditions are satisfied. The three conditions are :

1. The group of countries should not be hit by shock that are too asymmetric : i.e. one country should not be substantially worse off while the other regions are booming.
2. There is a high degree of labor mobility and/or wage flexibility within the group of countries.
3. There is a centralized fiscal policy in place that will transfer money.

Most focus on the characteristics of OCA. They are the degree of labor mobility, the system of fiscal transfers, the extent of trade and the similarity of shocks and business cycles. These characteristics are inter-related, which makes econometric testing difficult. The higher trade integration the higher the correlation of business cycles among countries. Business cycles and trade integration are inter-related establishing a currency union. Author also note that because countries link their currencies to their most important trading partners in order to keep its exchange rates stable, they loose a certain amount of independence of its monetary policy. Fidrmuc (2001) shows that the intensity of intra-industry trade is another variable, which has a positive impact on the synchronization of business cycles.

#### 3.1. Methodological Problems of Measurement.

In attempts to measure the symmetry of shocks, we would like to know whether we are facing demand or supply shocks and whether the shocks are transitory or persistent. By contrast, it can be argued that the difference in the speed of the transmission is caused by differences in labor market institutions or the rigidity of prices. It is also very important to consider possibly high transaction costs and of course political issues, which can seriously lower the attractiveness of a currency union. Due to these high transaction costs, markets can understand that currency union is not successful.

### 3.2. Other Empirical Findings.

Nevertheless, there seems to be a general understanding that the probability of asymmetric shocks is higher in EMU than in USA (that means the costs of common currency are higher), but for some EMU countries the probability of asymmetric shocks can be close to that of USA. The striking difference between EMU and USA can be seen in adjustment to shocks such as labor mobility or rigidity of prices or coordination of fiscal policies.

## 4. The OCA Theory and the Albanian case.

### 4.1. Choice of the Exchange Rates Regim.

Generally, the choice of the exchange rate regime has to consider various structural characteristics of the country, its strategic policy goals and timing. Usually, the most considered characteristics are: factor mobility, size and openness of the country, diversity of the production structure and employee skills, budget mechanisms, price and wage stickiness, financial system and the symmetry of the shocks and credibility.

### 4.2. Conditions for the choice of exchange rate regime.

**First**, a sufficient degree of freedom of the exchange rate is a necessity. This is dictated by the fact that the countries must economically transform.

**Second**, a foreseeable exchange rate regime, which is one of the most important economic information given the size and the openness of the transition economies.

Exchange rate regime of the transitive economy should create sufficient space for the natural trend of the real equilibrium exchange rate to appreciate (structural changes, higher productivity etc.), on the one hand and on the other, to allow to keep the real appreciation in the extent for maintaining international competitiveness. Albania faced strong asymmetric shocks with European country at the beginning of the 1997s and the OCA theory would suggest that the right choice is the floating exchange rate. Also, there was a strong dissimilarity in inflation rates between

Albania and their trading partners deteriorating Alb competitiveness under its fixed exchange rate regime in the long run. On the other hand, low financial integration with western European trading partners and relatively high openness of the Albanian economy is an argument to fix the currency in order to eliminate potentially high volatility in financial markets. As a result, we can see that the OCA theory does not have operational precision for decision making in the short-term. It is believed that the lower the volatility of exchange rates is among countries, the more they are prepared to join the monetary union. Some author find much lower correlation of the Albanian business cycle with the EU's cycle than the correlation of Montenegro, Kosovo or Fyrom business cycles with the EU's. adopting EURO will bring benefits and relative cost. The most important role in convergence is attributed to the intensity of intra-industry trade, foreign direct investment, the commodity and geographic structure of exports.

Any monetary union creates benefits and costs. This is also the case in the European Monetary Union. The benefits that were created in the euro zone are significant. They arise from the fact that the elimination of national currencies reduces transaction costs and eliminates the uncertainty produced by exchange rate volatility.

In addition, countries that join a monetary union lose their capacity to issue debt in a currency over which they have full control. As a result, a loss of confidence of investors can, in a self-fulfilling way, drive the country towards default. In these countries the central bank can always provide liquidity to the sovereign to avoid default. This may lead to future inflation, and make fragility markets.

Today, in most euro zone countries, spending and taxation by the national authorities amount to close to 50 per cent of GDP. The spending and taxing powers of the European authorities represent barely 1 per cent of GDP.

The second structural weakness arises from the fact that the euro is a currency without a country without a government with the full powers of a government to back up the value of the currency.

## 5. IS THE EMU AN OPTIMAL CURRENCY AREA?

Based on the above criteria the answer seems to be "No". Let's examine each of the criteria in more detail.

*Are the countries hit by symmetric shocks?*

Even though the European countries share many common cultural, economic and political links they remain a fairly diverse group of countries both in terms of their economies and their people. For example countries like Germany and Finland do a substantial amount of trading with East European nations while countries like Ireland have close economic links to the U.K. Finland is likely to be more symmetrically linked to its Scandinavian neighbors than it is to be linked to Spain and Portugal. The EMU countries are also at different points in their business cycle today: countries like Ireland are experiencing a technology related boom and are worrying more about growing too fast, while countries like Germany are more worried about stimulating a stagnant economy and expanding unemployment.

*Is there a high degree of labor mobility and/or wage flexibility?*

Even though travel within Europe has been greatly facilitated by the creation of a single Europe, there are substantial barriers to the mobility of labor. For all intents and purposes, Europe still remains a diverse collection of countries sharing an uneasy bond. Language and other barriers make it difficult for an Irish worker can move to Portugal and find a job with anywhere near the same ease that a displaced worker from Virginia can move to California and find a job. However, the young seem to be much more mobile, which augurs well for the future of the EMU. Furthermore, wage flexibility is hardly the word one would use to describe the state of the highly regulated, structural problem plagued European economies. The powerful roles played by unions and the generally high level of wage regulations mean that European workers have some of the highest wages in the world (\$30+ for German workers). The negative aspect of the high wages is of course the lack of jobs and it is extremely unlikely that a country will be able to improve the level of unemployment by lowering wages.

*Is there a centralized fiscal policy for redistribution of income?*

If anything Europe has the opposite. There will still be strong national governments which will effectively rule the country while a relatively weak European parliament plays a secondary role. It would be difficult to see how it would be politically feasible for the French government to raise taxes on its citizens so as to redistribute them to assist displaced Portuguese fishermen. The national identity of these countries coupled with the lack of mobility must mean that transferring taxes in the EMU will pose potentially significant political problems. In short, there are serious doubts, according to economic theory, as to how successful EMU will be. However, the European countries have shown substantial political willpower to get EMU together and we should not necessarily underestimate their willingness and their ability to succeed.

## Conclusions.

The OCA theory is an approach for discussion about monetary integration, but poor about the optimal number of currencies to be used in one region. Also, it should never be forgotten that all the monetary integrations are primarily political projects, where economic arguments do not have to be considered at all.

Albanian is affected by flows of foreign currency because of incoming remittances. Despite that in recent years these figures have faced cuts remittances, there remains significant effect their exchange in local currency, caused by the exchange rate. Based on this element and other Albanians faced a question. Will they accept euro currency? And in my perspective I think not, based on the effects treated above and the history not favorable to states that have agreed to turn this currency in the currency of their country.

In my opinion, I would suggest a monetary union between Albania and Kosovo. A strong currency and involved in more economic diversity

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## THE BOOMERANG EFFECT OF NON-PERFORMING LOANS ON THE ECONOMY OF ALBANIA

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### **Abstract:**

*The main purpose of this study is to examine the impact of Non Performing Loans in overall Albanian economy. Through this study I want to give in details all the effects in macroeconomic variables of an economy, especially in Albania. In the same time I would like to describe the main factors whose causes the increasing of NPL in Albania banking system. Analysis is focused on dynamics of the main macro economic indicators, based on figures for the period 2005–2011 and forecast for 2012. The main reason that I choose to study this phenomenon is because NPL is one of the best indicator of credit risk in Albanian banking system, since the credit risk remain the most important part of total risk. Specifically, this paper will examine the financial institutions in Albania and the effects that Non-Performing Loans have had on the economy of Albania. It will look at the ways in which failure to repay loans by borrowers have affected the economy of Albania, and it will provide recommendations about possible solutions for the problem of Non- Performing Loans.*

*Finally, some conclusions and policy recommendations are outlined, intended to get all possible solutions in how to reduce as much as possible the rate of Non Performing Loans in term of total loans gave by the Albanian commercial banks.*

**Key words:** non performing loans, macroeconomic, credit risk.

**JEL Classification:** G21, G29.

### **1. Introduction.**

The global financial crisis led to a sharp increase in the level of non-performing loans (NPLs) in the banking systems in Southeast Europe (SEE) and Eurasia and in Albania too. Problem loans obstacle credit channels and allover the economy.

A high level of problem or non-performing loans (NPLs) makes it difficult for banks to expand their loan portfolio and fund profitable new businesses and creditworthy households. Gains made in increasing access to finance, particularly to small and medium enterprises, are undermined or reversed. This leads to lower productivity, reduces competitiveness and leads to misallocation of resources as credit is tied up in ailing, unprofitable enterprises and over-indebted households, so it has a boomerang effect in overall economy. Additionally, problem loans weaken the financial system on a systemic and individual institution basis by hampering earnings, liquidity and capital adequacy.

Ultimately, high levels of problem loans in a financial sector limit or curtail opportunities for economic and private sector growth and job creation<sup>105</sup>.

### **2. Non-Performing Loans and Economic Stability.**

Each NPL in the financial sector can be viewed as a mirror image of an ailing, unprofitable enterprise operating in the economy or a financially distressed household.

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<sup>105</sup> EuropeanBankingCoordination“Vienna”Initiative Working Group on NPLs in Central, Eastern and Southeastern Europe March 2012

High levels of NPLs in a country are correlated with poor economic indicators, high unemployment levels, and increasing poverty which can eventually contribute to social or political uncertainties.

Based on many researches the world has been facing a global financial crisis since 2007. This crisis has affected the economies of almost all countries across the globe. The economy of Albania is a relatively small one, but it is a part of a bigger global economy. The global crisis has hit the economy of Albania just like other economies in the world. The effect it has had on Albania is considerably lower than in other countries. Facts show that banks were affected by this economic downturn. None of the many banks in Albania have ever filed for bankruptcy or gone solvent. This was not because these banks were different from other banks in other countries; it was because the regulatory authority in Albania has taken stringent measures to ensure that these banks remain stable despite the crisis in the economy.

Economic growth has slowed down and even stagnated in some countries as a result of the rising inflation. This happens to be the most difficult economic crisis that developed countries have gone through in the recent past. Even though the International Monetary Fund has stated that this is the worst economic turmoil that the world has gone through since 1930, some financial analysts still maintain that it may be too early to tell whether it is really the worst yet. Most other economic crises have never affected developed countries. This global crisis, however, was different. It began in the more developed countries (Asari et al. 2011).

Financial markets in Europe have been affected by the boomerang effect of Non- Performing Loans. Emerging economies, which are usually more vulnerable to economic turmoil, have been also adversely affected by this global crisis. This crisis has affected the well-structured financial institutions in the world. The financial shock that this crisis has caused has lowered the ability of banks to lend money to borrowers who need it. The liquidity in the inter-bank lending markets was lowered as a result.

The banking sector in Albania is very significant to the economy of the country. Economists in the country have, therefore, put a lot of emphasis on the stability of banks. Whether or not these banks are stable can only be addressed when compared to other sectors of the economy and how this sector interacts with them. Analysts usually assess the stability of banks depending on the risks involved. In order to understand the boomerang effect that Non-Performing Loans have had on the economy of Albania, we will define the meaning of Non- Performing Loans. Secondly, we will examine the common causes of Non- Performing Loans before stating the effects that these Non-Performing Loans have had on the economy (Williams, Corbridge, & Srivastava 2003).

### **3. Banking System in Albania.**

Since beginning of '90 after entering the free market system Albania has a two-tier banking system, Central Bank of Albania known as first level bank and second levels known as commercial banks. The number of commercial banks operating in the Albanian banking system is 17 two out of which are foreign bank branches; nine are subsidiaries of foreign banks and of foreign financial groups, two are domestically-owned capital banks, whereas four banks are owned by other shareholders, physical persons, legal ones or banks. The banking sector has the major weight in the Albanian financial system and in this respect its problems show a high interest. Therefore, in the last years the financial stability has been a major target for the Central Bank of Albania. This stability could be assessed based on the performance and risks derived from its interaction with the overall economic environment, both internal and external, and from its activity. In order to assess the risks arising from the financial system activity, we try to analyze the performance of the main indicators of its financial soundness, namely capital, asset quality and financial performance.

The banking system in Albania has faced numerous challenges in the last couple of years. A slowdown has been realized in the credit industry, especially as a result of Non- Performing Loans. It is very crucial that there is sustainability of funds when it comes to credit funds. It is important that the public understands the effects that Non-Performing Loans have on the economy and the ability of banks to lend to borrowers. The absence of loans in the economy blocks away poor households from their fair share in the economy. Due to the fact that needy households are only able to share in the national resources through loans, lack of loans denies them this right. A reason for the absence of credit for these deserving households could be widespread presence of Non- Performing Loans. Resources are shared and distributed among the poor in Albania according to their availability (Bloem & Gorter 2001).

Loan collection is also very important to the stability of the economy of Albania. This is because credit practices that are sound ensure that the economy is able to sustain its growth rate. Researchers have stated that loan collection is very important if lending and borrowing is to be sustained. Loans borrowed from financial institutions must be paid in full if banks are to continue lending and making profits. Funds from the government, which are known to be cheap, or resources from the donor community are not enough to keep the economy of Albania stable.

As such, borrowers who take loans from lending institutions need to make it their duty to pay back the money they owe to the bank. The rates at which loans are paid back to the bank determine the stability of an economy. This is because whether funds will be available in the future and whether banks will make any profits depend on repayment of loans.

NPLs are commonly used as a measure of the asset quality and the first NPLs emerged in the USA in 1987 as a result of severe financial crisis at stock markets. Generally, their ratio to outstanding bank loans significantly increases during financial crises worldwide. A sharp raise in domestic credit very frequently implies inability of bankers to extend the credit selectively, potentially implying a weakening banking system due to a deteriorated NPLs ratio. For example, experiences of double-digit annual growth rates in domestic credit in Indonesia, Malaysia, Thailand, and South Korea were associated with worsening NPLs ratios already prior to the crisis in 1990s in every country (Krueger 2000, p. 39). NPLs have become more closely observed so as to eliminate possible exposures and ensure a stable financial system. Interestingly, there is not yet a single classification system to facilitate not only the monitoring and management of credit risk in the loan portfolios within a bank, but also to facilitate international recognizing and accounting for credit losses by banks.

To facilitate the comparison across the countries, the Institute for International Finance uses five categories (Bloem & Gorter 2001, p. 7): 1. **Standard**: credit is sound, repayment difficulties are not foreseen and full repayment is expected. 2. **Watch**: if conditions of asset uncorrected, it may raise concern about full repayment. 3. **Substandard**: full repayment is in doubt due to inadequate protection, and/or interest or principal or both are more than 90 days overdue. Risk of becoming an impaired asset, i.e. its carrying amount is greater than its estimated recoverable amount. 4. **Doubtful**: collection or liquidation of asset in full is determined as improbable due to current conditions and/or interest and principal or both are overdue more than one year. Asset is impaired but not considered total loss because some pending factors might strengthen the asset's quality, e.g. capital injections and merger. 5. **Loss**: asset is virtually uncollectible and/or principal and interest or both are overdue more than one year.

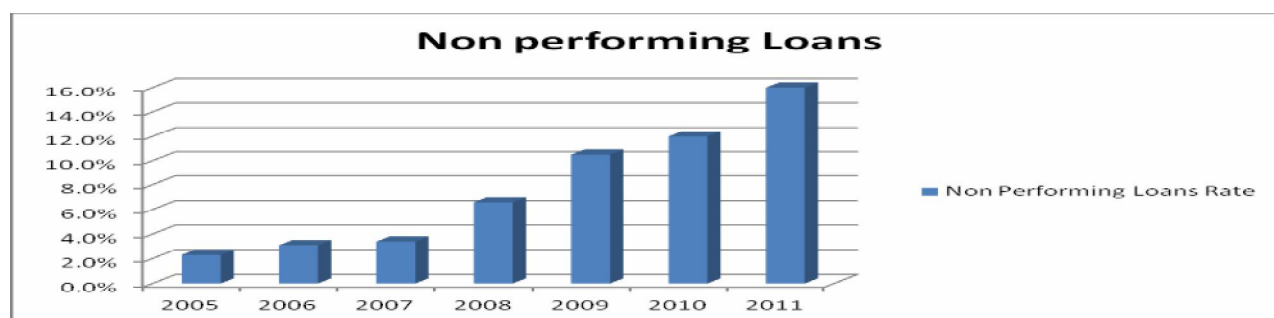
Gross classified debt, which is the sum of the last three categories, is then reported as the NPLs ratio in relation to total loans. NPLs are then commonly described as loans in arrears for at least 90 days.

Below are some figures related to Albanian economy of NPL rate during the period 2005-2011.

#### Non Performing Loans<sup>106</sup>

	2005	2006	2007	2008	2009	2010	2011
<b>Non Performing Loans Rate</b>	<b>2.3%</b>	<b>3.1%</b>	<b>3.4%</b>	<b>6.6%</b>	<b>10.5%</b>	<b>12.0%</b>	<b>16.0%</b>

Source: Bank of Albania

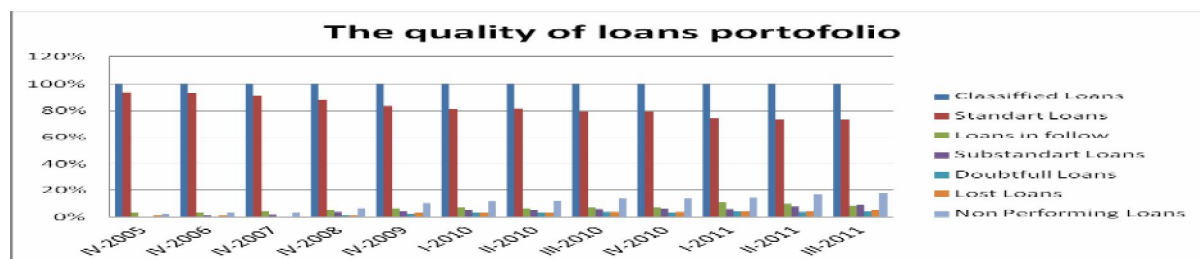


#### The Quality of Loans portfolio<sup>107</sup>

Loans	IV-2005	IV-2006	IV-2007	IV-2008	IV-2009	I-2010	II-2010	III-2010	IV-2010	I-2011	II-2011	III-2011
Classified	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Standart	94.1%	93.6%	91.9%	88.3%	83.4%	81.1%	81.5%	79.1%	79.4%	74.2%	73.7%	73.6%
in follow	3.6%	3.4%	4.8%	5.2%	6.4%	7.5%	6.5%	7.4%	6.9%	11.4%	9.7%	8.4%
Substandart	0.8%	1.1%	1.7%	3.9%	4.7%	5.4%	5.3%	5.8%	6.0%	5.9%	7.9%	8.8%
Doubtfull	0.5%	0.9%	0.8%	1.4%	2.7%	2.9%	3.1%	3.8%	3.6%	4.1%	3.9%	4.2%
Lost	1.0%	1.1%	0.8%	1.2%	2.9%	3.2%	3.5%	3.9%	4.0%	4.5%	4.8%	5.1%
<b>Non Performing</b>	<b>2.3%</b>	<b>3.1%</b>	<b>3.3%</b>	<b>6.5%</b>	<b>10.3%</b>	<b>11.5%</b>	<b>11.9%</b>	<b>13.5%</b>	<b>13.6%</b>	<b>14.5%</b>	<b>16.6%</b>	<b>18.1%</b>

<sup>106</sup> Source: Bank of Albania, Statistical Report

<sup>107</sup> Source: Bank of Albania, Statistical Report



Source: Bank of Albania

## 5. Causes of Non-Performing Loans.

There are many causes of lenders' problem loans. They frequently result from inappropriate lending practices at the outset, such as poor selection of risk, over-lending, incomplete credit information, or self-dealing. For example, in some transition economies, problem loans arise because restrictions on insider or inter-connected lending are lacking or not fully enforced; this is often the result of inappropriate influence on bank governance by influential persons or groups. Another example of poor selection of risk is lending in foreign currency to un-hedged borrowers, a frequent practice in SEE and Eurasia which is a symptom of high levels of euroization in SEE and dollarization in the Eurasian countries. (When the crisis led to a rapid and steep depreciation of the local currencies, repayment problems by borrowers who had no source of foreign currency was unavoidable.)

Problem loans arise at some banks because lenders fail to establish and enforce realistic loan repayment programs or neglect to take account of the potential for economic conditions to change. Rapid loan growth is another frequent contributor to problem loans and was clearly evident in SEE and Eurasia prior to the crisis when annual credit growth rates were averaging above 40 % for several years.

Moreover, the banking industry has always been subject to the "herd mentality." Once a few banks make large profits lending to a certain sector, e.g., housing and commercial real estate, then other banks jump into the market - without the proper risk management knowledge, contributing to asset price bubbles and ultimately a rise in problems across the financial system. Economic shocks may also lead to problem loans, as happened after the recent global financial crisis.

The other issue that is held responsible for the high rise of Non- Performing Loans is the schedule of loan payments and the amount of instalments that one has to give at each instalment. Repayments that are planned in such a way that a borrower is able to pay back will increase the chances of the bank recovering its funds. Borrowers that have small loans should be allowed to pay in small amounts and frequently. Banks that are able to successfully recover loans from borrowers are those that work with the borrowers in order to ensure that they come up with a payment plan that works for their client (Singh 1997).

Banks need to realize that different households have different sources of income, which must be put into consideration. The other cause of Non- Performing Loans has been high interest rates that lending institutions charge to borrowers. If the interest rate is so high, then chances are that many borrowers will be unable to pay back the money that they owe to banks. The rise in the number of Non- Performing Loans has also been a result of a sharp fall in the value of assets. According to the International Monetary Fund, Non- Performing Loans affect the GDP growth of countries and lead to unemployment.

Gibson (1999) reckons that unemployment is also related to Non- Performing Loans. When borrowers lose their jobs, they lose their ability to pay back their loans. Loans that are not paid back by borrowers lower the ability of banks to give out credit to deserving households. When there are hikes in the prices of products or real estate, this also affects borrower's ability to pay back their loans. Also, when banks increase the interests that are paid on loans, the borrowers are not able to pay back their loans. Lower interest rates allow the borrowers to pay back their rates with ease. When debtors are overburdened, they become less productive as they spend all the money they get in trying to pay back their debt instead of improving their business. The debts affect their income generating activities, and the debts they owe to banks are likely to become Non- Performing Loans.

Inflation has been known to have both positive and negative results on the level of Non- Performing Loans (Gibson 1999). Sometimes inflation is good because it lowers the value of the loan given to borrowers. On the other hand, inflation is negative because it raises the cost of living and borrowers are not able to service their loans like they should. Lenders may also decide to adjust their payment plans to cater for the reduced value of the loan. Unfortunately, this makes it even harder for borrowers to pay back what they owe to the banks. This is because sometimes, despite the inflation, like it is the case with Albania, the minimum wage is not increased to cater for the increased cost of living.

Non- Performing Loans have also been a result of changes in the exchange rates in Albania. This is especially true for businesses that specialize in imports and exports. They are the most affected by fluctuations in the foreign exchange rates. Such businesses may find it hard to service their loans, especially in instances where the exchange rates have reduced their profit margins.

For borrowers who borrow in foreign currency, on the other hand, it increases their ability to pay back. Analysts generally agree that non-performing loans slow down the supply of credit and the growth of the economy (Stokes & Anderson 1990).

Non- Performing Loans have been known to drive up the costs of doing business by banks. Banks have also increased their interest rates as a result of many loans that remain unpaid. Non- Performing Loans also drain capital that banks could use to grow their business. It also lessens their profit margins. Again, when banks increase their interest rate due to a large number of Non- Performing Loans, borrowers become sceptical and choose not to take loans. This also slows down business for banks, adversely affecting the economy (Stokes & Anderson 1990).

## **6. Effects of Non-Performing Loans on the Economy.**

Many authors believe that deposit taking institutions, financial institutions are significant to the economy of Albania. Any distress in the financial sector causes a crisis in the entire economy of the country. The one indicator that there has been distress in the banking sector in Albania has been the increase in the number of Non- Performing Loans. A loan is classified as a Non- Performing Loan when the due date for its repayment has passed by more than 90 days. A loan can be classified in various ways. Thus, loans are classified as passed if they are solvent. The other classification is that of substandard loans. A substandard loan is the one principal and interests of which are to be paid over three years. Banks are, however, required to make a 10% provision in case a loan becomes substandard (Hoque & Hossain 2008).

Certain loans are classified as doubtful. Doubtful loans are those where the outstanding balance, whether in principal or in interest, has not been paid and there is an indication that it may not be paid back. For these kinds of loans, banks normally make a 50% provision in order to prevent making losses. Finally, certain loans are referred to as virtual loss loans or irrecoverable loans.

These are the loans that the banks have lost all hope of recovering. Even though banks make provisions for these Non- Performing Loans, they are still very much affected by these loans (Jensen & William 2001).

The banks in Albania, in an attempt to avoid making losses, have tightened the lending standards. This is because they do not wish to make any losses. This is because they realize the risks involved in lending out money to borrowers. This has been especially because of the economic downturn due to which many borrowers are not able to pay back. Credit growth has been sluggish these last couple of years as banks shy away from lending out money to borrowers. Non- Performing Loans have the potential of severely affecting the efficiency and operation of the financial sector.

The impacts that Non- Performing Loans have on the banks are many, and they prevent the banks from optimizing their ability to lend to a wider clientele. This is what has led to what financial analysts call the financial crunch, where financial institutions are not willing to lend to borrowers who need the credit. In a credit crunch, the supply of credit is way below the normal demand by clients. The growth in the economy is slowed down because businesses that require loans in order to grow are denied access to these loans.

In his years of research, Christoffersen (2003) discovered that when a bank has a high rate of Non- Performing Loans in its portfolio, it becomes less willing to provide credit. The rate at which a loan grows is determined by a number of factors, including the rate of growth in the deposits and growth in other assets of the business. Banks depend on the deposits that come into the bank as a source of money that is given out to borrowers in the form of loans (Christoffersen 2003). If there is a high rate of deposits, the banks are able to expand their credit portfolio. In the event that borrowers do not deposit their instalments, the normal cash flow in the bank is hampered, meaning that their credit portfolio is also reduced.

Loans usually account for the largest part of asset portfolio for banks. When the asset sizes of banks are expanded, they are able to expand their credit portfolio as well. Under normal circumstances, the rate at which loans grow is the same as the rate at which deposits grow.

## **Recommendations for Reducing the Effects of Non- Performing Loans.**

In their analysis, Boyd and Nicolo (2005) established that the first issue that comes up when dealing with Non- Performing Loans is the amount of money involved. If the loan involves a lot of money, then the risk involved is higher. Lenders need to be very careful; otherwise, the number of loan defaulters will increase. If loans are not paid back on time, the banks lose income in the form of interests and the principal amount that was lent out. When a borrower gets a large loan, they have a greater depth of outreach. The amount of money given to the borrower could be a cause for the rising cases of Non- Performing Loans in Albania

If banks allow borrowers to take loans that are beyond their ability to pay, there are higher chances that the loans will end up becoming Non- Performing. Proper estimations need to be made about the ability of a borrower to repay a loan. This will ensure that borrowers are only allowed to borrow an amount that they are capable of paying back. Higher loan sizes should, therefore, be avoided by lending institutions unless a borrower shows evidence that he or she is able to pay back the loan.

When businesses are given more money than they actually need, the funds end up being used for personal needs instead of being used to build the business. When money that was intended for business is used for personal needs, repaying it may become hard as there will be no extra income earned as a result. The people who often access large loans are those who are friends with officers at the bank who approve loan allocation. Other people who have been known to access large amounts of loans are prominent persons like politicians or other influential people in government. These people are given loans without any consideration of their ability to pay (Collins & Wanju 2011).

The income of households should also be considered before loans are given. The amount of income that a family gets determines their ability to pay back a loan. The income that a family receives from other businesses or other jobs done by members of the family can be used to pay back a loan that the household owes the bank. Income generated by the household is a criterion that credit officers should use to determine whether a household is capable of paying back a loan if they are given one. This will help reduce the occurrence of Non- Performing Loans.

### Conclusions.

The central bank in Albania and the government have both come up with activities that are aimed at ensuring that confidence in the banking institutions is restored and that the stability of the financial institutions is also restored. Despite these challenges, the government has managed to maintain liquidity and stability. The financial markets today are very volatile and filled with a lot of risks. Banks should, therefore, come up with workable solutions for these Non-Performing Loans. The problem in Albania has been that individual banks operate independently without a sense of collective responsibility.

Even though authorities in Albania have done much to solve the problem of Non- Performing Loans, a lot still needs to be done. They need to put more pressure to accelerate the resolution of bad loans. Any attempts of over estimating the value of collateral should not be tolerated by a bank as this has been a common cause of Non-Performing Loans. No one should be spared in the evaluation of the credit worthiness of a borrower. Any obstacles that may hinder banks from recovering their loans should be removed so that they can operate freely. This is one of the ways through which the boomerang effects of the Non- Performing Loans on the economy of Albania can be remedied.

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## THE CONCENTRATION BETWEEN AMERICAN BANK OF ALBANIA & BANCA INTESA SANPAOLO

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### *Abstract:*

*Intesa Sanpaolo was created on 2006 as a result of the concentration between Banca Intesa and San Paolo Imi. From the beginnings the aim of this group was the extension of its activity in Center Eastern Europe countries, in the Mediterranean seaside and in the developing countries. In these days the group owns a very strong foreign division, which banks occupy almost in every country of origin the first places. The objectives of the group to increase its presence in the Center - Eastern Europe, led to the participations acquisition of two Albanian banks: the American Bank of Albania (ABA) and Banca Italo Albanese (BIA). Intesa Sanpaolo represents the majority shareholder for the two banks, owning at about 80 percent of the stocks on 2007, aiming to buy the other 20 percent within 2009. On December 2007 ABA and BIA banks have realized their merger in which the first has included the second one. The new created bank was named Intesa Sanpaolo Bank, as the controller of both concentrated banks. This kind of operation is new in the Albanian contest and has never been actuated before. Thanks to this operation the Code for Corporate and Commercial Companies was issued, which previews an accurate discipline related to the integrations. The purpose of this work is to evidence the effects of the banking merger and to discuss about the importance of the foreign intermediaries presence in Albania. The analysis is based primarily in accounting data considered before and after the merger and also in mergers support theories.*

**Key words:** American Bank of Albania, Banca Intesa Sanpaolo, Banca Italo Albanese, Integration, Mergers, Financial Situation.

**JEL Classification:** G210.

- **Integration between American Bank of Albania and Banca Italo-Albanese.**

### The Concentration Actors

<i>Bidder</i> <b>American Bank of Albania</b>	<i>Target</i> <b>Banca Italo-Albanese</b>
<p>The American Bank of Albania was born on 1998 as a result of the SEED Act, issued by the American government with the intent to support the Albanian economic development. The sole shareholder of the bank was represented by the American Albanian Fund of Enterprises, a private investments found. On December 2007, the bank was located as the 2<sup>nd</sup> operator in Albania, owning total deposits by 93,4 mld Lek, total credits by 39,7 mld Lek and total assets 106 mld Lek. On December 2006, the fund decided and lately signed the selling agreement of 80 percent of the shares to Intesa Sanpaolo. On June 2007, ABA officially became part of Intesa Sanpaolo Group, which led to the change of its visual identity in Intesa Sanpaolo Bank Albania.</p>	<p>Banca Italo-Albanese was born on 1993, as one of the first credit institutions having a private character. The bank was founded as a joint venture between Banka Kombetare Tregtare (which shares have been transferred to the Albanian Ministry of Finance) and Banca di Roma. On December 2005 the Intesa Sanpaolo Group decided the acquisition of 76,129 per cent of the shares, respectively 40 percent of the shares owned by Capitalia and 40 percent owned by the Albanian Ministry of Finances. On December 2007 the bank's shareholders were the European Bank for Reconstruction and Development, Intesa Sanpaolo Group and Società Italiana per le Imprese all'Estero (SIMEST), which respectively detained 20 percent, 76.129 percent, and 3.871 percent of the shares.</p>

The above mentioned summary tells us that the majority shareholder for both concentrated banks is Intesa Sanpaolo Group owning 80 percent of the shares in each. The extraordinary assembly of both banks decided the realization of the inclusive merger based on the Albanian discipline. The integration reasons are related to the fonts rationalization and to the costs decrease. In fact it had become unsustainable for Intesa Sanpaolo, as a majority shareholder, to manage the costs separately, as the banks acted as competitors. Thanks to the integration the new bank was named American Bank of Albania.

On 2008 American Bank of Albania confirmed its presence as part of one of the European strongest groups, changing its identity in Intesa Sanpaolo Bank.

- **The Merger Contract Effects.**

The effects of the integration contract are primarily related to the increase of the shareholders capital and the convertibility and cancellation of some stocks owned by different shareholders of both banks. The integration brought to the transfer of all assets and liabilities from BIA to ABA. The initial capital increased from 33,4 million USD to 48,8 million USD. Each ex shareholder of BIA retains the right to convert its stocks in ABA stocks based on the agreement conditions. The computation of the conversion value is based on the adjusted countable value of the stock and the financial position of the integrated banks.

- **Integration Purposes and Effects.**

The integration objectives are related to the reduction of the costs, the resources rationalization, the improvement of the offered services and the synergies increase between banks. The human resources reduction is one of the ways leading to costs reduction for the new bank. The costs saving process is also reflected on the operational technological system, in the maintenance of the back up copies costs and in the legal spending. A lot of double costs were cancelled thanks to costs reduction objective related to: licences, trademarks, external audit, administrative council expenses and some kind of insurance contracts. The banks integration had a very positive effect on the supply side of products and services.

- **“Payment Cards” Section.**

American Bank has a solid position in the offered services and products distribution network. The development of the automatic payment system is made possible thanks to the bank's activity, through the market entry of 6 personalized credit and debt cards. Thanks to the opening of the POS and ATM offices, an ulterior development was signed for the payment cards. Referring to the integration period, American Bank of Albania issued 61.800 debt cards, which were supported by 43 ATM activity and 656 POS terminals. Before the integration, the issuing of payment cards was not part of Banca Italo-Albanese reality.

As mentioned above, by the renewed payment system point of view, the integration played an important positive role.

**Lending Section.**

American Bank of Albania has matured more than 12 years of expertise in the individual and corporate lending sector. The most known form is the one supported by residential mortgage which operates through 1300 clients for a total amount of 6.3 mld Lek on 2007. The clients number was smoothly increased during the integration, viewed the fact that BIA operates in this sector since 2006. The American Bank of Albania, before the integration was positioned on the third place as a lending institution. After that, it was positioned on the second place.

**Corporate Business Section.**

In the business section Banca Italo-Albanese has gained a long experience, since it was the principal refer intermediary for the corporate Italian clients which used to operate in Albania. In this point of view, the banking integration has conducted to relevant effects in increasing the synergies and in exploiting the matured experience in the corporate sector as an important resource of profit.

Above all, the integration has led to an increased quality of services and an increased quantity of products from the supply side.

An other positive effect is related to the lending capacity increase, thanks to the shareholder's capital increase.

**Retail Section.**

The expertise owned by Intesa Sanpaolo Bank, helped American Bank of Albania to establish a very well functioning network of Internet Banking. This network was used to manage the retail clients and is named *Oracle Financial Services*. It has played an important role in facilitating the clients and make them feel less the integration consequences. In fact, the clients have found a personalized and efficient service, even though the referee bank is changed. During three years by the merger the clients number is increased from 22.000 to 110.000.

**Fund Transfer and Commercial Enterprises Support Section.**

The funds transfer from Italy to Albania and vice versa is one of the most important activities for American Bank of Albania, as Italy is the primary commercial partner to Albania.

Banca Intesa Sanpaolo, through its 5.800 offices and agencies in the Italian territory has made it easier to transfer funds towards Albania, considering the big number of agencies located there.

- **The Integration between American Bank of Albania and Banca Intesa Sanpaolo.**



Intesa Sanpaolo group was born on January 2007, as a result of an integration (merger) between Banca Intesa and Banca Sanpaolo IMI.

On the other side, Banca Intesa, is a result of numerous banking integrations. In fact, the bank was born on 1998, as the integration result between the credit institutes Ambroveneto and Cariplo. On 2001, Banca Commerciale Italiana became also part of the group.

Sanpaolo IMI Group was born on 1998, as an integration result between Istituto Bancario Sanpaolo di Torino and Istituto Mobiliare Italiano. On 2000, the group became part of an other integration with Banco di Napoli and lately, on 2002 with Cardine Group.

The facts mentioned above confirm that Intesa Sanpaolo group has gained an important expertise on the merger and acquisition aspect, also achieving positive results.

On 2007 Intesa Sanpaolo became the majority shareholder of American Bank of Albania, owning 80 percent of the shares (about 12 million shares with a nominal value equal to 2,2266 USD). On 2008, American bank of Albania was named Intesa Sanpaolo Bank.

On 2009 the group decided to buy the remained part of the shares. The integration process was guided by the resource rationalization principles, costs reduction and product optimization.

Intesa Sanpaolo Group is very active in the international area, especially in the Center-Eastern Europe and the Mediterranean seaside. A network of 1.895 agencies supports its operations and 8,5 million clients are managed by the group banks in the retail and corporate sections in almost 12 countries. The force of the group lays on high eradicated local banks which own an important quota of the origin country banking market.

Intesa Sanpaolo offers a vast number of products and banking services, which make the difference in terms of quality, innovation and ability to respond to all clients needs.

Competence, consulting, and high quality financial services are offered to the retail and corporate clients in an international banks, agencies and representative offices network (40 countries). The group is spread especially in: Ukraine, Slovenia, Bosnia Herzegovina, Russia, Hungary, Serbia, Greece, Romania, Slovakia and the Check Republic.

- **Mergers Advantages and Disadvantages.**

This form of merger, preceded by the control taking is the most usual type in the reality. The period in which this operation was realized coincided with the financial crisis, which indirectly harmed also Intesa Sanpaolo. The banking integration was more than useful for the group in this period as it played an important role in improving the negative effects, thanks to the geographic diversification of the credits portfolio, the spread of the distribution areas, and the management incentives. The Albanian economy in that period was represented by a high growth.

Teorically and practically, it is known the thesis that concentration operations realized in development countries, give the possibility to the bidder bank to realize scale and scope economies. However, a lot of difficulties have been encountered, considering the centralized politic and social Albanian environment origin.

Firstly, the difficulty was found in the different enterprise cultures realized by both banks. Under the totalitarian regime only one bank existed (the *monobank*) which was supposed to cover the functions related to the payment system, the international commercial affairs, the exchange (strictly prohibited to the other institutions). So, we can deduce that in Albania it was not present a real financial institution.

The passage to the decentralized economy made the big difference, primarily through privatizations, giving a real participation possibility to the foreign investors. Banking activity in Albania, even though the positive changes, is still long way far modern banks operations. The introduction in the banking scenario of the foreign financial institutions, as the clamorous case of Intesa Sanpaolo led to the modernization and the assignment of new functions of the existing banking system.

Even though the Albanian high economic growth scenario, the almost total lack of the financial markets, plays a negative role on the Intesa Sapaolo's activity. Still today, the banks of the group located in the Albanian area have been assigned a low rating grade.

The most important problem is related to the risk identification and management, especially the operational risk. This is a consequence of the different balance sheet redaction, the integration and control difficulties, the lack on identifying methods of risk, included the financial discipline. To avoid further inconvenient, Intesa Sanpaolo, implemented a new department dedicated to the identification and risk management.

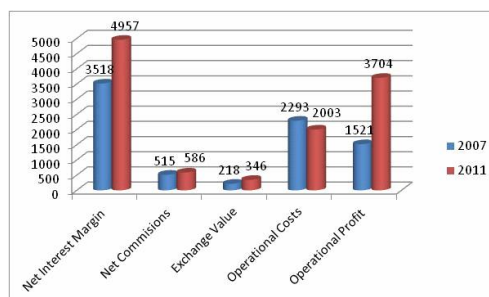
Absolutely, this was the most positive effect produced by the merger, becoming the bank more competitive and stable.

- **The financial situation 2007-2011.**

It results that on 31 december 2011, Intesa Sanpaolo Bank is owned for 98,61 percent by Intesa Sapaolo Group and for 1,39 percent by SIMEST.

The bank has realised important purposes, especially related to the risk identification, measurement, management, or the avoiding techniques during five years from the merger

The graph down illustrated shows the principal financial indicators during 2007 and 2011.



Font: Intesa Sanpaolo, in Annual Report, “*Management Analysis*”, 2007-2011

During 2008, Intesa Sanpaolo Bank Albania used to operate in two geographic contests: the Albanian one and Greek one, supported by 4 agencies. The Greek financial and economic crisis affected the banking operations, leading to the closure of the Intesa Sanpaolo Bank offices, in order to avoid further operational expenses. This closure was operated voluntarily, in order to prevent the crisis chain effect.

During these years, the prudent bank strategies have made possible the balanced increase of the financial indicators, considering the problematic European environment, and consequently the Albanian one. The drop of the European financial markets activity, investments, foreign commerce, and remittances, have played an important role in slowing down the banking development.

- **Intesa Sanpaolo Albania as part of the Group.**

One year after the merger Intesa Sanpaolo Albania has experienced important costs, related to the amortization and depreciation (about 22 percent). These costs are a consequence of fixed asset investments, in order to spread the distribution network of information technology.

Intesa Sanpaolo Albania owns 31 agencies over total 1642 foreign agencies part of the group. Even though the low number of agencies present in the Albanian territory, the financial results in a group scale have always been positive, thanks to resource and costs rationalization strategies. During 2011 the Net Operating Margin has increased by 13 percent respective to 2010. This increase is a result of the drop in administrative and human resources expenses and the incomes increase.

On the other side, the incomes increase is a consequence of the spread and clients drop compensated by the assets average volume increase. The net operating profit before taxes has increased by 15,3 percent, signing an other positive effect for the group.

### Conclusions.

The purpose of this work is bringing evidence that the bank mergers are advantageous for the interested actors, especially for the target bank.

Intesa Sanpaolo is a very important presence in the international arena, Albania included.

The position as a controller of two important local banks, and successively their merger, was an advantageous strategy for the group. On the other side, it is impossible to ignore the different difficulties encountered during the operation realization, as a natural consequence of the Albanian political, economical and social environment in the past. The incentives to take the control of an Albanian bank, for Intesa Sanpaolo are related to:

- The possibility to spread its operations and to be present in developing countries, considering the potential development and the increasing economic indicators.
- The banking portfolio diversification
- The scale and scope economies realization
- The foreign position enforcement, considering the target’s primary position in the local market.
- The manager incentive;
- The intention to assist the foreign clients

However, the Albanian financial system reality, particularly the banking sector, presents a lot of lacks considering the operational and the regulation point of view. This constitutes a difficulty on the bidder’s activity.

Albania comes out from a difficult politic situation, which has forbidden the development of the free economic initiative and also the functioning of the financial institutions. The difficulties related to the realization of the operations and activities by a modern bank such as Intesa Sanpaolo in are explicated in the different corporate culture of the Albanian managers, in the lack of a developed financial system, which constitutes an obstacle to the enhancement of the target bank, in the lack of a financial and a banking regulation in risk management area, in the different way of drafting the budget, and lately, in the different financial culture of the customers, which have a limited notion of a bank’s activity. However, the economic development through years and the introduction in a modern banking reality, like

Intesa Sanpaolo, has played an important role in changing the Albanian banking system. In fact, the integration between Banca Italo-Albanese and American Bank of Albania was the first of this kind ever realized in Albania, effectuated over the Albanian Central Bank supervision and with the extraordinary help of the Intesa Sanpaolo expertise.

The control assumption of American Bank of Albania (later Intesa Sanpaolo Bank Albania) by Gruppo Intesa Sanpaolo led to important innovation related to the bank's operations.

First, using the matured group experience, the Risk management Department was born.

An other important change after the merger is related to the usage of the IAS/IFRS principles in redacting the balance sheet.

Positive effects are noted also on the productivity and activity of the bank, as a natural consequence of the clients number increase, the agencies capillarity, and the capital increase.

After the merger, the quantity of the offered products and services is increased, in order to better respond to the client's needs. The force of Intesa Sanpaolo is the low prices and commission applied, which make it more competitive in the market.

The innovative department dedicated to the small/medium enterprises assistance, played an important role in increasing the clients number.

During the years 2007, 2008 and 2009, positive operational results are realized, even though not totally aligned with the group business plan. In fact, the foreign division of the group, during 2007-2009 has realized positive results, but scarce considered the Business Plan previsions. During 2010-2011, the foreign sector has realized incremental results, considered the markets collapse. The principal cause of these results lays on the financial crisis, that has not directly harmed the Foreign Division banks, but has made it difficult to obtain credit and liquidity in the interbank market and has spread a lot of uncertainty through clients. This fact is reflected in the intermediary volume and interest margin decrease. An other cause of the difficulties is related to the extraordinary social operations effectuated by the participated banks, through numerous integration processes. Obviously, the expenses are increased in the amount required by an internal reorganization process.

During 2008, Intesa Sanpaolo has diminished its administrative costs, thanks to the increased synergies with the included bank. During the last 4 years the bank has implemented prudential lending politics, rationalizing the credit for the riskier retail and corporate clients.

Obviously, other 2 or 3 years are required to have a better panorama of the merger and integration effects, considering that during these years the results have been positive, even under the crisis pressure.

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## FROM THE ECONOMIC CRISIS IN EUROPE THE ERRORS TO AVOID FOR THE CANDIDATE COUNTRIES FOR EU ACCESSION

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### **Abstract:**

*It is, especially, the strong debt crisis of some European States to trigger the fear of an effect contagion on other national economies to cause a global crisis. This it's a historical moment that we are living, particularly, difficult that seems to be prelude, however, of a bend without previous able to subvert the same way that the banks and government have created the finance and economy. In this context, the paper aims to examine this crisis which it is certainly the most studied and at the same time remains still the most unpredictable to its evolution. In view of this objective and the grave situation of Greece on which are pointed the eyes of the world that seems to be the focus of the contagion, a situation that results difficult also in others European States, the paper, being based on the analysis of EU discipline and financial systems of Member States and non-EU Member States, aims to analyze the consequences that would there be for Greece and Europe if this State exit from the EU. In consideration of this issue, the paper aims to evidence also the leading role in guiding the others States on the output of an emergency from the crisis, a role that it is providing the Germany for which arises the issue if its economy it is really very strong. The paper analyses also the delicate situation of others European States as Spain, Portugal, Ireland and also Italy that has a public debt. Nonetheless the overall economic comparison between Italy and France, it is even positive for Italy that now shows his pride at the strategy “Save Italy”. Meanwhile, in the EU zone grows everywhere the unemployment. In this situation it is yet an opportunity for the States as Albania to join the Europe?*

**Key words:** economic crisis, financial systems, accession, EU, Albania.

**JEL Classification:** F15.

### **1. Chapter 1: When the economic crisis will end?**

There is one question that everyone keeps repeating itself, with more and more frequency in recent years when the economic crisis will end? Venture an answer and give it to correct is like trying to win the superbingo. This joke actually means that, in my opinion, no one is able to specify a date for the end of the crisis. That said, however, it must be admitted that fascinates the attempt to answer the question without providing dates for the end of the crisis and even forecasts the world economy in the coming years.

#### **1.1. Section 1: The impact of the economic crisis to the economic order of European Union Member States.**

How can it be possible to make predictions even if there is only one certainty about the choices that each Government, in its own nation, will or can be done. Even for one country would be so many variables to consider and these would be to increase exponentially by combining data from two countries, therefore, imagine what would happen expanding the scenario on a global scale.

Nevertheless, each day there are still those investing in stock market, home buyers and car, those who deposit money in the bank, etc. So there are still people who invest, who spends regardless of the crisis is confident in the future?

Imagine that the crisis is now close to its conclusion? On the same day, however, in which some spend there are other, families and companies, who would rather cut on the purchases and avoid waste and others who prefer to bank savings and others, not trusting the banks, leaving the savings investment under the brick or mattress as it once was. What's more right? The answer this time is sure but it depends on what perspective you look the situation: who made the question? The government, banks, companies, citizens? Within each category must then examine the specificity of the groups and subgroups that make do with it.

For example, for the citizens category changes the valuation to express if the user that poses the question it is composed only by the head of the family or single, young or old, etc. Also, for the companies exist other diversification. For which economic sector we speak: engineering, manufacturing, energy, services, telecommunications, etc.

But helps everyone, regardless of category or sector, the analysis of the current and past situations, the technical and statistical data. And then here are some data on the severity of the economic situation: since 2007, to try to solve the crisis, the Countries of G20 have spent almost 23 thousand billion euro. In the last 5 years there have been 27 million more unemployed in the world. The Uil, a trade union, estimated that in this year 2012, every day in Italy lose a thousand jobs, then there are a thousand more unemployed in more per day that desperately seeking another place to work. Since 2007, large and medium-sized enterprises have been forced to close 280 thousand. The total cost of bank bailouts in the U.S. and Europe was 5,600 billion euro while the dollars spent by the Bce, the Fed and the central banks of England and Japan were always in the last five years, 9,500 billion. It 'a crisis that has had and continues to have very serious repercussions, as we have seen, firms, employment levels, on families, on consumption, but even on the banks (in the world since 2007 have failed 466) and even national governments: have changed governments in Italy, Spain, United Kingdom, Portugal, Belgium, France, Ireland, Romania, the Netherlands and Greece.

## 2. Chapter II: The European Union will continue to exist?

Having to get into the theme of this conference is basically a similar question to that with which I began: the European Union, taken as a monetary union, will continue to exist? And from this arise infinite questions: the European Union, this time a political entity, will continue to exist? The Greece will exit from the euro and from the European Union? Last but not least, and certainly more interesting: it is better or worse for Countries that are not part of the European Union to continue the implementation of the approach policies with the European Union up to be part of it? Giving up the clothes of the analyst and wearing those of the Albanian citizen would not hesitate even for a moment to pronounce yes convinced as I believe that the benefits for Albania would greatly far outweigh than the disadvantages. I admit that I watch this country with the same eyes of hope with which the Italians looked America in the years of economic recession and immigration and could not be otherwise in view of what happens in Italy, where the GDP of this year it's negative and may be even for two percentage points and where the taxes increase more and more, while in Albania the road is exactly the opposite: positive GDP and taxes to 10% when we have the even up to 45%.

### 2.1. What should not to do if want to deal with the crisis: Conclusions

In this conference, I thought to present the errors of Italy to say what you should not do if you want to deal with the crisis It's for you all know that Italy is among the Countries with the largest budget deficit. Mistakes committed not now but almost half a century ago, when, to put it succinctly, the governments spending more than they possessed in cash. I began to cite some statistics: in the period 1971-1974 the revenues in relation to gross domestic product (GDP) shrank by only 0.5% (from 29 to 28.5%) but increased very much the outputs from 36,9% to 43.4%.

The deficit has been compounded by interest: in 2010, the expense for the interest was € 70.1 billion of which is equivalent to 8,8% of public expenditure and 15.7% of tax revenue (direct taxes and indirect taxes excluding social security contributions). The Italian public debt is nearly two trillion euro: in June 2011 was 1.901 trillion euro, equal to 122% of GDP achieved in 2010. Having an excessive debt does not mean to be close to default. However, it is a component of many budget items for each country.

To find out if a nation is better than another must read also the amount of public debt but also much more. Inspire amazement a few years ago when argued that the economy of France was worse than the Italian and that Albanian, even with the proper proportions, was better than the Italian one. The so-called financial maneuvers: the revision of captions, the corrections to be applied to improve the differentiation between income and expenditure of a country, in Italy is focused more on increasing taxes and less on low costs. The last one is more than 75% due to new taxes and for the remaining part of spending cuts.

What is the problem? That the economy is slowed and is likely to move from stagnation to the recession. Add that technically Italy is already in recession. Many new taxes and higher rates for existing lines can not be the only recipe for ending the crisis. In transport, we think especially the increase in excise duties on fuel, revenues expected in a year are more than EUR 6 billion, one million comes from the increase of the contribution rate of artisans and merchants, 4 and a half billion households, 3 and a half billion of the savings, 11 billion from taxes on real estate and 16 and a half billion by 2014 if the VAT rate will be increased respectively from 10 to 12% and from 21 to 23%.

I insist on the need to rebalance the tax increase with a reduction of costs and explain why quoting a historical fact: in the 60s and 70s the rate of growth in the advanced economies, which were slowly declining for half a century, had a slowdown when the tax burden increased for a decade by about 5%, while the growth of these countries increased when, in the '80s and '90s, governments put in place a reduction in the tax burden. These I just mentioned, the 90's were the golden years of Italy because its economy grew well, better than the other European countries and even more the OECD average.

Now in Italy we are at maximum levels of taxation: the tax burden is close to 45% of GDP. And "This is one of the causes that hinder Italy. In all there must be balance because exaggerations are always evil and too many taxes a country can even die.

In the meantime, unfortunately, and I feel shame and discomfort at the mention this fact, are increasing cases of suicide of entrepreneurs in Greece but also in Italy, Spain and other Countries to the impossibility of dealing with emergencies encountered in their corporate balance sheets. To failure, to dishonor, to suffering to implement layoffs for their employees who preferred an escape from reality, from the world, from life.

But who pay the taxes? Officially all, actually almost all because we know that there is the phenomenon of tax evasion, that world production that it's by definition "in black" then not visible for the Tax Office. To return to the question of who pay the taxes should be said that in Italy are almost all those who have only a few money. Let me explain. The list of taxpayers of the Italian State is composed for the 50% from those who earn less than 15 thousand euro per year, almost one thousand euro per month. They are 20.2 million people. Do you know how many people who earn more than € 100 thousand a year? Only 1% while are 0.07% of taxpayers those who claim to earn more than € 300,000 a year. And that 0.07 of the total taxpayers are about 30 thousand people across Italy: very few. From this reasoning we understand, therefore, that the idea to increase taxes on the richest in the country, it may have a justification in terms of a supposed social equity which requires greater sacrifices to those who have more privileges, is not the solution to make it more rich Italy.

We said that the charge must be reduced: it is better to have from the State fewer services or with poor quality, rather than paying more taxes because of this, as we have seen, hampers the growth. Unfortunately, in Italy there is the double trouble: increase both taxes and charges. We compare the data in 1990 and the current one. Public expenditure was 373 billion euro and is now 800 billion euro. The tax burden was 38% and is now at 45%. The public debt was 663 billion and now is 1.93 trillion euro. Why spending has increased: in the five years prior to the crisis the medical supplies costing 37 billion and now "weigh" in the balance sheet for € 77 billion, then almost double. An item that represents the 50% of all expenditures for supplies in the public sector which now weigh in the balance sheet for € 140 billion a year.

If the taxes and expenses increase it's evident that the growth of the Country, as we have seen, it slows down as evidenced by the decline in GDP. This latter date, GDP, highlights the value of gross domestic production. If this value increases means that the economy is doing well, which is improving compared to the past but can not tell us if it is equally improved the standard of living of a population that is measured in terms of quality of life: think of the environment, health services, etc. That's why some prefer to measure the well-being of a country and it is done using other acronyms: IQV (indicator of quality of life is examined in addition to economic factors, the levels of social justice, political participation, and the environment life expectancy). It's also true that the quality of life can not fail to take into account the economic aspects. An example is the unemployment. Unfortunately a phenomenon on the rise everywhere. In Italy there are 7 million people. This means that almost half of Italian families living with this problem.

But if GDP would increase they would be a bit 'better all? Even if you want to stay in a comparison only of economic nature must be said that not always to an increase in GDP corresponds to an increase of wealth for the individual citizen. For example, if the population in ten years increased by 20% and the GDP has increased by 10% means that the average disposable income in real terms for each citizen has decreased. It may also happen that GDP and revenue will increase but to decrease the level of welfare by limiting the latter item in the economy. In Italy, in the period 2002 - 2007 the total income increased by 3.9%, but the purchasing power has remained almost constant (+0.2%). In the subsequent period, 2008-2011, total income decreased by 5%, but the purchasing power has been cut by as much as 7%.

The case of Italy, as we have seen, the negative aspects but in this crisis the country has more capacity than others to get out. Just think, a matter for all indebtedness of households with banks that is minimal or exposure of Italian banks to Greece which is also minimal.

What could Italy do to accelerate its exit from the crisis? Rebalancing the levers of power called taxes and charges and then intervene deeply into structural mechanisms of sustainable growth. These mechanisms or motors to be started immediately and with conviction, knowing that the results will not be unfortunately short, may be referred to briefly in three types. The first is the dynamism of meaning for it mainly the so-called liberalization of the market: what would happen if anyone could open a pharmacy or pharmacist is saying goodbye to the minimum rates for professionals (engineers, lawyers, notaries and all other categories)? It would certainly have a more competitive market where price and professional merit or quality would be governed solely by the market with their own benefits for all citizens and for the experts (that's the culture of merit) service providers or professional services. There would also be a strengthening of internal competition, that is, national, and indirectly the selectivity would produce a more competitive against foreign competition or global.

The second engine to be started is the competitiveness of the Italian system and the first action to be performed is to strengthen the infrastructure, ie, roads, railways, ports, schools, etc. Elsewhere port the positive example of Albania that, just in terms of infrastructure, has been able to make great strides.

I think of the 1000 km of secondary roads in one year contracted by the Government to renovation completed in the port of Vlora and those to be implemented in Durres, in making Porto Romano an industrial port and commercial port while the current one will be totally dedicated to the tourist, and benefits that their new buildings will have on the long-awaited development of the country, first of all for the tourism sector.

Just the ease of moving between one part of the country, so the speed of the connections, is one of the essential requirements of the tourists who, for the most part, want to explore the host country and know more places. Benefits which obviously also affect the quality of life of the Albanian population but also on cross-border transport becoming more competitive by transforming Albania, for example, the so-called Corridor 8, in a privileged gateway for trade from Europe and particularly from Italy to the Balkan countries.

In Italy need structural reforms can encourage private investment. In Albania, it must be said that there is no state funding that encourage private enterprise, but imagine how private investment, both domestic and especially foreign, are greatly encouraged by the current levels of taxation at the rate of 10%. In Italy we should have the courage to attempt more, that is to join the liberalization of innovative financial instruments but above all to make a rapid restructuring, violent and radical on Public Administration imposing, for example, simplification of administrative procedures and authorization in addition to the in tax matters. The reform of the system is strongly requested by citizens and business and the benefits for the country's economy would be enormous. A problem that is strong in Italy, and that is, yes, large similarities and even pejorative elements, in Albania.

A regulatory simplification and acceleration of bureaucratic and authorization procedures will permit the realization of the investments more quickly and effectively and thereby obtain a significant cost savings.

We talked about Italy but also other countries in Europe are not any better. France has a deficit / GDP ratio of 7% and the public debt is even 81% of GDP. Even Germany is not good but would like to believe otherwise and it looks like we're succeeding. If you really want to have a beautiful example then it is worth mentioning Sweden. Despite being a European Country has kept its currency, the Swedish krona, and excessive deficit at the end of the nineties has fallen by eight percentage points of GDP. Three-quarters of the credit for this result is due to the cut in spending. And that's what I hope for Italy.

The Germany, however, finance its debt at negative costs. The central bank is exposed to well 680 billion euro. The concept that Merkel is forcing Europe to tackle the crisis is that the so-called bottom "Save States" is not an ATM to be used indefinitely and without obligation to return the money taken. U.E. can and should provide financial assistance to countries in need, in exchange for responsibilities and rules on the settlement of the public debt, the growth of the domestic economy and the return of the loan. In this way, it must be said, that the economic aspects trespass necessarily those in the political arena because of the latter tasks, which are responsibility of the national government, the EU, because it is not an ATM inexhaustible impose constraints that prevent to increase the nation's debt and to do that, inevitably, must share economic policy decisions of that country transferred to the European level, for example, tax decisions. And what is this if not a limitation of sovereignty? Right or wrong this is also the price that you have to pay to get out, all together, by the crisis.

Said as a kind of slogan: the recipe out of the crisis could be reduced, if possible, taxes or at least not increase them but mostly it is essential to cut the charges and to privatize. Cut the charges and privatize more because the money of the failure to collect the taxes not increased can be partly offset by the sale of their "so-called family jewels": the real estate and equity interests of the State. In Italy you have defined a plan for the disposal of public property and improvements which should ensure revenue for at least five billion a year for the next three years.

Everybody talks about the crisis in Greece, where the impact on the policy framework is clear but the wind is blowing strong crisis across Europe and has made many governments reverse: in Greece, in Spain, in Portugal, as in France, in Ireland as in Romania and as happened also in Italy, where from a political government, the one led by Berlusconi, we have moved to a caretaker government with Prime Minister Mario Monti.

There is talk of default contagion to say that the situation in Greece could have serious consequences, with a domino effect on other countries, primarily Spain and Portugal. The problem in Spain, in addition to the economic system, it is also of bank typology. The banks have real estate loans compromises well one million euro and serve at least one hundred billion of fresh resources to save the entire national banking system. Spain already has the level of unemployment at 23% and after four financial maneuvers in two years should now do another worth 35 billion euro to break the 3% deficit. The previous government, that led Zapatero, said to have the deficit to 6% of GDP, and instead, as the new government of Prime Minister Mariano Rajoy, is 9% and for the EU had to go down this year, to 4.4%. In my opinion, the latter figure is a goal impossible mission. In this maelstrom of economic elements fits a given political diversity of treatment that the EU reserved to Spain in comparison to Greece. In Spain, for example, the financing banks does not go through the humiliation of the troika and the International Monetary Fund.

There is much talk in recent years also for the remedies of a fund "save states" of a piggy bank to be used in the dark ages, in fact right now. Yes, but what to make? Greece aid nor did many from EU but it will never be enough if it does not radically change the general approach of the budget and if there is the will to cover its deficit and create the conditions for economic revival. Otherwise, it is like handing a blank check, then no amount written to one that has a habit of playing cards.



Will change once the check to get money ready for groped their luck at the game again and this conviction will lose everything again and will bankrupt and was forced to ask for new loans. Continue to waste the money that will be received up to consume him completely and will never create the conditions for reverse course, invest the money in other assets and meet the needs of life.

In the meantime, she stands the original question: how long shall this crisis? I just summed up the particular aspects of the economic situation in Europe and already many are wondering if this crisis Greece can infect the whole of Europe or in part and if eventual crisis Europe can deteriorate at all, until default, the world economy. Of course in this 2012 and for the 2013 the world economy will increasingly slow down but there are exceptions, though to a lesser extent compared to their past, and these exceptions are China, India, Indonesia, South Korea, Russia, Brazil and South Africa. I conclude with a wish: I hope that in this list will soon fit my Italy and your Albania. Greetings! Thank you.

## THE INTERNAL CONTROL CULTURE IN THE ALBANIAN BANKING SYSTEM UNDER FRAUD PREVENTION CONTEXT

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### **Abstract :**

*In South- Eastern Europe a general increase in fraud and a recent shift from traditional, basic forms of individual fraud to more sophisticated fraud schemes performed by organised criminal groups or business owners and their relatives has been reported in the banking systems. The sophistication and resourcefulness of fraud are increasing, particularly where organised crime is involved. The best way of avoiding fraud, in the Albanian banking system, is implementing and maintaining of an internal control system in accordance with the standards set by Basel II and fully compliant with the Albanian legislation in force. So, the implementation and maintenance of an internal control system is the ultimate responsibility of every operating bank. By acting proactively, they can be safe in an environment which attracts and will potentially cause fraud. Despite the circumstances, the Albanian banking system should reinforce the success factors and provide the standards for operations in respect of business and reputation, by paying particular attention to the following areas:*

- *Internal Control System (in HO and branches in place/distance);*
- *Follow –up of the internal control results;*
- *Segregation of duties between “front & back office”;*
- *Motivation related the fraud investigation;*
- *Fraud identification (through civil and penal code);*
- *Fraud monitoring (customer, products, activities);*
- *Fraud mitigation objective (ethic rules and prevention culture);*
- *The fraud management regulation establishment (from Central bank);*
- *Fraud pool data sharing (which aims the banking cooperation and the practice learning).*

*The fraud management regulation establishment and respective data pool sharing ensures consistency and a harmonised approach across all banks which operate in Albania on fraud fighting as well as contributing in a safe banking business.*

**Keywords:** *Fraud Management, Internal Control Culture.*

**JEL Classification:** *G20, G29.*

### **1. Introduction.**

Statistically based the fraud management culture is still primitive in the Albanian banking system and that's why it can be easily become prey of the fraudsters. Actually the risks of fraud may only be increasing, as we see growing globalisation, more competitive markets, rapid developments in technology, and periods of economic difficulty. In this paper we explore on proposing to a/m system a developing strategy for prevention, detection and response to the fraud risk with highest standards of professionalism and the utmost integrity in dealing with all stakeholders of the Albanian banking system by providing also to its customers a safe banking business guaranteed from the banks control functions.

### **2. Risk's Management Role on Fraud Fighting**

*2.1. The Fraud Psychology and the Risk Management's Role Against It.*

The term 'fraud' commonly includes activities such as theft, corruption, conspiracy, embezzlement, money laundering, bribery and extortion even the legal definition varies from country to country. Fraud essentially involves using deception to dishonestly make a personal gain for oneself and/or create a loss for another.

Why do people commit fraud....

There is no single reason behind fraud and any explanation of it needs to take account of various factors.

Looking from the fraudster's perspective, it is necessary to take account of:

- motivation of potential offenders
- conditions under which people can rationalise their prospective crimes away
- opportunities to commit crime(s)
- perceived suitability of targets for fraud
- technical ability of the fraudster
- expected and actual risk of discovery after the fraud has been carried out
- expectations of consequences of discovery (including non-penal consequences such as job loss and family stigma, proceeds of crime confiscation, and traditional criminal sanctions)
- actual consequences of discovery.

A common model that brings together a number of these aspects is the Fraud Triangle (as presented in the Fig.1).

Who commits fraud ....

Fraudsters usually fall into one of three categories:

- a. Pre-planned fraudsters, who start out from the beginning intending to commit fraud. These can be short-term players, like many who use stolen credit cards or false social insurance numbers; or can be longer-term, like bankruptcy fraudsters and those who execute complex money laundering schemes.
- b. Intermediate fraudsters, who start off honest but turn to fraud when times get hard or when life events, such as irritation at being passed over for promotion or the need to pay for care for a family member, change the normal mode.
- c. Slippery-slope fraudsters, who simply carry on trading even when, objectively, they are not in a position to pay their debts. This can apply to ordinary traders or to major business people.

Fraud Classification

Mainly the fraud incidents are classified (based on the relation of the perpetrator with the institution) in:

- external (perpetrated by a customer or other third party); or
- internal (perpetrated by staff or management of the institution).

In the case of collaboration of internal and external parties, fraud is suggested to be classified as internal.

Characteristic fraud types in the banking business

The Albanian banking system is mostly affected from the following fraud types:

*Falsified Information, forgery*

Any falsehoods or false information, forgery used in order to gain a benefit, which would otherwise not be reached.

*Identity Theft, white horse*

Hiding own identity by using the identity of somebody else or through a nominee (white horse).

*Collateral (price & other) manipulation*

Any manipulation with collateral (inflated price, multiple mortgage, sale, non-existent collateral, "bubble" financing, corrupted resale, etc.)

*Electronic Fraud*

Unauthorised access or manipulation or disruption in systems, infrastructure or data, including denial of service attacks.

*Theft of financial assets*

Stealing any monetary fund (cash, deposits, bonds, etc.)

*Theft of non financial assets*

Stealing non monetary property of each bank (notebook, car, etc.).

*Other Fraud*

All frauds which are not fitting into types above

*2.2. The Risk Management's role against it.*

- The risk management cycle is an interactive process of identifying fraud risks, assessing their impact, and prioritising actions to control and reduce them.
- A number of iterative steps should be taken from the albanian banking system aiming a sound fraud risk management process (described in the Fig.2):
  - 1. Establish a risk management group and set goals;
  - 2. Identify risk areas;
  - 3. Understand and assess the scale of risk;
  - 4. Develop a risk response strategy;
  - 5. Implement the strategy and allocate responsibilities;
  - 6. Implement and monitor the suggested controls;
  - 7. Review and refine the process and do it again....

This process requires resources allocation from each bank pertaining to the a/m system by aiming a proactive fraud risk management. Thus, in the very beginning the banks should pay the necessary attention to the establishment of a Fraud Management Dept / Section depending from the respective size. And later on, their success can be guaranteed by implementing and managing the issue through the proposed anti-fraud strategy.

*2.2.1. Fraud Fighting Strategy Guaranteed from the Bank's Control Functions.*

Based on the earlier discussion around why people commit fraud, it would seem that one of the most effective ways for the system to deal with the problem of fraud is to adopt methods that will decrease motive, restrict opportunity and limit the ability for potential fraudsters to rationalize their actions. All this can be reached through the designation of the anti-fraud strategy.

An anti-fraud strategy

An effective anti-fraud strategy has four main components (presented in the Fig.3):

- prevention
- detection
- deterrence
- response.

The most important part of an anti-fraud strategy is the establishment and the implementation of the respective program. The anti-fraud program (in the Fig .4) is suggested to be managed and directed from the control functions of the bank. They have the crucial responsibility on fraud fighting which is escalated to the Audit/ Fraud Committee for further relevant management decisions.

*Fraud Prevention*

In the case of deliberate acts of fraud, the aim of preventative controls is to reduce opportunity and remove temptation from potential offenders. Prevention techniques include the introduction of policies, procedures and controls, and activities such as training and fraud awareness to stop fraud from occurring.

*Fraud detection*

The Albanian banking system is encouraged to explore as much as possible methods that could conduct it to fraud detection (as indicated in the Fig.5).

On the other hand the system should develop fraud indicators, these fraud indicators falls into two categories:

- Warning signs
- Fraud alerts

The fraud warning list encompasses: business risk, cultural issues, management issues, employee issues, process issues, transactions issues, financial issues, environmental risk and IT - data risk.

While, fraud alerts list is composed from : anonymous emails/letters/telephone calls, emails sent at unusual times, with unnecessary attachments, or to unusual destinations, discrepancy between earnings and lifestyle, unusual irrational, or inconsistent behaviour, alteration of documents and records, extensive use of correction fluid and unusual erasures, photocopies of documents in place of originals, Rubber Stamp signatures instead of originals, signature or handwriting discrepancies, missing approvals or authorisation signatures, transactions initiated without the appropriate authority, unexplained fluctuations in stock account balances, inventory variances and turnover rates, inventory adjustments, subsidiary ledgers, which do not reconcile with control accounts, extensive use of 'suspense' accounts, inappropriate or unusual journal entries, confirmation letters not returned, supplies purchased in excess of need, higher than average number of failed login attempts, systems being accessed outside of normal work hours or from outside the normal work area, controls or audit logs being switched off, etc.

But aiming a better fraud management process from the entire system is more than necessary the establishment of a fraud data pool (this one regulators responsibility) as the banks share the same fraud factors such as: business activity, environment control, etc which will be useful to the albanian system itself.

#### Responding to fraud

The fraud response plan should be defined to include the following components:

- Definition of initial actions to be taken after discovery of fraud (first 24 hours)
- Rules for structure and content of investigation
- Respective roles of members of the Fraud Response Team
- Securing evidence following discovery of fraud
- Communication lines to external parties (including lawyers, police, regulators)
- Loss recovery procedures
- Reassessment of controls, for areas where the fraud may have highlighted weaknesses
- Statement of Compliance department
- Legal steps in cooperation with Legal department.

- Fraud Response Team

Due to the nature of some fraud cases or to potentially high losses, it could be necessary to involve more control functions in the investigation process. The Fraud response plan defines who may be appointed from each department. Representatives of the following departments can be core members of the Fraud Response Team.

- Security
- Legal & Compliance / AML
- Internal Audit
- Operational Risk / Fraud Risk (FRO)
- Financial accounting & controlling
- Business line involved (HR, IT, etc...)

The Fraud Response Team is responsible for determining whether an investigation into the allegation / suspicion is merited, and for deciding whether the investigation will be conducted by an internal team, or whether external consultants and / or the police should be approached to conduct the investigation. In case of the first one to the FRO should be given the responsibility to lead the investigation.

#### ***The fraud investigation takes place by arguing on:***

- Preservation of evidence (Physical and Electronic);
- Interviews;
- Statements and witnesses;
- Statements from suspects.

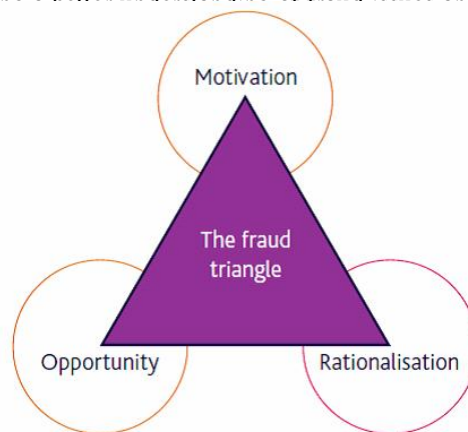
The Fraud Response Team must be responsible to designate members of the Team responsible for establishing and maintaining contact with external parties, for example with the external lawyers of the Company, forensic experts that may be appointed and the local Police, as may be required.

As integrative part of the fraud response plan are suggested the measures that the banks should undertake in fraud detection case such as: internal disciplinary action, a civil response, criminal prosecution, a parallel response. While the follow-up actions to be considered are: lessons learned and management fraud response through: internal reviews, changes implementation, annual report and enforcement policies.

2.2.2. The Regulators Responsibility in the Fraud Management Approach.

First of all, the indisputable role regarding the fraud management issue in the Albanian banking system remains within the regulator’s responsibility. His alliance with the banking system is essential for a sound management. Is decisive for the system to be guided towards the best fraud management standards accepted and requested to be implemented from the regulator aiming at the best management of fraud management respective management. What can be realised through the development of ongoing basis with additional directions in business.

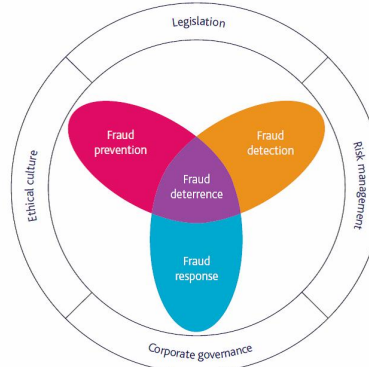
- **Fraud M**



(Figure 1-The Fraud Triangle: This model is likely to result from a combination of three factors: motivation, opportunity, and rationalisation. Source: [www.state.mn.us](http://www.state.mn.us)).



(Figure 2.- The risk management cycle: This cycle is necessary information in order to help the institutions to act promptly and in an effective manner. Source: [www.education.tas.gov.au](http://www.education.tas.gov.au))



(Fig 3.-An anti –fraud strategy: The diagram summarizes the components and the context within which an anti-fraud strategy sits, source: <http://www.humanitarianaccountant.com>).

Prevention	Detection	Response
Board/audit committee oversight Executive and line management functions Internal audit, compliance, and monitoring functions		
<ul style="list-style-type: none"> <li>• Fraud and misconduct risk assessment</li> <li>• Code of conduct and related standards</li> <li>• Employee and third-party due diligence</li> <li>• Communication and training</li> <li>• Process-specific fraud risk controls</li> </ul>	<ul style="list-style-type: none"> <li>• Hotlines and whistleblower mechanisms</li> <li>• Auditing and monitoring</li> <li>• Proactive forensic data analysis</li> </ul>	<ul style="list-style-type: none"> <li>• Internal investigation protocols</li> <li>• Enforcement and accountability protocols</li> <li>• Disclosure protocols</li> <li>• Remedial action protocols</li> </ul>

(Fig 4. - **The anti-fraud program:** This program ensures a fraud management harmonized approach with the bank control functions synergies, source: [www.us.kpmg.com](http://www.us.kpmg.com)).

(Fig 5. - **Methods of fraud detections :** The common methods used for fraud detection purposes, source : [www.pwc.com/crimesurvey](http://www.pwc.com/crimesurvey)).

## Conclusions.

Obviously the proposed anti-fraud strategy can't continuously ensure the appropriate fraud risk approach to the Albanian banking system. But certainly, it should help the system in a better understanding of fraud by integrating additional identification, control and management measures that could make it more flexible in the near future. Despite the efforts made regarding the fraud risk management the system can't completely eliminate it. The proposed solutions could be the business making in the areas where fraud risk can be managed this will help the banks to safe their values, performance and reputation and more investment regarding fraud awareness culture within the system.

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## PROBLEM LOANS, THEIR PERFORMANCE AND MANAGEMENT

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### **Abstract:**

*Our economy as well as the economies of the region is facing difficulties in managing the microeconomic and macroeconomic problems. The financial crisis even in Albania did not pass as claimed by stakeholders. Our banking system has been quite stabilized, however one of the problems it is facing today is the decline of the quality of loans. This means that the quality of credit in domestic and foreign currency granted to individuals and the business sector has decreased significantly. In this paper it will be properly analyzed the performance over years of problem loans according to relevant categories and industries. Another important element of the paper is the identification of factors that have led to the decline of the quality of loans. This phenomenon has made banks more cautious in lending to individuals and business entities.*

**Key words:** problem loans, loan portfolio quality; coercive measures.

**JEL Classification:** G21, G29.

### **1. General information on the performance of loans**

According to the Financial Stability Reports, our banking system has increased its activity despite the latest financial crisis. As result, during 2011 the assets of banking sector increased by 13.7%. Meanwhile the loans increased by 15.5% in annual terms, representing 50% of total banking assets. Loans in foreign currency make up 68% of the total loan portfolio. The level of total loans outstanding has increased by 0.64 billion leke during January and February in 2012 mainly due to the slight increase of loans to individuals. Meanwhile loans to business sector have remained at the same level as at the end of year 2011. Annual growth to private sector continued to slow down, reaching 9.9% and 9.2%, respectively in January and February compared to 10.4% in December 2011. In fact, the quality of loans has deteriorated in almost all its categories. Although with different rates, the quality of loans has deteriorated for loans in lek, loans in foreign currency, loans for business sector and loans for individuals.

#### **1.1 Quality of loans: Individuals vs Businesses**

##### **Individuals**

According to studies performed by Bank of Albania, the total outstanding loans for individuals have increased. During this period it is noticed a higher share of long term loans. Individuals have decreased the share of borrowing in foreign currency which in December 2011 stood at 56.6% compared to 58.2% in previous year. The improvement in the lending to individuals is reflected even in the quality of loan portfolio to individuals, which has deteriorated at a slower pace compared to quality of business loans.

##### **The share of problem loans**

Type of the client	H2 2010	H1 2011	H2 2011
Individuals	12.74%	13.91%	15.35%
Businesses	14.6%	18.5%	20%

*Burimi: Financial Stability Report H2 2011*



However, the increase of this ratio by 2.62 % during 12 months is disturbing although the stock of problem loans is increased at a slower pace compared to previous year. Meanwhile, the exposure of individuals towards credit risk for year 2012 is forecasted to be present due to slower economic growth, a moderate rate of increase in lending and the increase in uncertainties regarding the economic activity.

### **Businesses**

Loan portfolio for businesses increased during 2011 by 22.8% in annual terms. Loans to large businesses increased significantly reaching 60.3% of total loans, while small business and medium business hold respectively 19.9% dhe 19.8%. Large business has also increased the weight of long term loans (30 % of the total) even though short term loans continue to represent 51.7% of the total loans. Meanwhile, small and medium business have borrowed mainly long term loans, respectively 47% of the total loans for small business and 40.8% for the medium business loans. Despite, positive growth of credit, the quality of the total loan portfolio for the businesses has further deteriorated (table 1). The ratio of problem loans for businesses to outstanding loans reached 20% in December 2011 compared to 18.5% in June 2011 and 14.6% in December 2010. The rate of growth of business problem loans by 5.4% during 12 months is very concerning especially when the stock problem loans has increased by a higher rate than in the previous year (68.2% annual growth during 2011) while the total outstanding loans have increased at a slower rate. Comparing the quality of loans of businesses with that of individuals, it is clear that the quality of business loans has deteriorated at a higher rate. Uncertainty about international economic developments and their effect on economic development in our country is accompanied by a hesitation towards investments or consumption of economic agents and of a prudent policy by banks in lending. As result, the developments in the demand and supply side, have contributed to the further increase in the amount of problem loans in banking sector. In the second half of 2011, the volume of problem loans of banking sector has increased reaching 106.3 billion lek, from 88.9 billion lek in the first half of 2011. The ratio of problem loans against total loans increased to 18.8% from 17 % in the first half of 2011. The total of provisions has followed the same pattern as problem loans, by representing 9.7% of total loans.

#### **Quality of loan portfolio (%)**

Year	Classified loans	Standard loans	Special mention loans	Sub-standard loans	Year	Classified loans	Standard loans
2009	100	83.38%	6.35%	4.70%	2009	100	83.38%
2010	100	79.44%	6.94%	6.04%	2010	100	79.44%
2011	100	73.61%	8.36%	8.77%	2011	100	73.61%

Source: Bank of Albania

The distribution of loans according to categories continues to show a higher share even though in decrease of loans classified as “Standard”. In the second half of year 2011 it is noticed a movement of “Standard” and “Special mention” loans towards “sub-standard loans” whose weight increased to 9.2% from 7.8% in June 2011 and 6.1% in December 2010. The movement towards lower quality classes such as “doubtful” and “Lost” has been slower.

Banking sector is more exposed towards credit risk for the loan portfolio in foreign currency and that for businesses. Gross problem loans to total loans for both these categories increased respectively to 19.6 and 20.8%, from 13.8% dhe 15.5% in the previous year. Meanwhile the loans granted to public sector represent almost 3.6% credit portfolio, from 2.6% at the end of 2010. The quality of loan portfolio has decreased especially for the construction and trade sector, where the ratio of problem loans reached respectively 29.6% and 21.3%. From the analysis of the quality of loan portfolio of businesses, based on the level of problem loans according to sectors of economy combined with the specific weight of the sector itself, the most problematic sectors of the economy are: “Trade, auto home appliances repair”, “Construction”, “Processing industry” and “Hotels and Restaurants”. In contrast to the end of last year, the loan portfolio in foreign currency has a higher ratio of problem loans at the level of 19.6% compared to the portfolio in Lek with 16.9 %.

## **2. The performance of problem loans in CESEE**

The financial crisis 2008-2009 from different studies results as one of the crisis that was accompanied by a quick (high) rate of increase of problem loans, almost in all countries of our region. According to Gregorio Impavido, Christoph Kligen and Yan Sun (March 2012), when the global financial crisis affected the CESEE countries by the end of 2008, the easy foreign lending suffered an immediate blockage and the export markets collapsed and the region economy suffered a recession.

Immediately after this, problems with the quality of assets of banks surfaced and the ratios of problem loans increased considerably from 3 ½ % before the crisis to 11% in average for the region by the end of 2011. It is necessary to point out that in contrast to previous crisis where problems with the quality of loans were mainly present for the business sector, this time problem loans were present even for individuals.

High levels of NPL consist in another feature of the crisis which is very difficult to be solved only by economic growth. The economic growth in the second half of 2009 caused a slow down of increase of the NPL ratios and the economies that performed better reached the maximal levels in 2011. However the NPL levels are still high and the deterioration of assets; quality continues (during 2012) in a large number of countries, such as South Eastern European Countries in which economic growth was delayed and it was in low levels. Moreover, the economical forecasts for the whole region are not satisfactory because of the crisis in Euro Zone. Forecats for 2012 are for a decrease of economic growth and worsening of the risks.

### 3. Study: Credit clients in difficulties in settling their obligations, the factors contributing to this phenomenon

The expression “We have economic difficulites in settling our loans” has been one of the most used sentences by the clients we interviewed at some second level banks in Tirana, during June, July and August 2012. According to them, this was the main reason for delaying payments of their bank loans. As it was even mentioned by the credit analysts of second level banks, this expression has been repeated over and over again in front of them, and a part of these clients were referring exactly to their inability to settle their obligations due to the economic crisis that the region ang the global economy is facing. This was the starting point of preparing this study to discover more about this phenomenon, and the factors that have contributed to the the increase of credit risk, referring to the answers provided by the banks’ clients.

#### Methodology and the objectives of the study

In order to discover the relationship between the phenomenon of credit risk increase and the reasons that cause this increase, it was realized a study in the form of a questionnaire.

*The questionnaire is organized in three parts:*

- ∅ The first part contains general information related to the number of clients that have taken a loan from the bank. It is important the divison of the clients into two types: “Individuals” and “Business”, to better understand which category is facing more problems in settleing their obligations towards second level banks.
- ∅ Second part comntains information related to to the factors that have contributed to the non-settlement of loans within the term set in the loan contract.
- ∅ In the third part it is elaborated the clients’ view towards this phenomenon and their opinion and forecast in solving this problem in the future.

This questionnaire was distributed to 100 clients that currently have outstaning loans at second level banks. In this study were included only clients of group 3 peer banks.

*Important objectives of this study may be considered:*

- ∅ Obtaining information regarding the number of problem loans at second level banks.
- ∅ Obtaining information regaring the problems faced by the clients and the main factors that affect the non-settlement of their obligations towards banks.

*Some restrictions of this study:*

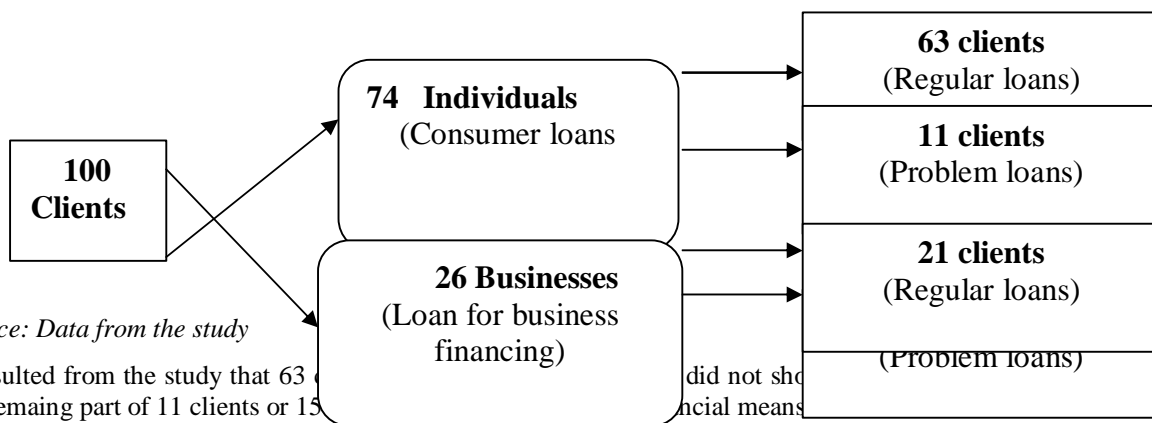
- ∅ This study is carried out only in Tirana City (geographic restriction). Other areas of the country, where the economic problems are even worse, are not included in this survey and as result its findings are not full.
- ∅ This study includes e relatively small number of clients. In order to derive statistically important results, a larger number of individuals and businesses should have been included as well as sophisticated methods based on econometric models.
- ∅ This study has not considered all factors related or that affect the level of unsettled loans.

#### 3.1 Summary of the study’s results

Here in under are analyzed some of the most important results of the study by deriving relevant findings.

**3.1.1 Problem loans: Individuals vs Businesses**

From the total number of the clients interviewed, 74% of them were individuals (consumer loans) and 26 % were businesses (the loan was used for business purposes). As it was previously mentioned, in the last few years problem loans have demonstrated an upward trend, and this was mainly noticed in business loans.



Source: Data from the study

It resulted from the study that 63 clients (86%) did not show any problems in settling their obligations and the remaining part of 11 clients or 15% exhibit serious problems and inability to settle their obligations.

From the 26 clients that have used the loans for business purposes, 21 of them (81% of business clients) did not have any problems in their periodical payments but only 5 of them (19%) exhibit serious problems and inability to settle their obligations.

The obtained results demonstrate clearly the problems that individuals and businesses have with shortage of liquidity, which according to them is due to the latest financial crises.

**3.1.2 The reasons of delays in settling loans**

Clients were asked about the factors that affect the loan performance and they provided some main reasons that are closely related to the effects of the financial crisis in our country. More specifically, the study data divided among the categories of the interviewed clients show that they have difficulties in settling their obligation as in all cases they have the desire and vulnerability to settle their obligations but they are faced with liquidity shortage.

From the results of the study it is noticed the important role of remittances in the wealfare of families. The decrease in remittances especially after 2008 and ongoing has negatively affected the economic health of Albanian families which are demonstraed by the figures concluded in this study.

Also, businesses are facing financial difficulties. The fact the businesses do not achieve their objectives means that people are positioned more towards savings. This trend reflects the insecurity of people for the economy of the country and the financial crisis advancement.

Businesses are also facing problems with their Accounts receivalbes. The increasing trend of the risk level of Trade loans is increasingly becoming a problem with bad influence towards the financial health of suppliers in general.

**The factors for not settling obligations (loans) towards second level banks**

Factors (Consumer loans)	Individuals	Factors (Business loans)	Business
No support from remittances	6 (55%)	No sales	2 (40%)
Loss of workplace	2 (18%)	Problems with "Receivable accounts"	2 (40%)
Sickness (Medical reasons)	2 (18%)	Other	1 (20%)
Other	1 (9%)		

Source: Data from the study

The data obtained demonstrates that “financial crisis” factor has contributed in the worsening of financial conditions of individuals / families. This phenomenon has forced banks to take restrictive measures in lending, due to increase in the level of problem loans.

Despite the actual situation individuals are more optimistic in surpassing financial difficulties. From the study data 55% of the individuals that are having problems in settling their loans regard this as a passing period. But it is not the same for the businesses as 60% of them are pessimistic for the future of their business. From their point of view there will be no improvement of their financial conditions in the short term.

### **Conclusions.**

The increase in the level of problem loans causes the increase of financial stress, especially if banks have not created adequate provisions, and especially if the trend of problem loans is upward. The increase in the level of problem loans would be accompanied by another problem such as the overload with debt (overdebtness) of individuals and businesses.

From the study resulted that families and businesses are affected by the global financial crisis, and even other sources confirm that the economy our country during the first quarter of 2012 signaled a slow down of its activity. The increase in the level of problem loans will cause a recession of the country.

It is important to find ways that improve the liquidity situation of individuals and businesses. This would positively affect in the improvement of loan quality in banking sector. Also, it is important the treatment of problem loans in the banking sector for the increase of lending and the future contribution of the banking and financial sector towards the economic development of the country.

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**FINANCIAL CRISIS AND BANKING SUPERVISION: THE BASEL ACCORDS**

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**Abstract:**

Since 1974, with the collapse of the German Herstatt Bank and the Franklin National Bank based in New York, the quick propagation of the financial crises showed clearly the immediate need of an international coordination and regulation system. The crisis had become for real unmanageable and too dangerous. The Bank for International Settlements (BIS), became then, the meeting place where the Basel Committee of Banking Supervision (BCBS) rose. In order to avoid another financial crisis the Basel Committee started compiling banking supervision accords also seen as recommendations on banking regulations based on international convergence of capital measurements and standards. Detecting this topic, the work done in this article, emphasizes precisely the need of the creation and the evolution of these international regulations. Indeed, each financial crisis that the world has experiences has brought its problems but also, after long studies, has brought several answers and solutions. Between 1975-1988, the creation and implementation of the Basel I accord, perfectly fulfilled the market needs and provided a financial harmony, which lasted unfortunately only until the next crises. The events of 1990-2000 with the propagation of several bankruptcies presented the time for an upgrade of the international banking regulatory system. With the Basel II accord in 2004, the leaks of the first one were filled, but yet the system was incomplete. The financial crisis of 2008 proved the Basel II accord wrong; there was once again failure of the international market harmony. The question stands, what will provide the Basel III accord? Is the international financial environment finally going to find the right equilibrium? In order to answer these questions, the work presented in this article will provide a “guided tour” through the components and pillars of the Basel III accord, but also its objective is to compare and contrast the accords with the intention to highlight the improvements reached.

**Key words:** Financial crisis, Basel Committee of Banking Supervision, banking regulatory accords, international capital measurements and standards.

**JEL Classification:** E44, E52.

- **Financial situation and Banking Regulations**
- **The need, introduction.**

Many finance orientated people would recognize that the term “Basel” is well-known for the fact of being an accord on banking supervision rather than for the beauty of the city itself (Basel, Switzerland). In fact, beneath the Bank for International Settlements, (BIS), lays the Basel Committee on Banking Supervision, BCBS, created and supervised by the governors of the G10 countries (nowadays we find implications and applications far beyond the original members). Since 1974 this Committee has achieved several international convergences and cooperation regarding the regulation of the banking system. In fact, in the ‘70, the globalization and international financial intermediation had bloomed. Ipso facto, with the advantages of international banking, the problems came along. As we can well imagine, to merge borders and go international comes in package with the “dominoes effect” in case of a single collapse. If one bank goes down, all banks go down.

The aim of this paper resides on revealing the importance of the international banking regulations and supervision. Why, in the first place there was found the urge of its creation and then the steps made till the day that we speak. In fact the international banking agreements, have passed through different steps, have proved themselves wrong or right, and as a result several improvements and adaptations have been made. These changes constitute the core of the work presented in this article, underlining the scientific problem of how to prevent financial crisis.

The methodology used for this article, lays on a widely spread qualitative research on, official documentation, opinion based working papers as well as reality observation working papers, and the several comparisons made. We have today a history of three Basel accords, and you will be able to find above in the article, the historic path of the creation of the first accord, the passage to Basel II and finally, the article concludes with the actual improvement of the brand new Basel III accord and its anticipations on avoiding crisis and creating standards for financial stability and harmony.

- **An historic overview, the creation of the Basel accord.**

All started when the German Herstatt Bank and the Franklin National Bank based in New York collapsed, followed also by the '80s "savings and loan" crisis. The confused situation on the international money markets, led to dangerous and uncontrolled speculations. Thus, international standards were needed; we can say that a set of measures to strengthen the regulation, supervision and risk management of the banking sector were indispensable. The aim was to substantially try to absorb the chances and the gravity of economic and financial torment. Forth central banks have responded to the crisis by reviewing micro prudential regulation. But, to assure the coverage of the problems arising from systemic risk and interconnected banks, several macro prudential regulations are required. Under this clear objective the Basel Committee on Banking Supervision came up with a regulatory supervision accord.

As a matter of fact the implementation of any regulatory framework should be vertically implemented; it should be situated in all levels of the banking system. This structure concerns the international level as well as the domestic level of implementation. You can observe in the figure below, the implementation levels of the Basel accord framework.

**Figure 1 Structure of the implementation level of the Basel accord. ( Bank for International Settlements.)**

*Reading : ( 1) Boundary of the predominant banking group. The Basel framework is applied at this level on a consolidated basis. (2),(3) and (4) the framework is also to be applied at lower levels to all internationally active banks on a consolidated basis.*

The Basel Committee has started up as a club of bank supervision and it has turn out to be the "de facto measure of sound banking supervision across the globe". As found in the "Proposal for international convergence of capital measurement and capital standards" of December 1987; "The Committee on Banking Regulations and Supervisory Practices has, for several years, been working to achieve a strengthening in the capital resources of international banks in order to strengthen the stability of international banking system. At the same time, achieving some convergence of capital adequacy standards in national supervisory regimes has been increasingly realized to be a desirable objective in order to remove an important source of competitive inequality for banks operating internationally"

The Accord of 1988, more widely known as Basel I, transformed the Basel Committee on Banking Supervision into the leader of bank policy-making, primarily for its regulations on capital adequacy requirements (used to cover the unpredicted or unexpected loss). After the cumbersome international financial situation, the aim of the accord was clearly to strengthen the stability of international banking system, and to try and reduce competitive inequality among international banks, which means covering the risks of repeated perpetual crisis among them. The achievement of this accord has been for sure the definition of bank capital and bank capital ratio aiming a reduced risk-based capital adequacy. Hence, the Basel I accord initiated by defining the term "capital". Forth, the capital was classified in two Tiers. The first one, concerning the "Core Capital", includes share holders equity and declared reserves. The second Tier, concerning the "Supplementary Capital", summarizes all the other forms of capital such as long-term debt, gain on investment asset, leaving outside the capital unguaranteed short-term debts. In the revision made to Basel I in 1996, there was seen the possibility to add a third capital tier with the purpose to include these short-term unguaranteed or unsecured debts.

The most important part of this accord are the capital requirements. What about those? Let's take a quick tour of this part that is constituted by the Credit Risk and the Market Risk. The credit risk designs the assets of a bank that are risk-weighted in relation with the credit risk levels. There are three kinds of credit risks:

- On-balance sheet risk (cash & gold, obligations, government claims, securities, corporate bonds, less-developed-countries debt, equities, real estate etc.)
- Trading off-balance sheet risk (derivatives, foreign exchanges, commodities etc.)
- Non-trading off-balance sheet risk (forward purchases of assets, debt assets etc.)

Pursuant to the Basel I accord, the integrality of the bank's capital should be represented at a level of 8% of its credit risk. The second subdivision of the capital requirements, the Market Risk, deals with two types of risks, the general market risk and the specific risk. The general market risk designs the loss provoked by movements in the market prices, such as foreign exchange, interest rate, commodities and equities. The specific risk on the other side, designs the value change of an asset as a response to security factors.

Hence, the Basel I accord was a major pace in developing international banking supervision and capital frameworks. The integrality of specifications and subdivisions of the accord illustrate a standard methodology on capital requirement's calculations, aiming the establishment of similar capital requirements through international banks to avoid unfair advantages that some banks may have as a result of inexistent capital requirements in the countries they operate. Basel I has therefore accomplished its principal scope with promoting international financial stability and implementing fair and impartial competition among internationally active banks. Notwithstanding this accord was thought to be cured in details, it failed to assure the financial harmony after the 2000's. As a matter of fact the several bankruptcies of that time showed the need of an upgrade or more properly, an amelioration of the Basel I accord. In a second paragraph you will find the main reasons of the fails of the first accord and the refinements done.

- **The Basel Accords**

- **The fail of Basel I, the passage to Basel II.**

Let's keep in mind the 2 key objectives of Basel I, first to ensure stability and second to provide equitable competitiveness. What was in reality the result of this regulatory framework? Banks, in fact, shifted assets off the balance sheet and moved toward to the riskiest assets, exactly to avoid those regulations. So as we can understand both objectives failed! The failure of Basel I served at least as a stress test and opened the path to a better designed framework. The principle critics made to this first accord were:

- The absence of term-structured credit risk recognition indulging same charges no matter the maturity of the credit exposure.
- Fixed measure of default risk at 8% considered to be adequate to avoid bank failure not taking in consideration the nature of the default risk.
- Plain calculation of the counterparty risk, by not taking in consideration the currency and macroeconomic risk.
- Reduced credit risk differentiation, affiliating the same amount of risk for all components of the capital.
- Absence of portfolio diversification, that provides an incorrect calculation of the portfolio risk.

In fact, Basel I clearly ignored the modern theory of portfolio and presented an insufficient evaluation of the risk. The accord also mostly focused on micro prudential regulations rather than the macro prudential ones. Basel II, compiled in 2004 introduced then some changes regarding the portfolio implications, such as differentiating between homogeneous and heterogeneous portfolios, also distinguishing between different customers that imply different types of risks. Basel II takes in consideration all of Basel I package, denoting only some slight moderations in the approach and the calculations. In fact, the Basel II accord was developed in three pillars. Indeed as you can see in Figure 2 the pillar's structure, all pillars are very important for the accords aim, but pillar one seems so far to be the most important one.

**Figure 2 Chart of the Basel accord structure. ( Bank for International Settlements.)**

Basel's II first pillar constitutes in fact the total composition of the first accord upgraded with several changes, because as cited before, the regulations regarding the capital requirements are the most important. The credit risk and market risk are also part of the Basel II accord, and they embody the core of the accord. On the contrary, there was an upgrade made to this pillar in comparison with the Basel I accord, the Operational Risk was added. The operational risk designs the loss provoked by the operations such as the risk of failure of the internal as well as external system, process or people. Exceptions were made for the reputational or strategic risk. The second pillar, the Supervisory Review Process, has as principal objective to ensure the correct implementation of the risk based capital requirements and to vividly motivate banks for research and improvement of the risk management in their institutions. As a matter of fact the four key principles of the pillar are:

- Principle 1: Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.
- Principle 2: Supervisors should review and evaluate bank's internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.
- Principle 3: Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.
- Principle 4: Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored."

Under this supervisory process, the bank's capital assessment is strictly monitored because of the direct correlation between on one side the bank's capital related to its risk and on the other side the goodness of the risk management.

The principal fields susceptible to be monitored under pillar two are the leaks of the first one such as, the factors and risks not taken in consideration by this pillar but also some external factor such as the business cycle effects etc.

Last but not least, is pillar three; its aim is to fulfill the two first ones. The objective of this pillar lies on the assurance of the market participant's well information through several market disclosures that urge themselves the market's discipline. These disclosures are widely applied; they may be on capital structure or adequacy, on credit risk of portfolio level or bank level, on credit risk mitigation, exposure to counterparty credit risk, on securitization, on market or operational risk as well as equities or interest rate risks. Below you may find a template of the disclosure structure and scope.

**Figure 3 Pillar three's disclosure format. ( Bank for International Settlements)**

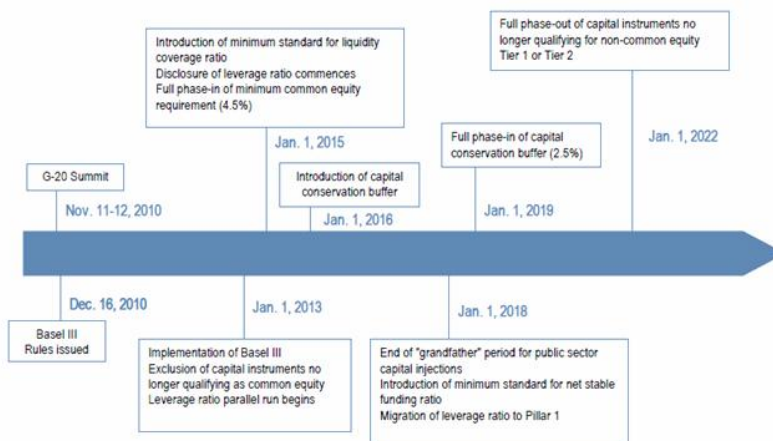
Several upgrades were made, even a revised version named Basel 2.5, but yet again, the second accord proved itself insufficient. The key objectives fixed failed. The accord actually favored the big international banks and reduced the equitable competitiveness. It assured a better risk management but on the other hand failed the internal bank model. And most of all the higher instability and lower capital inflated thereafter the financial global crisis. The crises showed in fact the leaks of the Basel II accord, with critics like the following presented by Petr Teplý :

- Lack of adequate data provoking asymmetric information.
- Lack of capacities due to high responsibility of the regulators.
- Mitigation of the credit risk due to inappropriate valuation and collateral.
- Concentrating the risk on mortgages.
- Lack of efficient market hypothesis due to the reliance of the past events and absence of foresight.
- Poor crisis management due to the absence of European leaders of last resort.
- Lack of implementation of systemic and liquidity risk.
- Difficult implementation of operational risk.

This critics cited above and more others one again showed the need of a more detailed and specific structure. Even with the several revisions on certain subdivisions, the situation on the financial markets in 2008-2009 needed a better treatment. The financial crisis of 2008, also seen as the worst financial crisis since the depression of the 1930's, included the collapse of many big financial institutions prompt by the "housing bubble" that caused problems in liquidity and valuation of the United States banking system. The several U.S. problems had repercussions overseas causing damages in global institutions. Let's have an insight of the passage to the third accord through the following part of this article.

#### • The Basel III improvements.

The rough crises that stroke the international financial markets need rough ameliorations of the market's regulatory supervision. In fact the several market leaks observed over time, that have been repeated or not, always keep directing the supervision authorities to define more strict and explicit international frameworks regarding the financial harmony of the markets. The Basel III accord was builds from the regulatory framework of Basel II and the improvements made during the 2.5 version of this one. Basel II was released in 2004, was well-known for the improvements made on the measurement of credit risk, and this accord was due to be implemented by the end of 2006. Basel 2.5 was releases in 2009, was conceived to improve the measurements of the securitization risks and the trading book exposures, and it was due to be implemented by the end of 2011. But in December 2010, the Basel Committee on Banking Supervision met again to settle up the third accord - Basel III accord - which introduced a liquidity framework and had for principal aim to indulge higher level: s that are planned to 2022. You can take



**Figure 4 Basel III important dates. ( Bank for International Settlements)**



The objectives of the Basel III accord follow:

- Improvement of the risk management and governance.
- Improvement of the bank's capacity to comprehend financial and economic shocks.
- Improvement of disclosure and banks transparency.

These objectives are to be implied on macro and micro prudential regulations to ensure the integrality of the system. The Basel Committee on Banking Supervision has established an agreement regarding the following principal measures aiming the strengthening of the regulation of the banking system:

- "Raise the quality, consistency and transparency of the Tier 1 capital base. The predominant form of Tier 1 capital must be common shares and retained earnings. Appropriate principles will be developed for non-joint stock companies to ensure they hold comparable levels of high quality Tier 1 capital. Moreover, deductions and prudential filters will be harmonized internationally and generally applied at the level of common equity or its equivalent in the case of non-joint stock companies. Finally, all components of the capital base will be fully disclosed.
- Introduce a leverage ratio as a supplementary measure to the Basel II risk-based framework with a view to migrating to a Pillar 1 treatment based on appropriate review and calibration. To ensure comparability, the details of the leverage ratio will be harmonized internationally, fully adjusting for differences in accounting.
- Introduce a minimum global standard for funding liquidity that includes a stressed liquidity coverage ratio requirement, underpinned by a longer-term structural liquidity ratio.
- Introduce a framework for countercyclical capital buffers above the minimum requirement. The framework will include capital conservation measures such as constraints on capital distributions. The Basel Committee will review an appropriate set of indicators, such as earnings and credit-based variables, as a way to condition the build up and release of capital buffers. In addition, the Committee will promote more forward-looking provisions based on expected losses.
- Issue recommendations to reduce the systemic risk associated with the resolution of cross-border banks".

As we can clearly spot, the accord tends to be more specific and comprehensive (For example you can see in appendix A a comparison between Basel II and Basel III regarding the capital ratios). The Basel Committee on Banking Supervision will also evaluate a capital surcharge needed to lighten the systemic bank's risk. To ensure a better understanding and implementation, some suitable standards will be developed as the government booster will be supervised. The chairman of the Basel Committee on Banking Supervision, Mr. Wellink affirms that "these measures will result over time in higher capital and liquidity requirements and less leverage in the banking system, less procyclicality, greater banking sector resilience to stress and strong incentives to ensure that compensation practices are properly aligned with long-term performance and prudent risk-taking". We can resume by saying that the accord was based on three key components; first on the capital reform, second the liquidity standards and the third component concerns systemic risk and interconnectedness (For a better understanding and details you can find in appendix B the Basel III reform). Because of the primordial importance affiliated to Basel III and the positive hopes for a better international financial harmony that follow, in September 2011 the Basel Committee on Banking Supervision initiated a reviewing process of the Basel III implementation. Reports on the implementation process will be delivered on a regular basis in order to fully supervise and support this process successfully. The improvements declared by Basel III, clearly reinforce the supervisory system of the banking sector, proving once again the weight of the institutions role in economics.

## Conclusion

In this article you have been able to undertake an historic tour of the Basel banking supervision history on the international basis. As a matter of fact, we have seen the importance of a regulatory framework upon the financial markets and the banking sector. When did this framework urge to be indispensable? As like the first time economists were convinced that the market needed to be supervised and regulated, when a financial market crisis showed up, the need of regulations in the sector concerned also showed up. Consequently, the collapse of several internationally connected banks in 1974, causing an international financial crisis through a simple "domino effect" urged the conception of an international regulatory and supervisory framework, so called Basel agreement. From the first agreement to the third one existing nowadays, you have been able to closely observe their objectives and matters.

Nevertheless, they failed one by one. Certainly they failed, but during the periods of success they assured financial harmony over the international markets and banking system. Every time a failure of the regulatory system was observed, a leak actually existed in its framework. Therefore every upgrade secured the leaks and tent to assure improvements and a better understanding of the evolving market theory, structure and means.

I can clearly state that the existence of a supervisory system seems to be not only very important but, indispensable. The Basel III accord stands up to be pretty meticulous and clear. The most important issue for this transitional step is the correct implementation of the accord meeting the timetable perfectly. Some other questions to be studied might be: - What's the implementation cost of the agreement? - Should the emerging countries follow this model? – Are they concerned? – Are they ready? - Etc. The objective to follow in the first place is the perpetual research for any possible leak of the system and the continuous upgrade of the system referring to the constant evolution of the financial market itself.

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## ANALYSIS ALAN –REYNOLDS, THE FISCAL-MONETARY POLICY MIX

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#### **Abstract:**

*There are two kinds of policies that can be used in a macroeconomic view, the monetary policy that is implemented by the Central Bank and Fiscal Policy that is implemented by the Government. One of the most important debates of all times in macroeconomics is about the effectiveness of monetary and fiscal policy. Which is more effective the fiscal or the monetary policy? One of the economists who is a supporter of Monetary Policy is Alan Reynolds. He is a supply-side economist. In his paper (Reynolds, 2001) he tries to explain the significance of the Central Bank policies and criticizes the so called fiscalists. He begins with a short overview of the macroeconomics opinion during the postwar era. At that time monetary policy was not seen as an important tool that could be used to solve the macroeconomic problems of countries. The main function of this institution was to keep the interest rates low enough to enable the government to borrow money. The inflation could be fought only with fiscal policy, with surtaxes and the control of wages and prices. One interesting thing is the difference between Tobin and Mundell ideas. The higher tax rates and fast money growth during the 70s produced stagflation. This increased the attention in monetary policy. Tobin developed a theory, called the “funnel theory”. This theory has the name “funnel theory” because according to Tobin the use of monetary or fiscal stimulus would cause a faster growth of nominal GDP. If the economy is below the full employment the faster growth of nominal GDP will cause faster growth of real GDP. If the economy is above the full employment, the workers will demand higher wages and this will be a pressure for increasing inflation. This will require the control of wages and prices.*

**Key words:** macroeconomic, interest rates, tax rates.

**JEL Classification:** E0.

## Chapter 1

The Keynesianists approach to increase the level of national income was to stimulate demand. The Keynesianists approach for the inflation was to curb the demand. These two things are incompatible with each other. Thus Robert Mundell proposed that the inflation targeting should be assigned to the Monetary Policy. The fiscal policy should be used in a microeconomic view of supply side.

The debate between Mundell and Tobin was present during the Clinton administration. Tobin's funnel theory says that monetary and fiscal policies are interchangeable. Thus if we have a fiscal restraint and a monetary stimulus we should have no real impact on real GDP growth. Because the inflation was caused by the high growth, there would be no impact on inflation. Before, a fiscal stimulus meant budget deficit. The Government sells more bonds to the public. People would have more money in their hands and will increase their spending. Fiscal surpluses were considered the inversion of this policy.

Monetary stimulus is defined as the extent of the purchases of Treasury Bonds by the Central Bank. This expands the monetary supply. On the other hand a monetary stimulus could be defined as the Fed efforts to keep the interest rates low.

As Alan Reynolds says, the monetary and fiscal stimuli are not interchangeable. The budget deficit cannot be financed by issuing new money. If we use "easy money" this will cause inflation regardless we have a deficit, a surplus or a balanced deficit. If we have a restrictive monetary policy this will cause deflation. One important conclusion of Alan Reynolds is that "Inflation and deflation are monetary phenomena, not fiscal or real".

One of the fiscalist that thinks that monetary policy is ineffective is Tom Sargent. He tries to explain the old idea that monetary and fiscal theory is interchangeable.

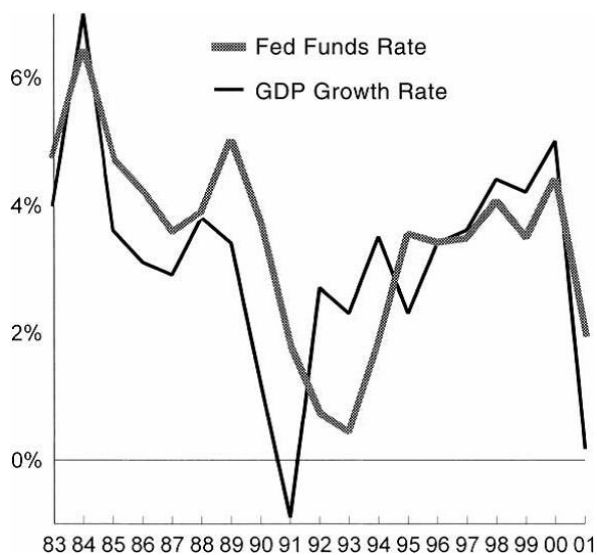
A new theory called the theory of "twin deficits" emerged in the early 90s. This theory says that the countries with large budget deficits must have large trade deficits and that the countries with large budget surpluses must have large trade surpluses. This is again a fiscal theory that tries to explain everything about the economy with the budget deficits.

Clintonomics is called the economic policy during the presidency of Bill Clinton. The main idea behind this policy was that the budget surplus caused a high economic growth. Thus, according to them, the budget surplus was a stimulus for the economy. Budget surpluses increased national savings as a share of GDP and therefore pushed the real interest rates down. The reduction of real interest rates increased the investments.

But the fact gives different conclusions. The interest rates rose when the national savings rate was highest and fell when the saving rates were the lowest. In addition the reduction in budget deficit was offset by a reduction in private savings.

The national saving can rise because of increasing investments that stimulates the corporate income.

Sargent (1988), one of the supporter of the idea that the monetary and fiscal policy are interchangeable stated that monetary policy is impotent to influence the real interest rate. On the other hand, some other fiscalists go on with the idea that the budget surpluses reduce real interest rates. But Reynolds (2001) used the data of real fund rate and real GDP over the years. He sees that the Central Bank "raises or lowers the real funds rate only in response to what has been happening to real GDP growth over the past year or so". This change has nothing to do with the budget deficit or budget surplus. This is shown in this figure (Reynolds, 2001):



**Figure 1**

The declarations of the Central Bank are often about the level of unemployment, stock prices, the gap between potential and real GDP and things related to the fiscal policy. But many of these topics are not part of the Central Bank's objectives.

Reynolds is against the classical Phillips curve. Based on actual data the results are reversed. The move of inflation is in reverse of that is shown in the Phillips curve. Greenspan, the former Chairman of the Federal Reserve, bases his ideas on the logic of this curve. In his analysis he uses the productivity increase. An increasing productivity can be inflationary and a decreasing productivity can also be inflationary. The conclusion of Greenspan is that is needed a lower rate of economic growth but that doesn't aggravate the productivity growth. But, as Reynolds says (Reynolds, 2001, p. 274), the slowing in real output growth would slow the real productivity growth. Fed should not put limits to the productivity growth.

The conclusion is that the price stability should be assigned to the monetary policy and the fiscal policy should be focused in a microeconomic view of the economy.

### **Analysis of "Fiscal-Monetary Policy Mix"**

Alan Reynolds tries to explain and to defend his ideas based on the real data. He doesn't use any mathematical model as others do. All his conclusions are derived from the time series of inflation, real GDP growth, FED real fund rate, GDP gap etc.

The fiscalists use a mathematical model and their conclusions are derived from these models rather than the actual data. But, according to the actual data the conclusions are different from those of fiscalists.

We will begin with the model under which the fiscalists build their ideas and then we will try to give a reason why this model has problems.

Along the paper we saw that the approach of Clintonomics was that the surpluses increased the national savings which on the other way decreased the real interest rate.

We know that:

$$Y = C + I + G + NX$$

Or  $Y = C + I + G$  if we assume that  $NX=0$ .

Then we have:

$$Y - C - G = I \text{ (from the above identity)}$$

Thus we have that National Savings equal Investment.

If we add and subtract taxes  $T$  in the left hand side we have:

$$(Y-T-C)+(T-G)=I$$

Thus, the national savings have two parts:

$$\text{Private Saving}=Y-T-C$$

And

$$\text{Public Saving}=T-G$$

Equilibrium occurs when national savings equal national investments.

### Figure 2

If we have a budget surplus we will have an increase in the public saving and thus an increase in the national saving. The curve of national saving will move to the right. The interest rate will decrease and the investment will increase (Figure 3). This will happen if we use the above relation.

Based on this system of identities, the fiscalists explained the economic boom during the presidency of Clinton and the importance of Fiscal Policy in the economy, especially its effect in the real rate of interest. But Reynolds, using the real data, saw that the budget surplus had no impact in the national savings rate. He explained this with the logic that the federal deficit was fully offset by a reduction in private savings and vice versa (Reynolds, 2001, p. 268).

### Figure 3

We can explain the data using the Ricardian view of budget deficits.

As we know, there are two approaches for the effect of a budget deficit, the standard model and the Ricardian Model.

The standard model approach says that “desired private saving rises by less than the tax cut, so that desired national saving declines. It follows for a closed economy that the expected real interest rate would have to rise to restore equality between desired national saving and investment demand. The higher real interest rate crowds out investment, which shows up in the long run as a smaller stock of productive capital.” (Barro, 1989).

In the Ricardian approach we have that the desired national saving does not change and the real interest rate does not have to rise in a closed economy to maintain balance between desired national saving and investment demand. Hence, there is no effect on investment (Barro, 1989).

Ricardian view is the most successful approach for the effects of budget deficits in the economy.

As Barro(1989) says: “Overall, the empirical results on interest rates support the Ricardian view. Given these findings it is remarkable that most macroeconomists remain confident that budget deficits raise interest rates.”

He reaches this conclusion using the empirical evidences for the US economy. Thus, “Charles Plosser (1982, p. 339) finds for quarterly U.S. data from 1954 to 1978 that unexpected movements in privately-held federal debt do not raise the nominal yield on government securities of various maturities” (Barro, 1989). Also, the evidences in the Alan Reynolds’ paper agree with this view.

The fiscalists are wrong because the people in US act as described in the Ricardian Approach.

Alan Reynolds is a supply side economist. This means that he supports the idea that the Government should intervene only in the microeconomic aspect.

What does it mean to intervene in the microeconomic aspect?

The Government should lower the taxes to stimulate the supply of firms. One other aspect is the intervention in the case of Natural Monopolies. The Government should use subsidies in order to increase the production and lower the price. Fiscal Policy effects on inflation are minimal. Public debt should not be much considered by the Central Bank policy.

## Chapter II

### **Evidence in Albania**

Unlike USA that has a big economy; Albania has a small open economy. We saw that in the case of United States, the approach developed by Reynolds was true.

We can see the data provided from the Albanian Institute of Statistics and the Bank of Albania to derive a conclusion about the effectiveness of Monetary Policy and Fiscal Policy.

Albania has relatively a new Central Bank in the conditions of capitalism (20 years). Before, the central bank had quite different goals from the actual Central Bank.

The ricardian view says that the budget deficit has no real impact in economy. The increase of the budget deficit leads to an increase of the private savings.

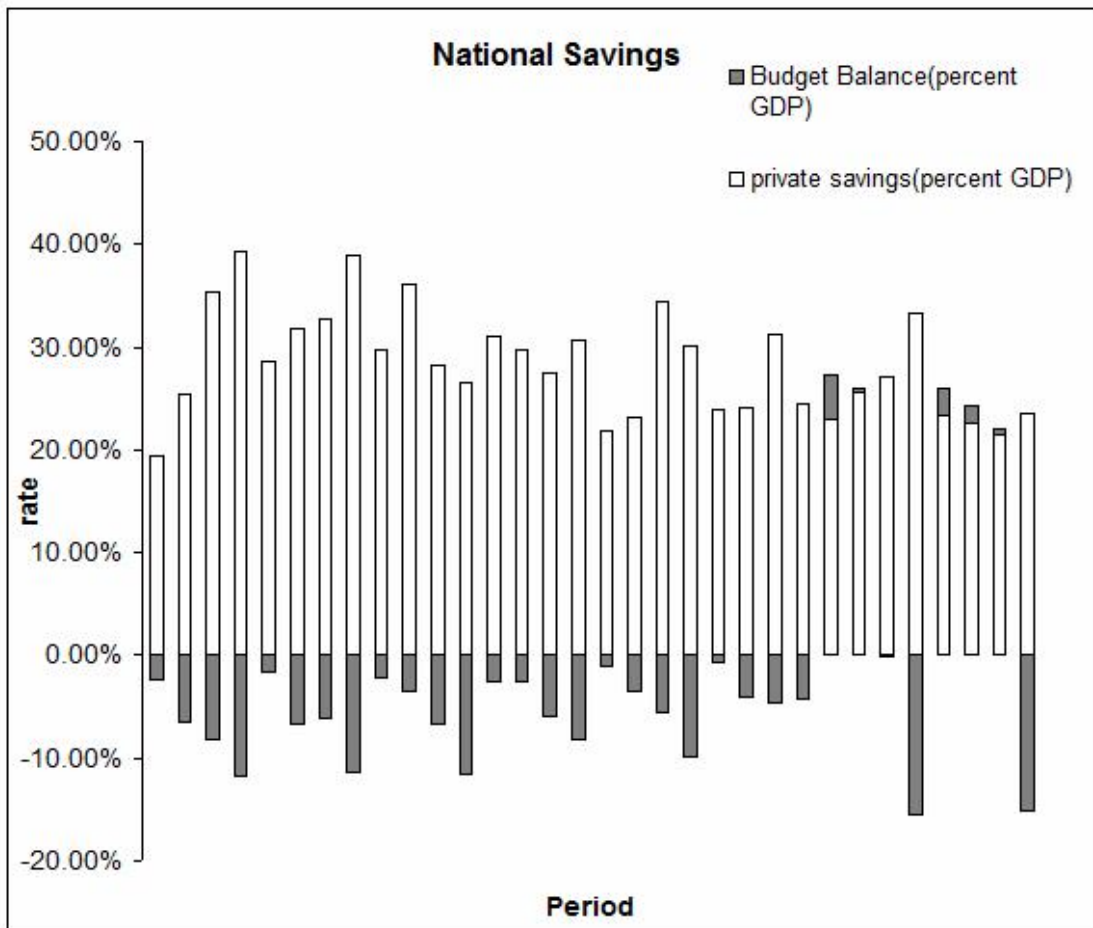
If we use the data of the budget deficits and private savings in Albania from the first quarter 2000 to the last quarter of 2007 we can see the pattern shown in figure 4. The budget deficit and the private savings are shown in percent of nominal GDP.

The logic is evident: The higher the budget deficit, the higher the private savings. The reduction in the budget deficits gives a reduction in the private savings. Thus, the ricardian approach is evident again here. The influence in the interest rate is minimal.

The Central Bank should not base too many its declarations on the budget deficit size. This institution must concentrate itself in the inflation targeting. Inflation, as Reynolds (2001) said is a monetary phenomenon. Government in Albania should adopt a microeconomic view of the economy and stimulate the supply of producers. It hasn't been done a lot on this direction.

An old approach of the fiscalists was that the inflation was caused by "overheating" (Reynolds, 2001). The data in USA showed the inverse. Now let's take a look on the data of Albania.

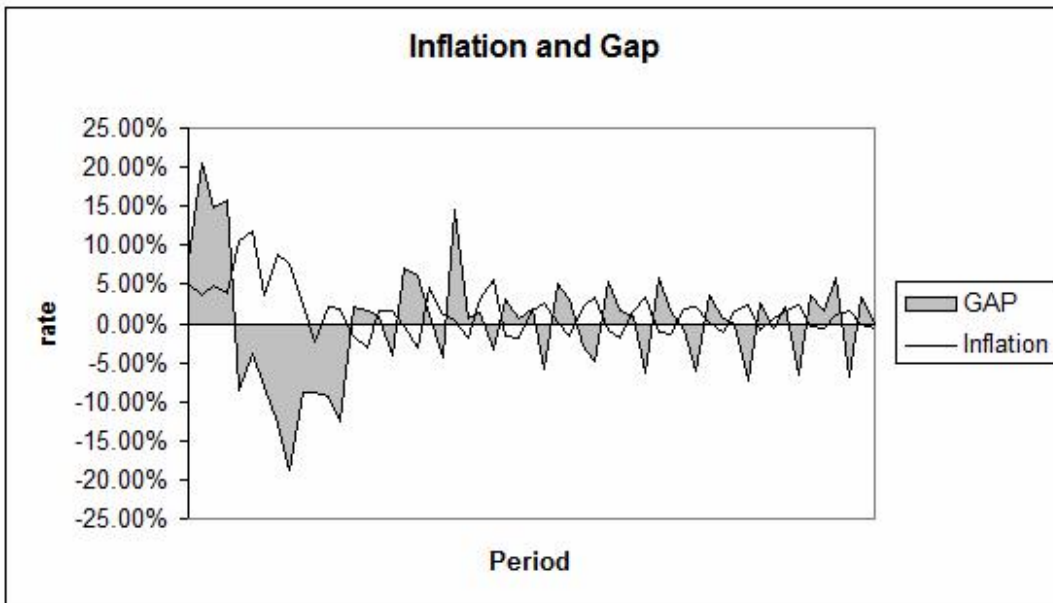




**Figure 4**  
Source: Department of Research, Bank of Albania

We use again quarterly data, from the first quarter of the year 1996 to the before last quarter of 2009. The result of this data is the graphic shown in figure 5. It's evident that the conclusions of Reynolds apply here too. There's a perfect pattern. If the GDP is below the potential product, the inflation will be high and vice versa.

We don't have a positive relationship between "overheating" and inflation. Looking at the graphic we can see that high inflation occurred during expansive monetary policy and that slow GDP growth occurred during government problems periods.



**Figure 5**

Source: Research Department, Bank of Albania (2009)

Thus we have inflation only when we have “overcooling” and not “overheating”.

The periods of “overheating” in Albania were during the year 1996 and the year 2008.

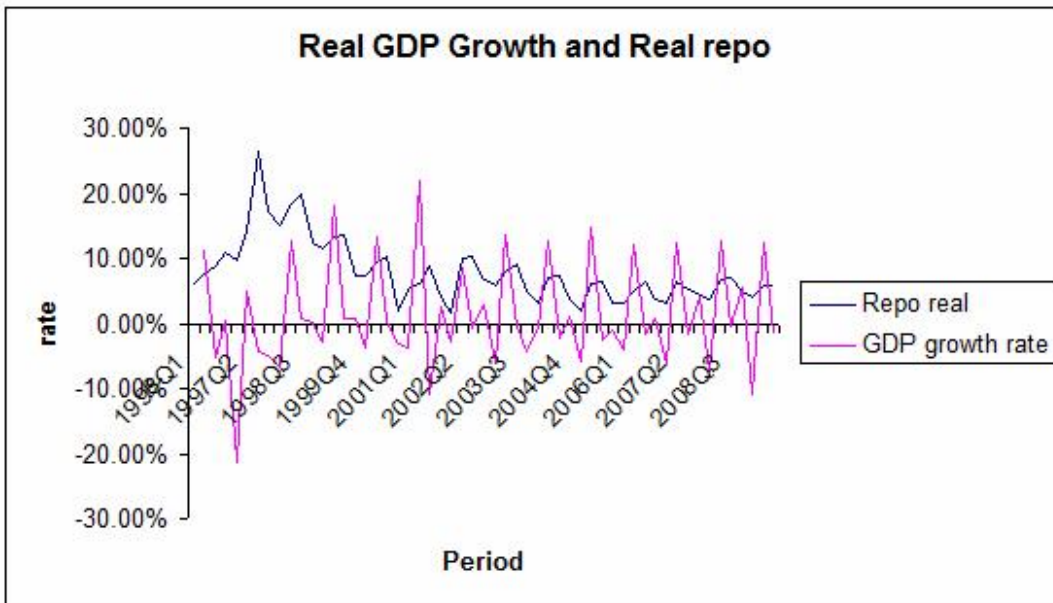
Stagnation occurs because of inefficient government policies and lower productivity. During the years 1997-1998-1999 the inflation was highest because a main part of the budget was financed by the Central Bank and because of lower productivity (Another important point is the productivity that is explained below). Inflation occurs by the monetary supply and the stagnation because of ineffective fiscal policy.

The central Bank has another instrument, the changing of the repo rate. This is an important instrument that affects the real interest rate and the economy growth. Let’s see the historic data of Albania real repo rate and GDP growth from the first quarter of 1996 to the before last quarter of 2009. This is shown in Figure 6. When the repo real rate is higher, the GDP growth rate is higher and when the repo real rate is lower the GDP growth rate is lower. The explanation of this fact is related to the lag impact of the real repo rate on the real GDP growth.

The data used for the graphics are listed in the appendix.

So far we’ve seen that the Keynesianism view of fiscal effectiveness on the economy is not true. Another important point about inflation is the productivity. With a fixed Labor Supply an economic growth can arise only from an increase in productivity. But an increase in productivity cannot be inflationary because this will reduce the costs of production. With the same logic, with a fixed Labor Supply, a decrease in the productivity will increase the costs and will be a pressure for the inflation. “Overheating” is not inflationary.

Thus the inflationary periods in Albania were due to high Money Supply and very low productivity.

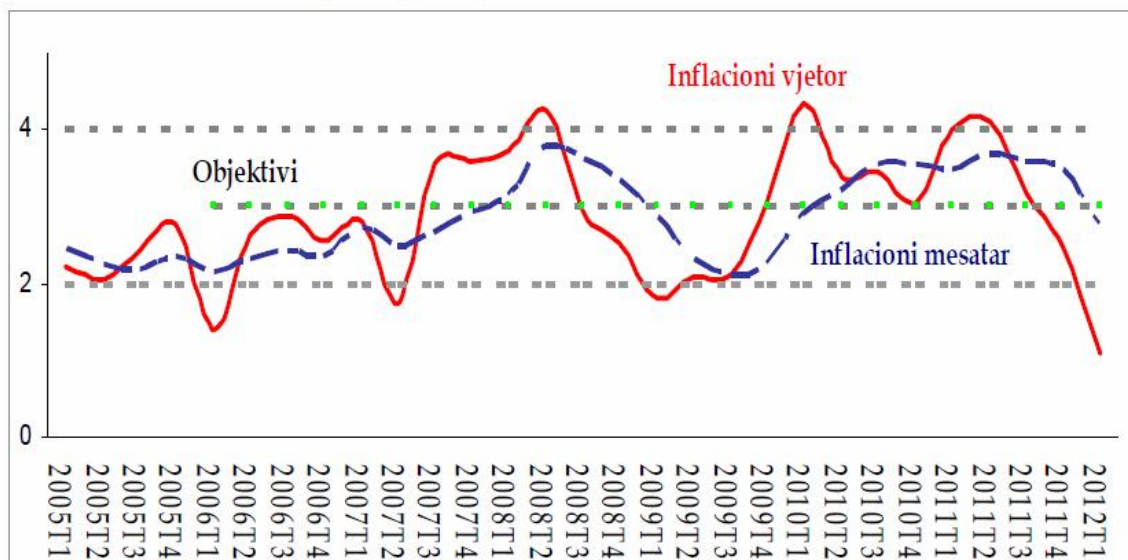


**Figure 6**  
Source: Research Department, Bank of Albania (2009)

Albania in 2012

- Macroeconomics developments :
- 3.1% grow of economy in 2011 and with a grow in unemployment rate in this period has caused that inflation rate has fall in the first quarter of 2012.
- Current economic condition suggests that inflationary pressures from aggregate demand will remain weak all the year.

Earliest development in inflation and the other economic real actor, market and labor cost do not allow danger signal for the existence of stable inflationary pressures in the economy. Also statistical effect of a high comparative base will be present but weakening through the half of the 2012.



Burimi: INSTAT dhe Banka e Shqipërisë.

Figure 7

GDP and Capacity utilization rate

Albanian economy

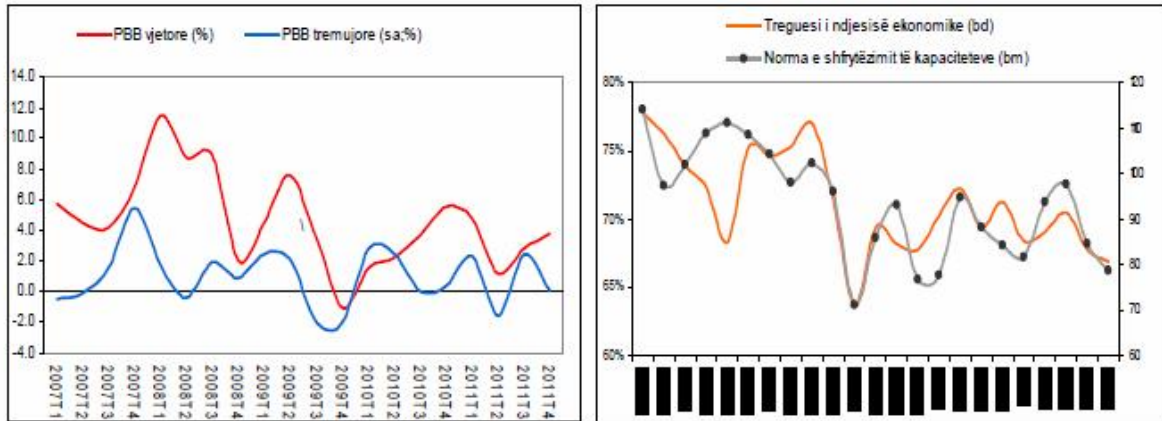


Figure 8

Source INSTAT and Bank of Albania (2012)

GDP(%) in Economy

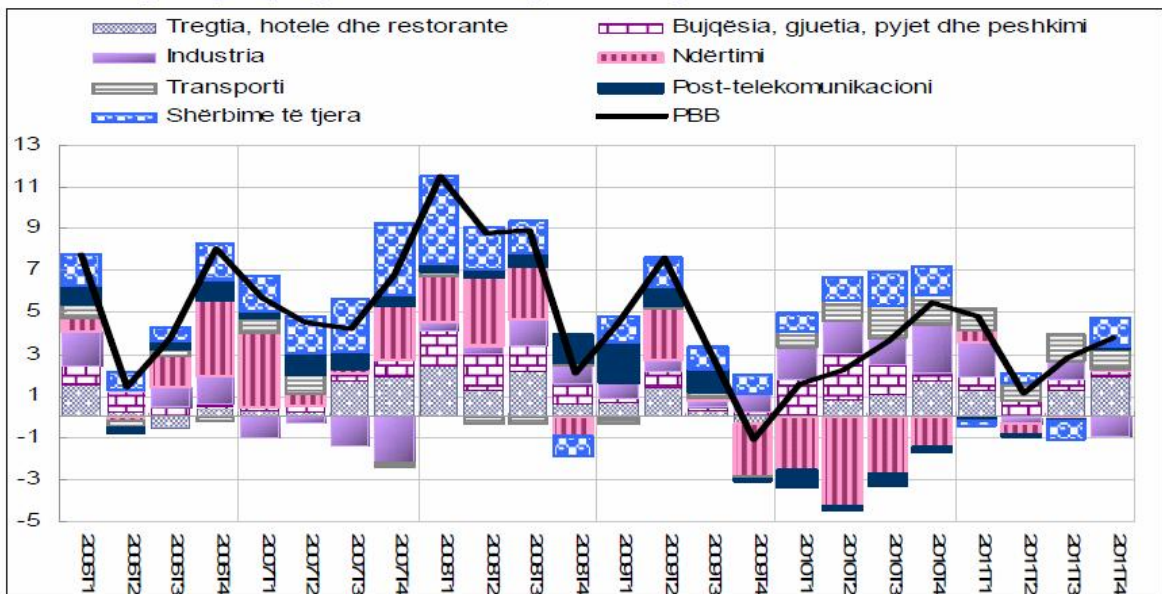


Figure 9

Source :INSTAT and Bank of Albania (2012)

Also in this gap we can see that the gross domestic production has been raise with 3.8% in annual terms in fourth quarter of 2011 by accelerating the pace of growth. In the economy the main part that has contributed most are the service sectors with 4.4 point in %.

The performance activity of agriculture, hunting, forestry and fishing, also as the construction industry has given a positive approach to economic growth with 0.4 point %. But negative approach has given in the economy sector of energy, water and gas with 0.5 point in % of sector of productivity on annual growth of GDP

### Conclusions

Inflation is a monetary phenomenon. It is not related to the fiscal policy and thus should be assigned to the monetary policy. Unemployment, real GDP growth are related to the fiscal policy. The government should stimulate the supply of firms through the tax incentives, subsidies in the case they are needed to stimulate the supply (natural monopolies). The government should not try to influence the inflation because this is not part of its goals.

The size of the budget deficit does not affect the size of the national savings, and thus, does not affect the real interest rate. The Central Bank should not consider very much the budget deficit or surplus impact on the economy.

The inflation and the GDP gap are not related to each other. The main cause of high inflation is related to the money supply. The GDP gap is related to the level of supply, the effectiveness of fiscal policy.

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**SECTION III: CORRUPTION MANAGEMENT AND TRANSPARENCY****CORPORATE BRAND STRATEGY AND MANAGEMENT WITH KEY STAKEHOLDERS OF COMPANIES**

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**Abstract:**

*Corporate reputation is one of the unused resources of many companies. Key people who assess corporate reputation, especially consumers, employees, stakeholders, competitors and others are that have an impact on the business sector. Corporate reputation plays a major role in achieving the objectives of each organization. It is very difficult to build a good reputation in the eyes of consumers and other stakeholders. But also once built a reputation very difficult to change. Each company in its business faces a number of different stakeholders. What is most important to determine is which of all these stakeholders are key to the company and work with them to be well managed. Management is working with stakeholders that never ends, and is aimed at balancing and integration of multiple connections and tasks arising from the interrelationships of the stakeholders. Each company is interested in building a sustainable and profitable relationship with its stakeholders. Good relations with customers and business partners, healthy corporate reputation, satisfied employees and efficient internal process to define the winners in today's global economy. Most of profitable companies have strong long term relationships with their stakeholders. As stakeholders on the Company Profile which can to some extent affect include: employees, its management, strategic partners and internal processes taking place in the Company Profile. On the other hand, are stakeholders on which company does leather affect and include: customers, distributors, suppliers and shareholders. Finally, the behavior of all these influences creating corporate reputation.*

**Key words:** corporation, brand, reputation, stakeholders, strategy.

**JEL Classification:** M15.

**1.1 Importance of corporate branding.**

Many companies have realized the fact that in order to maintain competitive advantage in the market, it is not enough just to have a branded product. Necessary and the company has its own distinctive stamp. It is necessary to build a corporate brand. Namely, when a brand will reach 80% of consumers, he starts experiencing stagnation. Therefore, it is necessary to go further. In fact many companies have based their growth and brand-based products have now decided to build a corporate brand in order to make their actions, values and mission prominent. There is another very important reason why companies are turning to corporate brand, and it is chosen reputation. Companies have become very sensitive about their reputation. Reputation shows that, although the company has many different stakeholder - stakeholders, SKOJ of them responding to a particular aspect of it, in fact they are all concerned company to meet their expectations. Reputation takes the company as a whole.

Since changes reputation affect all stakeholders, Fombrun has detect 6 kinds of factors or pillars that affect corporate reputation:

- Emotional appeal (trust, loyalty and admiration);
- Products and services (quality, innovation);
- Vision and leadership;
- Workplace and quality (good management, superb staff);
- Financial performance;
- Social responsibility.

Many companies can not secure growth and development only of the activities of stakeholders. Is necessary to build a good reputation. In an attempt to define corporate reputation, in the literature there are several definitions of the authors, including the following: Corporate reputation is founded judgment on the basis of corporate identity and image of the organization.

According to another definition of corporate reputation concept refers to the overall assessment that the company has in the eyes of internal and external stakeholders, and is based on its past actions and assumptions about its behavior in the future.

Corporate reputation is one of the unused resources of many companies. Key people who evaluate corporate reputation, especially consumers, employees, stakeholders, competitors and others who have an impact on the business sector. Corporate reputation plays a major role in achieving the objectives of each organization. It is very difficult to build a good reputation in the eyes of consumers and other stakeholders. But also a reputation built very difficult to change.

There are several elements that are essential to creating a good reputation. Among them the most important in many literatures can be found as follows:

- ethical elements - in terms of whether the organization refers to its ethical employees, customers, competitors and other interest groups;
- employees - employees are one of the most important elements in creating a good reputation. If the company has a highly professional staff, who can answer all the challenges caused by the environment, employees who are to perform their tasks and are always willing to give a larger contribution, then it is safe to say that they create a good reputation for company;
- financial performance company - this refers to how company financially powerful, profitable and whether accomplished growth and development in its operations;
- Leadership - companies with a good reputation and are often market leaders, they are the ones who bring innovation;
- Management - the company have to have a clear vision and mission, have highly trained management team who will lead;
- Social Responsibility - the company must recognize its responsibilities to society;
- oriented consumers - all activities undertaken are aimed at satisfying the needs and desires of consumers;
- Quality - the company has a range of high quality products and services.

Sure, we can list many more items that more or less influence in the creation of the company's reputation, but these have the greatest impact.

**1.2 Interdependence of corporate brand strategy and management with key stakeholders of the companies.**

Stakeholders is a person, group, organization or system that affect or are affected by the activities of the company. From this definition follows that stakeholders is anyone who has an interest of company. Also, stakeholders may be directly or indirectly involved in the activities of the company. Each company in its operations faced with many different stakeholders. The following figure presents some of the main stakeholders, which generally affect or are affected by almost every company.

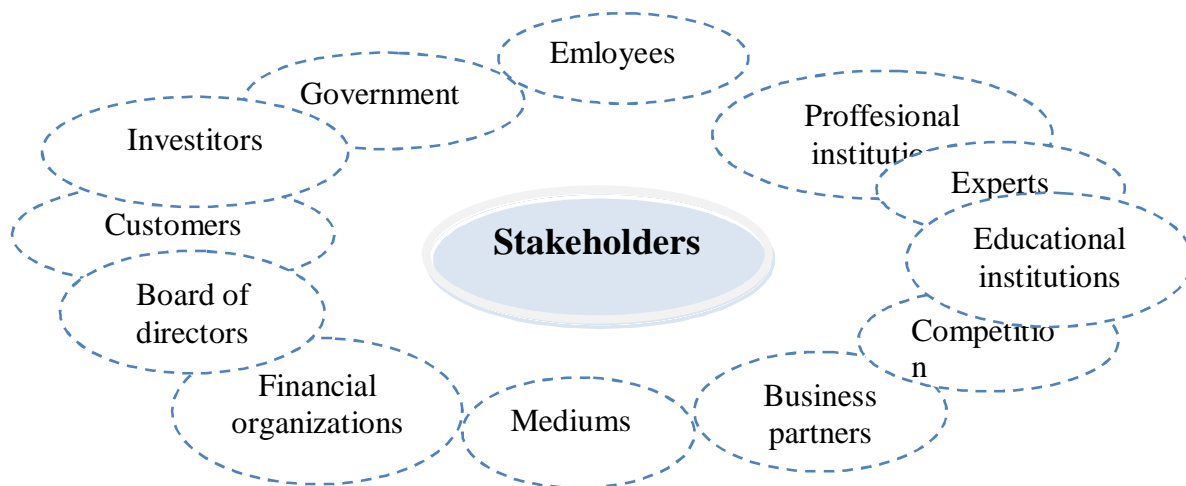


Figure 1: Company Profile of stakeholders

What is most important is to determine which of all stakeholders are key to the company's operation and good relations with them to manage. Management with stakeholders is a job that never ends, and is aimed at balancing and integration of multiple connections and tasks arising from the mutual relations of stakeholders. Management with key stakeholders is central to the effectiveness of any company.

The first step in managing stakeholders is determining what they actually want, and to know what their needs and expectations of the company. Once you define good expectations of stakeholders, the Foundation will undertake activities to meet those expectations. In this step should be especially careful, because there are different stakeholders who have different requirements. Therefore, it is necessary to make that balance, so that the specific activity to meet all the different demands of stakeholders. Company should not afford with an activity to cause a stakeholders satisfaction and dissatisfaction with another. On this particular care in the design of strategies for the company. Sure, sometimes you have to make a priority among stakeholders. It is therefore necessary, their separation and determination are key stakeholders. Key stakeholders always have priority. Any company interested in building a sustainable and profitable relationship with its stakeholders.

Good relationships with customers and business partners, healthy corporate reputation, satisfied employees and efficient internal process to define the winners in today's global economy. Most of profitable company have strong long-term relationships with their stakeholders.

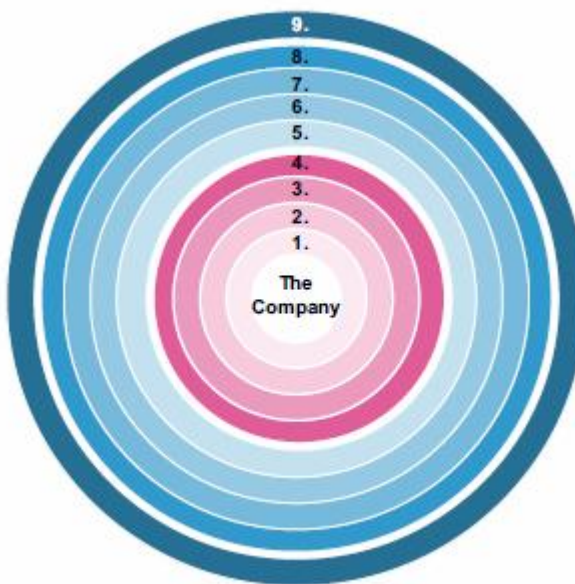
The previous picture presented common stakeholders that arise in the operation of almost any company. The next image will be represented stakeholders, but grouped into two groups: internal stakeholders (those over which the company has influence and can control to some extent) and external stakeholders (those on which Company Profile can not be affected and will almost no control).

**Interior:**

- 1. Management
- 2. Employees
- 3. Strategic partners
- 4. Internal processes

**External:**

- 5. Consumers
- 6. Distributors
- 7. Suppliers
- 8. Shareholders
- 9. Corporate Reputation



**Figure 2.** Separation of key stakeholders both internal and external

As stakeholders on which Company Profile may to some extent be affected are: employees, its management, strategic partners and internal processes taking place in the Company Profile. On the other hand, there are stakeholders on which the company does care provider so affecting, and these include: customers, distributors, suppliers and shareholders. In the end, the behavior of all these influences creating corporate reputation.

**1.3 Strategic implications of branding.**

Branding is not just giving the name of the brand and the market signaling that such a product exists and is launched by the organization. When we talk about branding is necessary to make long-term involvement of corporate relations and to invest vast resources and skills. The brand is a direct consequence of the strategy of market segmentation and product differentiation. This means that the brand is created for a specific market segment exactly know what consumers buy brand. Differentiation in turn, means that the brand with its own characteristics different from other products that fall into this category.

Companies are oriented towards meeting the expectations of specific customers through a combination of different attributes of the product that are important to consumers. When talking about the brand you need to know what benefits it offers, which benefits are realized from it. Branding is not to be top of something, but to be top in something. Some brands with their slogans fail to define the functional characteristics of the product.

Brand-management has a long history, but the rapid changes occurring in the business environment, global competition and ever more specific demands of consumers who are now more informed than ever, gave greater importance. Now the corporation through brand management has been able to position and maintain the market easier. In other words, a strong brand of the company will enable it to survive. Global competition is very intense. At the same time, consumers are more informed and selective in their choice of products and services. They are becoming more and more increasing their demands. Under such conditions each brand gets bigger meaning.



The brand is a platform on which the corporation can stand and win customers. When the corporation has established brand, much easier to launch their new product lines, because it is a well known brand that has been tempered in the minds of consumers. The brand also makes it possible to realize a premium price. In other words the company brand is a powerful tool that enables successful positioning and survival in the market.

In fact, using the brand, the company is different from its competitors. But today goes beyond the brand differentiation. Today is a very complex, dynamic and multidimensional matter when it comes to brand management. In addition, corporate brand management requires strong support from marketing strategies. In other words, managing the corporate brand is not only design the visual identity of a company logo or slogan through. At the end requires three basic elements of a strong corporate brand, such as: a clear vision, strong leadership and consistency. The main goal must be clearly defined and universal for a longer period. At the same time corporate brand is a reflection of the company's vision.

What are the corporate values? Corporate values could define as a source of opportunity the company to offer products and services that meet the needs values market and society.

#### **1.4 Corporate strategy and the design of individual brand strategies.**

When we talk about corporate strategy, what should first make a distinction between brand strategy and corporate strategy. Corporate strategy is primarily focused on the scope of activities of the firm. Corporate strategy refers to markets where the company wants to perform. Corporate strategy concerns the scope of the goods and products which category fall. For example, Golden Oak is in the category of beer products Prilepska gazoza falls into the category of soft fizzy drinks. Furthermore, corporate strategy includes the geographical scope of the company, how and what part it serves the market. Also, the corporate strategy includes vertical connectivity of the activities of the company.

There are two dimensions that relate to corporate strategy, such as: diversification and vertical integration of the organization. Diversification occurs when a company decides to participate in a new industry that had never worked. Vertical integration however, appears when the company decided some activities that had been left to run another company, it can take its responsibility. For example, deciding to produce components that are needed to produce the products, purchased from a supplier. Vertical integration is present in Prilep Brewery. In previous years, brewery, beer yeast required for production of the beer purchased, and today it produces. Also, the brewery has a few own wells for water.

On the other side we have a business strategy that is still known as a competitive strategy. Business strategy includes the part about how the company competes with competition, it refers to activities undertaken by the company in order to achieve a competitive advantage in the marketplace. The goal of any company is to provide leadership in the market. This position can be achieved only if a step ahead of the competition with its offer.

The difference between corporate strategy and business strategy we can see the following: corporate strategy refers to where company compete, and business strategy refers to how company compete. But of course, there must be a connection between these two strategies. They should complement each other and be directed towards achieving the goals of the organization, its mission and vision

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## MANAGEMENT OF BANKING OPERATIONS TO AVOID CRISES

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### **Abstract:**

*Purpose of this paper is the management of banking activities in order to avoid imbalances. The main purpose is the display method of operation that applies to countries with lower financial market. Method of operation is a theoretical approach and understanding of the management structure in banking institutions, and the outcome is to show that working in banks must be followed by consistent monitoring of the regulations and has exactly coordinated and strict control. The paper has consistent form. The significance of this paper is great for countries where financial markets are less developed. Meaning is important because in these economies shocks to the global financial markets have affected to them but they are small countries and they have small opportunities to avoid the imbalances.*

**Keywords:** bank regulation, financial regulation, monitoring, risk management.

**JEL Classification:** G21, G22, M10.

### **1. LEGAL FRAME OF THE FINANCIAL REGULATION IN THE BANK SECTOR**

The legal frame of the regulation in the bank sector is usually based on laws, statutes, acts and other, which strictly determine the work of these institutions and their authorities. The control of the banks in different countries is delegated differently, therefore somewhere is on central level and somewhere is divided by regions.

Restrictive policy is performing by the aspect of opening new banks, issuing working permits, affiliations etc. By deciding to give or not control, the monitors in the USA start by two criteria pointed from *Ph.D. Ljupcho Trpeski (2003): quality and need (p.375)*. The control is performed through federal agencies: Monitor of the monetary system, Central Bank of the USA and Federal insurance corporation. In frames of the European Union, financial regulation through the European central bank is performed through the Executive board and the General council. Above them is the Management council, but the Executive board has the part of regulator of the financial system, and the General council collects data and statistic information, prepares standardizing rules and lays down employment conditions of the personnel of the ECB. In Germany, the control is executed in two lines from *Ph.D Ljupcho Trpeski (2003): line of the state and Central bank (p. 406)*. The control in this country is very firm and pointed through the statute of the banks, overstepping the authorities, proper applying of the credits, change of capital, division of the effectuated income, how are executed the bank's obligations to the state, the work of the Management board, the work of the bank's management and other. In this country the banks are obliged to report the intention with their capital to found some bank, for the intention of any change of the bank's statute and the change of the amount of their own capital. In Great Britain, the control is also performed by the Central Bank, and the supervision is appointed to the Financial Supervisory Authority. France, a country member of the EU, has especially and mostly contained the control of their bank system in responsibility of the Central Bank of France. Switzerland is a country with special position, especially from her tempting part in banking through the history. *Ph.D Ljupcho Trpeski (2003) also point that the banking system in Switzerland is contained by the next types of banks (415):*

- Big banks
- Cantonal banks
- Regional and savings banks
- Credit associations
- Commercial banks
- Banks for securities
- Small credit banks
- Affiliates of foreign banks (around 16 affiliates of foreign banks and 134 foreign banks)

For this country, it's specific that the central bank acts as private joint stock company, but still under control of the State. In Canada, it's noticed a bigger independence of the central bank in relation of the rest of the independent central banks. Therefore, for example, the costs of the bank are not controlled by the Minister of finance, but the Management board of the bank. The management board of the bank is the highest management body of the Central Bank in Canada.

In the developing countries, the regulation is not neglected, it's present, but there are also countries in this segment that felt down into financial crises especially because of a bad regulation of the bank sector. Such example is Argentina and the South American countries that have faced this kind of crisis spiral.

## 2. DEPOSIT INSURANCE

The confidence in the banking system and its functioning is maybe the most significant moment. All the system of functioning of the financial system, which is mostly based on banks, especially on the commercial banks, is up to a certain degree, effectuated as a result of a risky trust.

Deponents put their resources on the usage of the banks and thus they take interests. Banks use these resources mostly to give credits, on which the banks take interests. Therefore, the base of the banking activity is posed on deposited resources.

Bank panics appear in the moment when the deponents suddenly and at once return their deposits and thus leaving the bank without resources to make turnover.

Bank panic is a process that usually takes a spiral blow, *Mishkin (2004) "so in the 1920 were registered an average of 600 bank failure per year" (p.261).*

*Mishkin (2004) "The insurance of deposits is one of the measures that significantly decrease the risk of bank panic.*

*In the USA 1934, i.e. after the introduction of a corporation for federal deposit insurance, until 1981, average annual bank failure is 15%" (p.261), which is also previously recorded.*

Deposit insurance is important because it is also closely connected with the government security network.

Often, the government and state resources are the ones that invest on the financial market when something is not functioning properly. This kind of investment is necessary because the bank crises bring with them recession appearances in the economy and the failure of the big banks and the smaller ones also brings many institutions and participants on the market.

That's why in economy is often used the term "too big to fail".

That's the reason why the regulation of the bank sector is very important, not to permit creating a market on which some are very big, have big participation on the market, going so, being enough undifferentiated, but still powerful enough to play with the risk.

Maintaining the trust in the bank system is mostly achievable trough the organizations that insure the deposits. On the other hand, this leads to another problem.

It is a problem till where and how much to protect the depositors, so that protection doesn't cause moral hazard on one side and wrong selection on the other.

Moral hazard because the banks are aware that their depositors are protected, independently from the bank activity, they can go into insufficiently justified transactions and activities which endanger the deposit resources.

The wrong selection can appear on the side of a bad chose of institution to invest the resources because the certainty of protection, but a wrong selection as well, in the sense of insufficient commitment of the presented and not presented data.

## 3. CREDIT INSURANCE

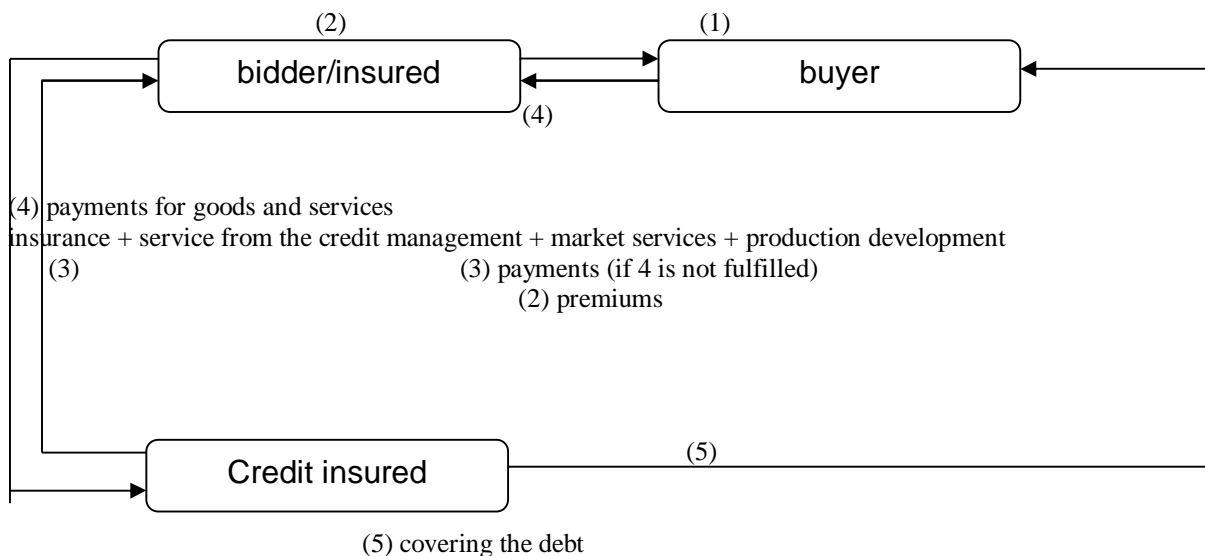
Biggest part of the commercial transactions is based on credits. From this reason, incorrect working with them can lead to serious problems in the economic development. The effective credit management becomes sensitive and important tool for success in the financial working. To avoid the possible inconsistencies of the credit management, there is a possibility for credit insurance. The credit insurance for the sector of small business provides guaranties for return of nonpaid bills, in an interval of 70-90% from the acceptable insured and insurances.

The credit insurance provides the companies by covering from no chargeability and risk from insolvent of the credit applicants. This policy usually excludes:

- trading between companies that belong to the same group with close connection,
- trading with government sectors or agencies and
- credit insurance for individuals (physical entities)

Credit insurance as a process is performed as following:

- (1) goods/services + commercial credits



**Figure1:** Function of the credit insurance

Amparo San Jose Riesta, “Credit Insurance in Europe – Impact, Measurement and Policy Recommendations”, Centre for European Policy Studies, (p. 1) shows that the credit insurance is quite different between the countries, thus there are also differences in this segment and in the frames of the EU member states:

- the development of the credit insurance in the European union differs from the developed and markets and markets in development. In Holland, Germany, France and Spain this process is newer and less significant. The average rate of premiums is 0.03 % of the GDP (in the European Union). The rate of premiums is highest in Spain where is 0,06% of the GDP, whilst lowest is in Greece 0,006%.
- around 14% of the European GDP and 20 % of the export are insured with significant differences between countries (within EU) – 21% of the GDP is covered in Holland, and in Greece only 1,7%, whilst generally the coverage of the export is bigger.
- compared with the 15% of all big enterprises, only 8% of the small enterprises use credit insurance in Europe. Spain and Belgium are the countries where dominates use of credit insurance by the small and middle enterprises
- France, Austria and Germany have the biggest percent of big insured enterprises, whilst in Greece has the smallest percent, almost 10 % of the big companies are insured with credit.

The insurance of deposits and credit insurance are the segment that permits effective work of the risk management.

**4. MANAGEMENT WITH THE RISKS IN THE BANKS**

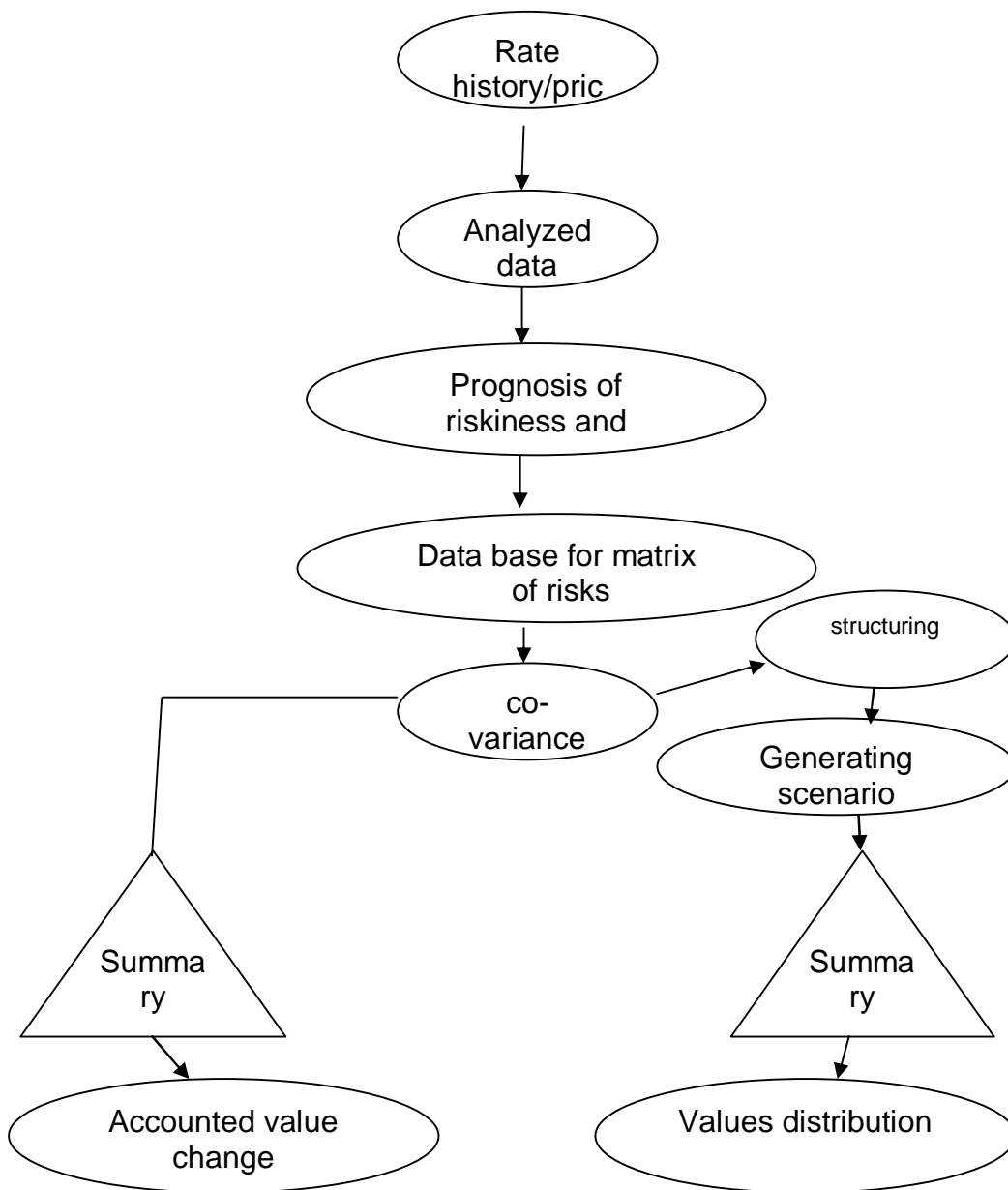
The management with the risks is a process which directs the activities to reduce the risk from the overtaken activities in frames which are acceptable and justified.

Strict regulation that interdicts the banks to keep risk resources, such as risky stocks, imposing avoiding the big risks.

The risk management is also achieved by prescription of norms and rules about the volume of the capital part that banks have to keep and not to invest, nor borrow. In addition, the rate of leverage which is determined by intervals of legal realization appears as a significant element.

In this part the history noticed a regulatory arbitrage. However, every regulatory tolerance does not show as a justified moment.

The management with risks in the banks is realized through procedures which include dissolving of risks of credit risk, interest rates, monetary risk management, liquidity modality and other modalities of risk management. For better determination of the whole process of risk management are also formed dissolving of the working procedures and steps by use of matrixes. Here is an example:



**Figure 2:** Matrix for risk management

All this process should give directions and control of effective working of the bank institutions, so that they can act with prevention if necessary, and not to have the consequences widely spread.

**5. BANK SUPERVISION AS A FACTOR FOR CRISES PREVENTION**

The bank supervision can be freely considered as maybe one of the most important factors for crises prevention.

The bank supervision should build expectations and to demand their fulfillment, which will comprise implementation of organizational structure which includes adequate accounts and balances. The solvency and transparency are the primary conditions posed by the regulatory frames of the supervision. Supervision should monitor the board of directors and the middle management on a level of the banks. In the previously numbered are also included the individual participants and for everybody is necessary to have controlling of the achievement of their obligations and responsibilities.

The banking board of directors as well as the rest of the participants of the financial market is ultimately responsible for the performances of the bank. Typically with the supervision is checked if the bank/banks are conducting and taking care of any problem which is detected through the supervisory reports. When the bank is taking an immeasurable or uncontrollable risk, the supervision is the one that looks for corrective measures from the board of directors in an adequate time, i.e. on time. The supervisors should be open for all warning signals that are appearing in the banking work. They have to insure a direction for the banks in frames of modern trade occurrences and proactive practices. The constituents of supervision include the banks, but also all the participants in the banking process, including the depositors, which interests are not always recognizable.

Almost everywhere, the supervision is centrally appointed to the central banks.

In Macedonia, the supervision is evaluating the security, stability, riskiness and accordance of the bank work with the regulation, with a special accent on the quantification and following the exposure of the banks to different types of risk, such as credit, liquidity, operational, currency and other risks.

The supervisory function is effectuated through permanent off-site following of the banks' work by gathering and analyzing reports and data which are delivered to the central bank and close complete, as well as partial control which is performed in the banks.

The primary five postulates on which upon is based the supervisory activity in Macedonia are:

- Capital adequacy
- Assets quality
- Management
- Gain (profitability)
- Liquidity

Indicators of the financial stability of the banking sector in Macedonia are divided according to the five postulates:

#### **Capital adequacy**

1. capital adequacy
2. basic capital / asset weighted according to the risks

#### **Asset quality**

3. nonfunctional credits / entire credits
4. nonfunctional credits / personal resources
- 5A. total residents credits / total credits
- 5B. total nonresidents credits / total credits

#### **Profitability**

6. ROAA – financial result / average asset
7. ROE – financial result / average personal resources
8. net interest incomes / gross incomes
9. non-interest bearing expenses / gross incomes

#### **Liquidity risk**

10. liquidity asset / total asset
- 10A. high liquidity asset / total asset
11. liquidity asset / short term obligations
- 11A. high liquidity asset / short term obligations

#### **Market risk**

12. net GDP / personal resources

In global frames, there is more and more action on unification of indicators and standards which will be the base to execute the supervisory process. Therefore it is formed the Basel Committee. This committee for bank supervision is a forum for regulating the cooperation of bank supervisory frames. Its purpose is to solidify and develop more the quality of the supervision internationally, through exchange of accesses and techniques in order promote the "common understanding (approach)".

This committee is known by its international standards for adequacy of the capital; Key principles for effective bank supervision; and Concordat for international bank supervision.

The Basel Committee is formed of representatives of numerous national banks and members of the financial institutions where the supervision is not appointed to the central banks.

The committee organizes the main work through:

- The Accord Implementation Group (group for implementation of the Basel II frame)
- The Policy Development Group (for identification and revision of the supervision in the developing countries)
- The Accounting Task Force (for international accounting standards)
- The International Liaison Group (for alteration of former central principles of the Liason group)

The whole system of supervision is a significant prevention not only from the bank crises, but also from the financial crises.

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## SECTION IV: CORRUPTION MANAGEMENT AND TRANSPARENCY

## CORRUPTION AND ITS INFLUENCE ON ECONOMIC GROWTH AND POLITICAL STABILITY: THE CASE OF ALBANIA

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**Abstract:**

*Corruption has been evidenced as a problem in many new democracies and especially in developing countries which are facing a transition phase from a nondemocratic country to a democratic country. This paper aims at providing an analysis of corruption as the main indicator of the political stability in Albania. Corruption as a persistent phenomenon and its relationship to the overall political stability of Albania is discussed through the use of quantitative and qualitative data. Moreover, corruption is also considered by many authors as an influencing factor of economic growth, by so reflecting the political stability of a country. That is why, this paper is focused on examining the relationship between corruption and the economic growth in the lenses of the country's political stability. It follows with offering a general overview of the case of Albania considering this logic. The data shows that considerable levels of corruption affect negatively the economic growth, especially when the political stability of the country is not high enough as in the case of consolidated democracies.*

**Key words:** corruption, political stability, economic growth, transition to democracy.

**JEL Classification:** 043.

**1. Introduction.**

Corruption has been around for a very long time and will be around in the future unless governments can figure out effective ways to combat it<sup>108</sup>. This is how Mauro, a well-known author for his analyzes on corruption evaluates the general world situation about it. Nowadays, corruption is one of the most important issues that governments are dealing with. It is perceived as a phenomenon present not only in developing countries but also in well-developed countries despite the type of the political regime that these countries have. Thus, corruption has caught the attention not only of states, but also of international organizations which are putting pressures on governments for taking the right measures to fight it.

The high emphasis and importance that this issue has had and will continue to have on the good and efficient governance, has led to considerable research not only by political scientists, but also by economists, especially after the 1990's. What was becoming different in the mid-1990s was the international community's willingness to discuss issues of corruption in an open and transparent manner<sup>109</sup>.

Defined as the abuse of public office for private benefit (Johnston, 1998, pg.89), corruption might be caused by different factors and it might result in a variety of consequences.

<sup>108</sup> Mauro, P. (1997), "Why worry about corruption", International Monetary Fund, pg. 1/  
<http://www.imf.org/external/pubs/ft/issues6/issue6.pdf>/Accessed on August 11th, 2012.

<sup>109</sup> Mauro, P. (2007), "World Bank Researchers and the Study of Corruption", Journal of World Affairs, 13(2):.2.



According to Mauro, some of the causes of corruption are: trade restrictions, government subsidies, price controls, low levels in the civil service, natural resource endowments, sociological factors, etc.<sup>110</sup> The same author identifies, besides other specific economic consequences of corruption, the retarding of economic growth<sup>111</sup>.

It is also important to note that the concept of corruption is very wide and includes a variety of different kinds. This paper is focused on examining how public corruption is related to the political stability and economic growth in a specific developing country such as Albania. One of the main relationships studied so far has been that between corruption and economic growth and the former's influence on the political stability of a country.

Albania, as a southeast European country was part of the changes that took place in the 1990's including here the building of a new political regime and economic system. In the framework of the reforms undertaken to implement these changes during the transitory phase, corruption has been a persistent phenomenon and problematic issue that governments are dealing with. Deeply institutionalized corruption and a weak judiciary are key obstacles to improving the public welfare, as corruption reduces revenues and disproportionately hurts the poor<sup>112</sup>.

Recent literature about corruption in Albania is mainly focused on descriptive statistics about the actual situation, analyses of the corruption indices provided by international agencies, as well as reports or other data provided by national agencies and institutions. There is a need for further, deeper research especially on the causality relationship that corruption might have with political or economic indicators.

Focusing on the topic of corruption in Albania, this paper aims at providing an analysis of corruption as one of the main indicators of political stability in Albania by focusing on the corruption-growth relationship. It follows with an overview of the most recent and influential research about this relationship and the main approaches followed. Then, it continues with presenting the actual situation of Albania on corruption, especially the corruption indices and other data published by international agencies and organizations. It then, focuses on the effects of corruption on the economic growth and political stability in Albania and some concluding remarks.

## 2. Literature review.

When studying the relationship between corruption and economic growth, the general accepted view is the one that corruption affects economic growth. However, authors differ in their results about the nature of this relationship, if there is a negative or positive effect of corruption on economic growth. Despite increasing recognition that corruption has substantial adverse effects on economic growth, governments seem to be unable to break that vicious circle<sup>113</sup>.

On one hand, there is a group of authors, who mainly through cross country studies arrive to the conclusion that corruption lowers the economic growth in a country. For example, Del Monte and Papagni deal with the phenomenon of corruption that arises from purchases made by government officials. They maintain that this kind of corruption has a direct negative effect on the long-run opportunities of economic growth because governments can offer fewer inputs to private economic activities<sup>114</sup>. This view is further stressed by Mauro (1995, 1997) who through the first econometric study revealed that corruption lowers the economic growth.

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<sup>110</sup> Mauro, P. (1997), "Why worry about corruption", International Monetary Fund, pg. 4-5 / <http://www.imf.org/external/pubs/ft/issues6/issue6.pdf> Accessed on August 11th, 2012.

<sup>111</sup> *Ibid*, pg.6-7.

<sup>112</sup> BTI 2012, Albania Country Report, pg. 19/

<http://www.btiproject.de/fileadmin/Inhalte/reports/2012/pdf/BTI%202012%20Albania.pdf>

Accessed on September 10<sup>th</sup>, 2012.

<sup>113</sup> Mauro, P. (2004), "The persistence of corruption and slow economic growth", IMF Staff Papers, 51(1), pg. 17.

<sup>114</sup> Del Monte, A. and Papagni, A. "Public Expenditure, Corruption, and Economic Growth: The case of Italy", pg.17.

According to the latter "a one standard deviation improvement in corruption index causes investment to rise by 5 percent of GDP and the annual rate of growth of GDP per capita to rise by 0.5 percentage point"<sup>115</sup>.

Furthermore, Akçay through an empirical analyses of 54 developed and developing countries concludes that corruption has a statistically significant and negative effect on economic growth<sup>116</sup>. However, the impact of corruption on growth is not the same in all countries. Differences arise when the difference between developed and developing countries is taken into consideration. Thus, Kutan, Douglas and Judge in their study focused on MENA and Latin American countries find significant differences in terms of the impact of corruption on economic development in both regions<sup>117</sup>. According to them, while corruption was associated with improved economic development in MENA countries, it had no significant relationship with economic growth in Latin American countries during the sample period<sup>118</sup>. Within this line of research, focusing on the relationship between privatization and corruption, a highly statistically significant and negative association between privatization and corruption in transition economies for three different corruption indices and six different privatization indicators has been found by Koyuncu, Ozturkler and Yilmaz<sup>119</sup>.

On the other hand, there is considerable research which supports the view that corruption might have a positive impact on economic growth. Huntington stresses the role of corruption in the maintenance of the political system and elimination of revolutions<sup>120</sup>, an idea followed by Friedrich who also arrives to the idea that corruption is helpful to the economic growth of the country and consequently affects it positively<sup>121</sup>. Furthermore, Swaleheen and Stansel by using a panel of 60 countries, with their findings arrive to the conclusion that for countries with low economic freedom (where individuals have limited economic choices), corruption reduces economic growth. However, in countries with high economic freedom, corruption is found to increase economic growth<sup>122</sup>.

Choi and Woo empirically show that highly corrupt governments demonstrate even more economic success than less corrupt regimes in developing countries. Successful economic performance tends to mute the effect of corruption on electoral outcome<sup>123</sup>. Thus, in developing countries, corruption is a matter of benefits in the sense that for citizens the economic growth is more important as an issue than corruption, when the former is considerably high. This leads to the idea that in a developing country as Albania a successful economy might put the citizen's attention towards corruption in the second place when participating politically.

What is important is the fact that corruption and growth take place within a political framework. The political system produces the phenomenon of political corruption and on the same time initiates and is responsible for the implementation of economic policies.

<sup>115</sup> Mauro, P. (1995), "Corruption and Growth", *Quarterly Journal of Economics*, 110(3): 704.

<sup>116</sup> Akçay, S. "Corruption and economic growth: A cross-national study", *Ankara Üniversitesi SBF Dergisi*, 57(1).

<sup>117</sup> Kutan, A. Douglas, Th. and Judge, W. "Does corruption hurt economic development?: Evidence from Middle Eastern, North African and Latin American countries".

<sup>118</sup> *Ibid.*, pg.15.

<sup>119</sup> Koyuncu, C. Ozturkler, H and Yilmaz, R. (2010), "Privatization and corruption in transition economies: a panel study", *Journal of Economic Policy Reform*, 13(3): 277.

<sup>120</sup> Huntington, S. (1968), "Political Order in Changing Societies", New Haven: Yale University Press, pg.64.

<sup>121</sup> Friedrich, C.J. (1972), "The Pathology of Politics, Violence, Betrayal, Corruption, Secrecy and Propaganda", New York: Harper and Row.

<sup>122</sup> Swaleheen, M and Stansel, D. (2007), "Economic freedom, Corruption and growth", *Cato Journal*, 27(3):343.

<sup>123</sup> Choi, E and Woo, J. (2010), "Political corruption, economic performance, and electoral outcomes: a cross-national analysis", *Contemporary Politics*, 16(3):249.

Ebben and de Vaal emphasize the idea that the interaction between the political system and other institutions is important for the relationship between corruption and economic growth<sup>124</sup>. Thus, this leads to the idea that political stability might be an explanatory variable for corruption as well. Mo shows that corruption creates sociopolitical instability which, by creating uncertainty, lowers productivity and economic growth<sup>125</sup>.

### Corruption in Albania

When dealing with corruption in Albania during the post-communist period, this paper doesn't focus on the communist past of the country. Relying on the study of Moller and Skaating, they indicate that a communist past per se has no independent impact on the general corruption levels if the proper structural control variables are included into the explanatory model<sup>126</sup>.

However, in order to examine corruption in this developing country, the most handful measures to use are the corruption indices provided by international agencies, whose data is reliable and with few deviations from one another about the situation of corruption in a specific country or region. Researchers focus on three of them, despite the different emphasis put on each of these measures. They are Transparency International's Corruption Perceptions Index (CPI), the World Bank's Control of Corruption Index (CCI), and the Corruption in Government index from the *International Country Risk Guide* prepared by the Political Risk Services, known as the ICRG index<sup>127</sup>.

One of the most credible indices which measures domestic public corruption is the CPI. It scores countries on a scale of zero to 10, with zero indicating high levels of corruption and 10, low levels<sup>128</sup>. According to this corruption index, especially in the last four years, Albania is ranked in considerably low positions concerning the issue of corruption. It is ranked in the 95<sup>th</sup> position out of 182 rankings in total in the same group with India, Tonga, Kiribati and Swaziland with a scale of 3.1 for 2011<sup>129</sup>. This is the lowest scale in the last four years. As it can be seen from the table, the annual scores for Albania have been subject to a downward curb, which means that in the last five years, the 2008 score was the highest (3.4) and the 2011's score, the lowest. However, the lowest score of CPI has been that of 2005, lower than 2.5.



Graph.1 Corruption Perceptions Index in Albania from 2002<sup>130</sup>

<sup>124</sup> Ebben, W and de Vaal, A. (2009), "Institutions and the Relation between Corruption and Economic Growth", pg.27/ [http://www.degit.ifw-kiel.de/papers/degit\\_14/c014\\_014.pdf](http://www.degit.ifw-kiel.de/papers/degit_14/c014_014.pdf)/Accessed on August 10th, 2012.

<sup>125</sup> Mo, P.H., (2001), "Corruption and Economic Growth", *Journal of Comparative Economics*, 29: 66-79.

<sup>126</sup> Moller, J and Skaating, S. E. (2009), "Post-Communist Corruption: In a League of its Own?", *Australian Journal of Political Science*, 44(4):728.

<sup>127</sup> Swaleheen, M and Stansel, D. (2007), "Economic freedom, Corruption and growth", *Cato Journal*, 27(3): 347.

<sup>128</sup> <http://www.guardian.co.uk/news/datablog/2011/dec/01/corruption-index-2011-transparency-international/>Accessed on August 13<sup>th</sup>, 2012.

<sup>129</sup> Transparency international world corruption index/ <http://www.guardian.co.uk/news/datablog/2011/dec/01/corruption-index-2011-transparency-international/>Accessed on August 12<sup>th</sup>, 2012.

<sup>130</sup> <http://knoema.com/azqcseb#Albania/> Accessed on August 15<sup>th</sup>, 2012.

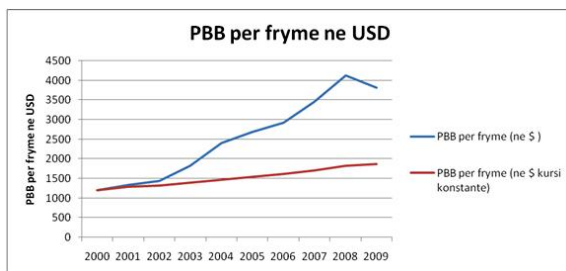
On the other hand, the Control of Corruption Index is another important tool used to measure the extent of corruption in different countries. The index ranges from -2.5 (for very poor performance) to +2.5 (for excellent performance)<sup>131</sup>. If we refer to the Country Data Report for Albania, 1996-2010 from the World Bank Institute, the CCI shows an upward curb from 1996 up to 2010, with a percentile rank of 39<sup>132</sup>.



Graph.2 Worldwide Governance Indicators for Albania, World Bank Institute, 2010

### Effects of corruption on the economic growth and political stability in Albania

“This year we have seen corruption on protestors’ banners be they rich or poor. Whether in a Europe hit by debt crisis or an Arab world starting a new political era, leaders must heed the demands for better government,” said Huguette Labelle, Chair of Transparency International<sup>133</sup>. This declaration reemphasizes the recent attention caught internationally and nationally on corruption. An UNODC study of 2011 in Albania reveals that the Albanian citizens rank corruption as the second most important problem facing their country today, after unemployment<sup>134</sup>. If we refer to the Choi and Woo study, these recent findings lead to the idea that the successful economic performance cannot be used by the government to mute the importance of corruption because both corruption and the other economic indicator (unemployment) are considered to be the most problematic issues by the Albanian citizens. Looking at the economic growth in Albania during this period, even though Albania has had a positive economic performance, poverty remains still high. One of the best indicators of individuals’ wealth is the GDP per capita<sup>135</sup>.



Graph.3 Open Data Albania (GDP per capita 2000-2009)<sup>136</sup> (blue curve in \$, red curve in \$ constant exchange rate)

<sup>131</sup> <http://info.worldbank.org/governance/wgi/pdf/c6.pdf> Accessed on August 13<sup>th</sup>, 2012.

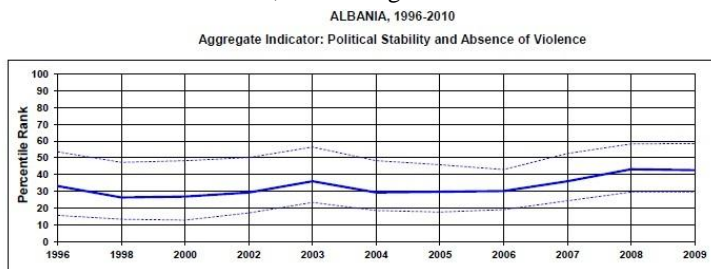
<sup>132</sup> Worldwide Governance Indicators, “Country Data Report for ALBANIA, 1996-2010”, World Bank Institute.

<sup>133</sup> “Corruption Perceptions Index 2011”, (2011), Transparency International, pg.3/  
<http://www.transparency.org/cpi2011/press/> Accessed on August 12th, 2012.

<sup>134</sup> “Corruption in Albania: Bribery as experienced by the population”, (2011), United Nations Office on Drugs and Crime, pg.7/  
<http://www.instat.gov.al/graphics/doc/downloads/Survey%20on%20use%20of%20public%20services%20and%20public%20integrity%20.pdf> Accessed on August 14th, 2012.

<sup>135</sup> Open Data Albania, PBB per fryme, <http://open.data.al/> Accessed on August, 2012.

As it can be seen from the graph, there is a positive growing trend of the GDP per capita. However, from 2008 this trend has had no significant increases by thus producing lower levels of GDP per capita increase. According to the same source<sup>137</sup> of data, the only moments when the GDP per capita has had a negative trend were the beginning of the 1990s and the period between 1997-1998 which were characterized by decisive moments of political change and consequently political instability. The political framework where the economic activity takes place, as previously presented by the literature review, can be explained to a considerable extent by corruption indices of the country. The graph shows the country's percentile rank on the political stability indicator. Percentile ranks indicate the percentage of countries worldwide that rate below the selected country. Thus, higher values indicate better governance ratings<sup>138</sup>. In the case of Albania, such ratings remain still low.



Graph.4 Worldwide Governance Indicators for Albania, World Bank Institute, 2010

### Conclusions.

Corruption is closely related to economic growth in a country. However, the nature of this relationship is quite specific in the case of Albania. In general terms, it has had a negative effect on the economic growth of this country. The post-communist period shows a positive trend in terms of GDP per capita. The last years have been categorized by lower rates of growth in comparison to earlier years. This phenomenon is paralleled by higher scores of corruption in Albania. Thus, higher levels of corruption have produced lower growth rates in the country especially from 2008 and on.

On the other hand, the macro-political stability of the country is negatively influenced by high levels of public corruption. Considering the international corruption indices such as CPI and CCI considerable high scores of corruption explain to a certain extent the general trend of political stability in Albania. What is more, those years when corruption is presented in very low scores correspond to the lower levels of political stability of the country (especially 1997-1998 and 2005).

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<sup>136</sup> <http://open.data.al/sq/lajme/lajm/id/160/Treguesi-i-PBB-per-Fryme-per-Shqiperine-2000-2009>.

<sup>137</sup> *Ibid*, pg.2.

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**FREE ACCESS TO PUBLIC INFORMATION - MORE TRANSPARENCY, LESS CORRUPTION:  
THE CASE OF REPUBLIC OF MACEDONIA**

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**Abstract**

*The traditional model of not transparent administration today disappears step by step. Citizens are increasingly becoming an equal entity with state institutions which have responsibility to ensure protection of their rights, accountability, openness and transparency in its operations - as the basic principles upon which rests the principle of good governance. Therefore, adoption of a law of free access to public information in many countries in the world which seek to enhance democracy in their societies today is a trend (process) that can not stop. Nowadays, countries that don't have such a law can not claim that they have full democracy. One of the reasons for passing this law is reducing corruption. Corruption is based on secrecy. Citizens and institutions become corrupted when the public has no insight into their work. If the work of public institutions is transparent and offered for public inspection, then the chance for them to be corrupt is smaller. Republic of Macedonia has adopted the Law of free access to public information in 2006. This paper analyzes the law and its application; the situation in Macedonia after the adoption of the law; concluding that despite some inconsistencies, the law has contributed to increasing transparency and reducing corruption.*

**Keywords:** Free access, information, transparency, corruption.

**JEL Classification:** K19.

**Introduction**

Transparency is one of the highest qualities of democracy based on ethics and good governance where the interests and needs are focused on the citizens. It is a set of policies, practices and procedures that allow citizens to have access to documents and information in public administration, finance, employment in public administration, etc., as well as to review the operations of government.

"Open government", as the value of highly developed democratic societies, and extremely important standard in the functioning of the administration, means a high level of transparency. This means that public administration is available for testing from outside and that everyone has a right to know the reasons which led to a particular decision or action of the administration, especially if the citizens are affected by decisions.

In order to establish and implement the principles of the concept of good governance (involvement and participation of the citizens; rule of law; transparency; responsiveness; consensus oriented; equality and inclusiveness; effectiveness and efficiency; accountability) the adoption of the Law on Free Access to Information is a trend in the world today. As a matter of fact, the countries that haven't adopted these laws yet are considered to be far from the fundamentals of democracy, especially from the principles of establishing good governance.

**1.1 Fundamentals.**

Freedom of information – FOI or the right to access information is defined as a universal right to access information which is owned by the public institutions.

The FOI laws reflect the fundamental premises that all of the information that are owned by the governments or the government institutions are public, and only if there are legitimate reasons, such as privacy or safety, should not be given to the public.

The fundamentals of this democratic and human right were set in the year of 1866 in Sweden. This is the first country in the world which has constitutional guarantee of the freedom of information. One of the main benefits of the special *Freedom of information act* (initiated by the Finnish priest and philosopher Anders Chydenius), adopted in 1766, is the access of the public to the governments documents. According to this Act, all of the information and documents created or received by the government, must be available to the entire public. It is very important that this Act obliges the state institutions to do everything in their power to deliver the information to the requestor as fast as possible.

As it was stressed by Gustav Björkstrand and Juha Mustonen, president and general secretary of the Chydenius Foundation, over recent decades, Anders Chydenius' legacy has received increased recognition globally.

“With the creation of the United Nations and international standards on human rights, the right to information began to spread. Freedom of information is recognized in international law. Article 19 of both the Universal Declaration on Human Rights and the International Covenant on Civil and Political Rights provide that every person shall have the right to seek and impart information. There is growing recognition that the right to seek information includes a right of freedom of information”.

(Björkstrand & Mustonen, 2006:4)

During the last 12 years the right to FOI was recognized in a large number of countries, including developed countries, through clear acceptance of this right with its inclusion in Laws. In 1990 only 13 countries had adopted national laws for free access to information, while today, together with the adopted Law on Free Access to Information in Yemen, 96 countries in the world<sup>139</sup> have adopted laws on free access to information or appropriate legal and constitutional provisions with which this area is truly regulated.

### 1.2 Free access in the Republic of Macedonia

The legislative in the Republic of Macedonia emphasizes the principles of legality and transparency in the work of the public administration. According to article 9 from the Law on Organization and Operation of the State Administrative Bodies, the governmental institutions are obliged to “inform the public about its work in accordance with the Constitution and the law”, and “exercise their competencies established by law in accordance with the principles of legality, accountability, efficiency, economy, transparency, equality and predictability“ (article 3).

The Civil Servants Law of 2010, in Article 21 states: "A civil servant is obliged, in accordance with the law, at the request of the citizens, to give information in order to enable them to exercise their rights and interests, except for information referred to in Article 20<sup>140</sup> of this Law“.

The Local Government Law of 2002, in Article 8 precisely enumerates the obligations of municipal bodies, committees of councils and public services established by the municipality without compensation to inform citizens of their work, as well as plans and programs that are of importance for the development of the municipality.

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<sup>139</sup> The Right to Information: Good Law and Practice (Online: [www.Right2INFO.org](http://www.Right2INFO.org))

<sup>140</sup> Article 20

(1) The civil servant is obliged to keep the public and classified information with the degree of protection specified in accordance with the law in a manner and under conditions determined by law or other regulation.

(2) The obligation to keep classified information with the degree of protection specified in accordance with the law lasts up to three years after termination of service.



At the same time, the municipality has the obligation to enable the citizens access to basic information of the services it provides, in a manner and under conditions regulated by the statute.

Free access to information, the freedom of receiving and transferring information is guaranteed by the Constitution of the Republic of Macedonia (article 16). To fully implement this constitutional provision, the Parliament of the Republic of Macedonia in January 2006 adopted the Law on Free Access to Public Information, which defines the procedures for the exercise of this right. Application of the law began on 1 September of the same year. The Law has undergone significant amendments at the beginning of 2010. With the amendments, the biggest drawback of the Law on Free Access to Public Information in 2006, regarding the arrangement of the institute "silence of the administration" was solved and fully complied with the provisions of the Law on General Administrative Procedure. According to this amendment as long as the holder of information does not respond in the stated deadline, or in the additional legal deadline, the applicant has the right to appeal without legal deadline limitations. Also, in order to improve the law, an additional obligation was introduced for the holders of information, according to which they need to conduct the "harm test" when they refuse access to the requested information under the exemptions listed in Article 6 of the Law. By conducting the harm test, the holders of information are obliged to estimate which is larger – the harmful consequences that might occur by revealing the classified information or the public interest.

The Law on Free Access to Public Information emphasizes the obligation of the institutions to provide information with precise deadlines, ensuring transparency in the operation of the holders of information, allowing individuals and legal entities to exercise their right of free access to public information, and obliging the holders of information to provide information to the public.

According to the Law, "holders of information"<sup>141</sup> are governmental institutions and other bodies and institutions set by law, municipal bodies, the City of Skopje and the municipalities of the City of Skopje, public institutions and services, public enterprises and natural persons and legal entities with public authorities and activities of public interest set by law. "Public information" is information in any form that was created by and is available to the holder of information.

In general, all information available to the holders of information is public. Access to them may be refused in exceptional cases determined by law (Law on Protection of Personal Data, Law on Classified Information<sup>142</sup>). Law on Free Access to Information of the Republic of Macedonia guarantees free access to all domestic and foreign legal entities or natural persons. All institutions included in the Law are required to have appointed officials for public information mediation (further in the text: **officials**) to whom the citizens will turn to while exercising their right to access public information.

## 2.1 Implementation of the Law

As of September 1, 2012, exactly six years have passed since the beginning of the implementation of the Law in the Republic of Macedonia. In this time the Commission for Protection of the Right to Free

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<sup>141</sup> At the moment the Republic of Macedonia has 1.247 holders of public information, placed in the Commission's list, for which there are precise records and which is constantly updated

<sup>142</sup> Every classified information needs to be marked with a visible sign that indicates that the information is:

1. top secret;
2. highly classified;
3. classified;
4. internal

Access to Public Information (KOMSPI)<sup>143</sup> had an important role in providing information to the citizens regarding the rights they have in accordance with this Law, catalyzing its application with everyday monitoring of the situation regarding the implementation of the Law, reacting on citizens appeals and delivering regular annual reports regarding the application of the Law to the Parliament. What was especially significant was the series of trainings conducted by the Commission aimed at educating officials.

In its latest report (Annual Report on the work of the Commission for Protection of the Right to Free Access to Public Information, from January 1 to December 31, 2011), the Commission notes that this new democratic right not only gets a stable position in the Republic of Macedonia, but speaking comparatively with countries of the wider region and some European countries, it is in an enviable position. Thus, it refers to research carried out by the relevant institute "Centre for Law and Democracy," according to which Macedonia is in the high 14<sup>th</sup> place on the world ranking list of states that have the most functional Law on Free Access to Public Information, regardless that this democratic right was transformed into legislation in a relatively recent period.

"The Republic of Macedonia has 108 of the maximum 150 points that are awarded on various criteria, among which the most important are those related to the number of exceptions to the free access, the monitoring mechanisms and awareness raising, or the promotion of the right of free access to public information", emphasized in the Annual report of 2011.

Nevertheless, as the Commission noted in this report, the main problem for the application of the idea "I have the right to know" is the not so small degree of ignorance, apathy and lack of understanding, resulting in its slow acceptance, pointing out thereby the silence of the administration as the basis for filing most complaints from citizens.

According to the records of the Commission in 2011, 70% of complaints (324 of a total of 409 complaints) were filed due to silence of the information holders, which leads to the conclusion that it is still necessary to take a series of activities for raising awareness of public bodies, getting them used to providing information and helping them realize that it is their duty to provide them.

## 2.2 Silence of the administration

One of the reasons for the silence of the administration and thus hindering the implementation of the Law is the internal exchange of information within the institutions themselves. Namely, the officials often encounter so-called internal resistance to receive the required information and deliver it to the applicant. The complaints that were voiced by the officials during the trainings organized by the Commission have confirmed this. In the period 2008 – 2009, the Commission for the Protection of Free Access to Public Information and the Macedonian Institute for the Media in the framework of a joint project organized a series of trainings for officials to free access to information. During these trainings it was stated that one of the problems they faced was when the requested information is not within their department or sector, it was more difficult to receive it from another department or sector. It also happened that they were unable to receive or provide the requested information when the persons in charge might have considered by their own subjective reasons that the information should not be shared with the employees, and even less be given to the public, even if the information is not classified with the appropriate level of secrecy in accordance with the Law on Classified Information and provisions arising from it.

The results of research done in the period 2008 - 2010, which included 130 civil servants from the Ministry of Education and Science, Ministry of Environment and Physical Planning and the Ministry of Economy of the Republic of Macedonia also confirm this. The emphasis of the research was placed on the internal exchange of information related to the activities and programs of the departments / sectors in governmental institutions.

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<sup>143</sup> The Commission is independent in its operations and decision-making in accordance with the legal responsibilities. The Commission is accountable for its activities to the Assembly of the Republic of Macedonia, and submits annual reports for its work.

According to the results: The majority of respondents are not or are only partially informed about the work of other departments and divisions; they do not receive information about the work of other departments and divisions on regular basis; almost all believe that they need to be more informed about the work of other sectors and departments and that the (dis)information about the activities of other sectors/departments affect their activities; most respondents say they are not sufficiently familiar with the activities of the institution in which they work (Communication in Public Administration, 2012:148).

Obviously the employees, and therefore the officials, due to the lack of an internal system for regular exchange of information, face difficulties to obtain the necessary information within the institution in which they work. Among officials this is reflected on the timely submission of the requested information to the citizens who have submitted a request on the basis of free access to public information.

### 2.3 “I have a right to know” in the battle against corruption

On the importance of free access to information the United Nations Secretary-General Ban Ki-moon during the World Press Freedom Day in 2008 said: "When information flows freely, people are equipped with the tools to take control of their lives"<sup>144</sup>. “Montinola and Jackman for instance, argue that ‘the freedom of information and association characteristic of democracies helps monitoring of public officials, thereby limiting their opportunities for corrupt behavior’”, (Lindstedt & Naurin:2005:3).

In this regard, one of the main objectives of the Law on Free Access to Public Information is increasing transparency of the public administration and reducing the corruption in a society. It is generally known that corruption is based on secrecy. It takes place behind closed doors, away from the public eye. Citizens and public institutions become corrupt when the public has no access to their work. If the work of public institutions is offered to the public, then the chance for them to be corrupt is reduced.

Free access to information is a powerful tool in the fight against corruption and wrong conduct of public authorities, because the citizens through free access actually control and evaluate the work of the public bodies they fund. But it is not enough just passing a law on free access to information. It is also necessary to implement it thoroughly and monitor its implementation. Along with the adoption of such a law the full engagement of governmental and non-governmental institutions is necessary for raising citizens' awareness of the possibility they receive by this law and their right to request information. At the same time, it is necessary to raise the awareness of the public administration for their duty of accountability to the citizens and timely provision of requested information, with the exception of those that are protected under this or any other law.

There are many other factors that affect the level of free access to information, such as the level of education of the population, the relationship between the government and the business community, but above all the cultural and psychological environment in which it occurs and implements such a law. The countries in transition which were stuck in a system of a traditionally closed administration and closed government naturally have a much greater challenge in the development of this democratic right.

The example of the Republic of Macedonia is on the way of proving the claims that countries which have adopted the law on free access to information and have greater transparency, have less corruption.

Since the adoption of the Law in the Republic of Macedonia, the country has ascended on Transparency International Corruption Perception Index. According to the corruption index of Transparency International, in 2005 Macedonia was on the 103rd place. In 2009 and 2010, three to four years ago after the implementation of the Law, there has been a significant improvement of the situation: in 2009, the Republic of Macedonia has climbed on the 71<sup>st</sup> place, in 2010, it climbed on the 62<sup>nd</sup> place. In 2011 the country shared the 69<sup>th</sup> place on the Transparency International Corruption Perception Index which surveyed 183 countries worldwide<sup>145</sup>.

<sup>144</sup> <http://www.un.org/apps/news/story.asp?NewsID=26553&Cr=press>

<sup>145</sup> Online: <http://cpi.transparency.org/cpi2011/results/#CountryResults>

### 2.3.1 Application of the new democratic right

The number of applications submitted by citizens can be taken as a kind of an indicator of the acceptance of the right to be informed, i.e. of the rising awareness of their right to seek information. Based on an analysis of the 2011 Annual Report of the Commission for Protection of the Right to Free Access to Public Information, it can be concluded that the situation in the Republic of Macedonia in 2011 is much better than in 2006 when implementation of the Law began. Namely, the record number of 3.496 requests submitted in 2011 indicates that applicants used the new democratic right to a much greater extent than ever before. By comparison, the number of requests in 2006 was 513. In 2007 there were 1.476 requests. In 2008, 1.876 applications were filed; in 2009 their number was 2106. In 2010, the number of requests was 2.379.

In 2011 from the total number of requests, there were 1.728 requests that were filed to the governmental institutions regarding all areas of their operations. In addition, 212 complaints were filed against the governmental institutions and 124 complaints against political parties. This represents a move towards breaking taboos for the inviolability of governmental institutions and political parties, and of course overcoming of the psychological fear of going into the "privacy" of "government authority" and appropriate repercussions because of the persistence to receive certain information and demand accountability.

Moreover, the role of the Commission in order to support the right of the citizens who request public information is very important. Thus, in the six years since the implementation of the Law 2.320 complaints have been submitted due to disabling of access to public information and the Commission has positively responded to 1.591 appeals, i.e. it has obligated the holders to allow access to the requested public documents. In 2011, 409 complaints were filed to the Commission, which is a significantly reduced number compared to the previous year when 540 complaints were filed. According to the statement in the Commission's Annual Report for 2011, "this is satisfactory data, because in the year when the number of requests for free access to information has increased (according to data from the annual reports of the information holders - total 3.496), the number of complaints has decreased, which means that holders of information are slowly but surely realizing the seriousness of the law and are opening to applicants" (Annual Report 2011:6)

As the number of requests increases, so does the number of received answers. Thus, in 2011 the officials have positively responded to 3.283 requests, while the access to 172 requests has been denied according to the exemptions included in the Law, or according to other regulations.

	2006	2007	2008	2009	2010	2011
Submitted requests	513	1476	1876	2106	2379	3496
Answered requests	482	1330	1765	1890	2208	3283

*Table 1: Comparative view since the initial application of the law (source: Annual Report on the work of the Commission for Protection of the Right to Free Access to Public Information, from January 1 to December 31, 2011)*

But despite all these information, the following data indicates the need for greater affirmation of the law and raising awareness about the possibilities it offers and for the acceptance of the idea "I have a right to know." Namely, according to the Report of the Commission, the highest percentage of applicants, i.e. complainers, are citizens' associations and foundations. In 2011, 70% of the requests come from non-governmental organizations and associations.

Citizens participate as requestors in 30% of submitted cases. Furthermore, the total numbers of complaints, 98 were submitted by individuals, and the remaining 311 from citizens' associations and foundations.

"These figures confirm that in this reporting period complaints submitted by citizens' associations and foundations dominate in comparison to individuals, who do not yet use this right that is ensured by the law and the Constitution" (Annual Report 2011: 9).

The free access to information in order to prevent corruption could not survive on its own and develop in its implementation, unless all of the society's stakeholders actively engage in its affirmation. In affirming the right of citizens to request and access information, the media can and should play a significant role. However, before that they need to use the benefits provided by this law themselves. So far, in the Republic of Macedonia the Law on Free Access to Information of Public Character is still not widely applied by journalists.

In April 2012 there was a panel debate organized by the Center for Civil Communications<sup>146</sup> on which it was concluded that a very small number of journalists within their profession obtain information exercising the Law on free access. Even fewer are informed of the opportunities offered by the law. As noted in the panel debate, their role and their participation in the consumption of the access to information is extremely important particularly given the extensive experience of the journalists in Bulgaria, who have managed to reveal a series of corruption scandals in the country through these instruments, among others the misuse of money from European funds.

## CONCLUSIONS.

The contemporary democratic pillars emphasize that the individuals are prepared to effectively participate in decision making and evaluating the work of their governments. The level of participation depends on the level of access to different information, which is owned by governmental and public institutions. The legal grounds for free access to information enables active participation of the citizens. However, their implementation and the level of participation depends on the competence of the resources, the dynamic of the civil society, the activities of non-government organization that ensure transparency, the level of professional investigative journalism, as well as the capacity of the citizens to use the benefits of the Law.

The legal basis for free access to public information in the Republic of Macedonia has been well placed. The government has articulated its commitment for transparency and combat against corruption, all in order to achieve the EU criteria, among which the criteria for good governance and an open government. Although the corruption is still not on a satisfactory level, yet the Law has influenced its reduction.

In order to ensure a more successful application of the Law in the following period it is necessary to concentrate on:

- Educating citizens through the mass media regarding their "I have Right to Know";
- Educating the journalists to ensure greater participation from them in the application of the access to information, especially in the area of investigative journalism;
- Establishing a system for exchange of information within the institutions in order to ensure that the officials receive the requested information in a timely manner, and provide it to the requestors.

All of this will strengthen the implementation of the Law, as one of the mechanisms that ensures removal of comfortable positions behind closed doors and with its constant presence is a powerful tool in the fight against corruption and misconduct of governments and public authorities.

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**LEGAL ANALYSIS OF CORRUPTION AS PART OF THE WAR AGAINST ECONOMIC CRIME**

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**Abstract:**

*The transition process in Albania has revealed a number of problems, one of which is corruption. By signing the Stabilization-Association Agreement between Albania and European Union, this sharpened and emerged the problems of Albanian society. Obviously the fighting of corruption was one of the fundamental conditions that Albania had to implement to achieve its aspirations for membership in EU. Stemming from this, we decided to analyze this issue in order to provide a clearer picture of the phenomenon and we thought to analyze it in 4 different aspects. Firstly, we will present an overview of the phenomenon of corruption by making a general conspectus of it. Secondly, we will handle corruption by looking how has it changed throughout the Albanian history, divided into different stages. Then we will write a detailed analysis of specific types of corruption offences according to the current legislation of Albania. Finally, we are going to treat corruption according to the international framework in order to give the relevant conclusions.*

**Keywords:** corruption, economic crime, transparency, money laundering.

**JEL Classification:** K19.

**1. General conceptualizations about corruption.**

The word corruptions come from the word “corrumpere”, which means damage, destroy, ruin, falsify and give or take bribes. Based on the Albanian literature, to bribe means to brake the law, making other people act against the rules of their position/job, by offering them different types of rewards like money, favours etc. If we deeper in the history of our society, we will realize that corruption has always been an unseparate part of it, during all the times, regardless the different ways which has appeared. There have been many talks about corruption since the period of Antiquity, with the great philosopher such as Aristotel, or even before if we refer to the Old Empire of Syria. Nevertheless even though corruption was obvious and active there has not been a clear definition at that time which would be accepted by all. It is easily understandable that corruption is a deviant behavior, that just to achieve what it wants its “willing” to go against the right, logical and reasonable way of behavior. Corruption itself strikes in the heart of the economy, by disrupting the decision making and by results the performance of the economy itself would be lowerd. The most disturbing part is shown at the public sector where there is a high level of indifference, which allows bigger opportunities for corruption to take place.

This is seen clearly at public investment sector where predetermined government procurement (or also known as public tenders) is won from companies which have close relationship with the people that work in the government.

Corruption should also be analyzed in different points of view, as a legal process and also as a social process.

- ∅ As a social process should be analyzed as an unmoral and deviant behavior.
- ∅ As a legal process it should be analyzed juristically, as a violation of laws.

*Since we are more interested on how corruption is analyzed on a juristical scale, we will be focusing on the legal process rather than the social process.*

From the juristical process corruption is prestended as: “search, offer, giving or taking favours, money, advantages, etc in a direct way or through other people, which would have a bad influence or scramble a behavior or interferes in the decision making of the person whom is being bribed, which would result to unfair benefits”<sup>147</sup>.

There is not any clear measuring unit for corruption since it is an illegal act, so of course at the same time when it occurs it is done in a hidden way. What we could measure about corruption is the perception about it, which could be different or totally opposite from the media and press perception. Media and press tend to show a different reality based on their own interest, since mass media itself it's a business.

Corruption is a widespread phenomenon and it is infiltrated deep in the legal system, no matter how much developed that legal system is. The fact that corruption exists in every part of our life makes it as much dangerous as acceptable by the society. Due to the fact that in a society where corruption, favours and connections are the only way to get along and benefit from the “weaker” ones, as a result makes a general scrambled view of the culture and people don't get bothered by corruption no more. On the opposite they start to “feed” it and support it rather than fight it.

A good example for this case would be Albania. Based on different reports from different international organizations, Albania has a high level of corruption, not only on the public system but on the private one also. It is becoming very normal that to benefit from a public service which you pay taxes for, people have to bribe someone. This factor can be seen crystal clear in Albania in the health service, a very important service, but also a very corrupted service. There has been many occasions where because of the doctors' negligence the patients have died. These mostly happened due to the negligence of the doctors toward these patients, since they can not afford to pay the doctor himself/herself for the service that he/she swore an oath he/she would do. But the doctors are not satisfied with the salaries so they try to rip off the people in need.

We can try to separate corruption in two different parts. In the first part we include corruption on a low level, which makes it less disturbing from its size, but of course very disturbing as an element of the society. These kinds of corruptions are usually used by the low and normal economy class, which do not have enough money to pay. On the other hand in the second part we include corruption of a high level, which is more disturbing from its size and also more disturbing as an element of the society. In this kind of corruption we include politicians, judges, prosecutors, etc.

This kind of corruption in these kinds of levels is very disturbing as a phenomenon and as the size of corruption itself, since it clearly affects the civilian's way of life. To do a better description of corruption of course we have to make an analysis of the way that it followed through the years.

## 2. Corruption in a historical context

As we mentioned before corruption has always existed in every society and in every system. First data date back to the XIII century BC in the Old Empire of Syria where you can find data about how they used to bribe the servants<sup>148</sup>.

<sup>147</sup> Konventa Civile për Korrupsionin, neni 2.

<sup>148</sup> Masa për të ndaluar korrupsionin në Bashkimin Europian, Mars 1998.



To go even further in the Ancient Greece, corruption was discussed and analyzed by the great philosopher Aristotel, whom inspired many other philosopher and scholars to discuss about it, but as a legal document corruption has been discussed in the Code of Hamurab in the XVIII century BC.

Albania has always used moral values and tradition as a way of life where some of them were written and some of them were not. There are few written books about the traditions and the way of life which at the time were considered laws. These books were called “Kanun” and corruption was analyzed there also. Each kanun had its own characteristics and would analyze corruption in different ways, based on the society’s way of thinking. Kanun of Leke Dukagjini would include many corruptive behaviors starting from the priest, the assets of the church, which were normal at the time and also the offenses committed by the state officers and the Sultan himself<sup>149</sup>. In different periods of time the Principality of Dukagjin had deal and alliances with the Ottoman Empire, also cause of the rivalities with Gjergj Kastriot Skenderbeg. Leka defined corruption as the action or non-action that contradict the law and consists in getting rewards or gifts, for the favorization of one side toward another one.

Another Kanun which is worth mentioning about corruption is the Kanun of Skenderbeg, which was used in a lot of places. The main figure about corruption in this Kanun is again the priest, whom could use the assets of the church, the livestock, etc for his own profit without asking the permission of the bishop. Also the priest can not sell nor gift these assets of the church<sup>150</sup>.

To continue even further in analyzing the written facts, we will talk about the Statutes of Albanian cities in the XV century, where we mention the Statutes of Shkodra which were a representation of city-states of Italy. Also there is the Statutes of Durres and later the Statutes of Drishtin in 1468. Statues were organized in a perfect way and would include a series of offenses, based on the object that was discussed about. The Statutes of Shkodra would include corruption cases of judges, where they would be fined and also lose the rights to practice their professions<sup>151</sup>.

With the arrival of the Ottoman Empire in the XIV century in Albania, the ottoman laws, which would include mostly Sharia laws, started to be practiced in Albania as well. Sharia Laws were used at the same time with Kanun Laws also. In 1858 the Ottoman penal code came in power and was used even after the declaration of the independence of Albania<sup>152</sup>.

The Penal Code of the year 1928<sup>153</sup> which was compiled by King Zog could be called the first Albanian Genuine Legislation, which was based mostly in the French and Italian penal code. In this penal code was used the term “mite” and not the term corruption which is being used today. Also the offenses were grouped in different categories based on their types. From the objective side mites’s offenses of the public officers were used in two different ways: by accepting bribe for himself (at the time was called darovi), by accepting bribe for someone else. Mostly the subjects of this kind of corruption were public officers, judges and prosecutors when they were exercising their profession. The given sentences for these offenses would vary from a fine till jail time, including temporary suspension of the right to exercise the profession.

With the regime changes it came in power a new penal code, the one of the year 1952. This penal code would describe corruption in its third chapter and it would refer to it with the name “Mita”. From the objective side this offense could be committed in all kind of form (direct or indirect form). Mita could be accepted or taken before or after of the offense or even taking it and not committing the offense was against the law. This differ from the current penal code where accepting gifts after performing the demanded action (or not performing it) it is not a cause for an offense, since it is not against the law, as long as you may follow the other restrictions decided by law from the V.K.M about gifts. Also this penal code would predict a lot of aggravating circumstances such as the repeat of the offense from the person who has a position.

<sup>149</sup> Kanuni i Lekë Dukagjinit.

<sup>150</sup> Kanuni I Skënderbeut.

<sup>151</sup> Elezi.I, Elezi. E., “Historia e së Drejtës Penale”, Bot. SHBLU.Tiranë 2010.

<sup>152</sup> Ligja penale otomane, Përkthyer nga Kacimbra. Dh., Tasi.K, botim i Ministrisë së Drejtësisë, Tirane 1924.

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In the penal code of the year 1977, the term corruption was not recognized yet; it was used still the term “Mite”. The interaction and exchange of material goods through bribery was the main form which corruption was manifested<sup>154</sup>. Based on this penal code not every gift would be considered mite (bribery), but in every case of mite had a material gainings. If someone would gain different material staffs he would not be accused of corruption but instead for dereliction of duty. Also the penal code would notice that the dereliction of duty would start at the moment the person would accept the “mite”, no matter if he actually did or did not do what it was asked from him/her. Even though this penal code and the previous code are different in most of their parts, there are similarities also. For example both of these penal codes would predict that as soon as the bribery was accepted it was not important if you would fulfill what you were bribed to do or not. Just accepting it would make an offense and the person who would accept it would be penalized. But in the second code these person would not be charged only for corruption but he/she would have to answer also the charges for dereliction of duty.

In the next chapter we will analyze the penal code of 1995 which is still being used even today.

### 3. CURRENT LEGAL FRAMEWORK FOR CORRUPTION

If compare our legislation with the International legislation based on the criminal convention about corruption<sup>155</sup>, a lot of changes were made to the penal code to achieve the necessary standards. EU has paid a lot of attention to the penal code about corruption since Albania has a high level of corruption. Currently in order to fight corruption more a new law is being voted which would deprive the members of parliament from their immunity. This will be a big change since the members of the parliament can not be investigated unless they give up their immunity. Also important steps were made in the long term strategies which define the tactics and different institutions that would help against the war toward corruption. We could refer to “Udhëzuesi Praktik Kunder Korrupsionit” (Practical Guide Against Corruption) a project of Transparency International<sup>156</sup>, which is the most specialized and most trusted organization about corruption. This project was first made for the war of corruption in Kosovo, but Albania can refer to it since it gives a clear definition about corruption and at the same time the problems and tactics toward corruption are very similar for both countries. Furthermore Albania is part of many international projects like the one for the Southeastern Europe (PACO), also part of SPAI (Stability Pact Anti-Corruption Initiative).

To be even more specific on our analysis we should refer and analyze the current Penal Code being used in Albania. In the year 2004 numerous changes were made by anticipating 11 disposition about corruption, which were divided in different sections which are:

Article 164/a – Active corruption in the private sector

Article 164/b – Passive corruption in the private sector

Article 244 – Active corruption of persons exercising public functions

Article 244/1 – The exercising of unlawful influence on public officials

Article 255 – Hindering and violating the secrecy of correspondence

Article 259 – Passive corruption by public officials

Article 260 – Passive corruption by High State Officials or local elected officials

Article 312 – Active corruption of the witness, expert or translator

Article 319 – Active corruption of the judge, prosecutor and of other justice officials

Article 319/a – The passive corruption of the judges, prosecutors and other officials of the justice bodies/ system

Article 328 – Remuneration and promises<sup>157</sup>

For the above dispositions active corruption is defined as “The promise, proposition, giving directly or indirectly of any irregular benefit, for yourself or other people,....., to perform an act or the failure of performing an act which goes against which goes in violation with its function, or our occupation/job.”

<sup>154</sup> Prof. Dr. Elezi.I.”E Drejta Penale e R.P.S.SH.”,fq.256, Tiranë 1989.

<sup>155</sup> Konventa Penale për Korrupsionin ratifikuar me ligjin Nr.8778, dt. 26.04.2001.

<sup>156</sup> Udhëzues Praktik Kundër Korrupsionit,Transparency International, dhjetor 2010.

<sup>157</sup> Kodi Penal I R.SH.,i vitit 1995 me ndryshimet përkatëse.

It is not necessary that all of these actions should be committed to be persecuted and charged. It is only necessary to commit one of these actions for the offense to be persecuted

On the other hand passive corruption is defined as: “ Searching or receiving in a direct or indirect way, of any irregular benefit for him/herself or for any other person, or the acceptance of an offer or promise that comes from improper benefit, ....., to perform or not to perform something that goes in violation with our job or function.”

As we mentioned before the performance of only one of the action would be enough to be charged for corruption and be considered a criminal offense. Also it is not necessary to come at the consequences, for the offense to be done, since these dispositions are based only on criminal offenses and irregular behaviors of the specific subjects, no matter if the action/offense achieves its results or not. Even though these is of highly significance in the context of criminal policy at the time the sentence will be taken.

Regarding the element of irregular or illegal benefits, there is not yet a definition about what does it include, neither by the gained object or reward nor from the subject whom benefits from it. On the other hand in the legislation has been clearly defined that public administration employee shall not seek or receive any kind of favor nor gift, for himself or anyone close to him/her, which would be as a result of performing or not performing a specific action and going as far as to determine what a public administration employee should do when they are confronted with such situations<sup>158</sup>. However there is also a space in the legislation where gifts are included and the employee is not obligated to declare those, but the gift must not pass the value of 1000 Lek and the employee is not obligated to declare those<sup>159</sup>. Yet gifts must not be expressed in currency, since this would be a criminal offense.

The subject to the Article 245/1, summarized active and passive corruption, and especially a particular thing for the person who promises or ensures, that will have an impact or influence in decision making or performance of the duty of those whom exercise public functions (may them be Albanian citizens or foreign citizens), despite if the promised or ensured task is fulfilled or not.

The above disposition represents an innovation not only for the object which is considered a criminal act, but also in terms of its subjects.

Article 164/a and article 164/b refers to the situations where these offenses are caused in the private sector and consequently its subjects will be individuals in these private trade companies or simple trade units. In both of these dispositions the main subject will be the person who exercises managerial or leading functions in the commercial companies, or any function in the private sector, which would allow him/her to perform or not to perform an offense in violation with his duty function. Exactly the performance or non-performance of an offense which goes in violation of the duty, defines the separation between these to article with the other articles.

Precisely the performance or non- performance of offense in violation with the decision making and function of the duty, is what makes the difference between this two articles and the rest of them, since here the attention is at the private sector and there is no defining whether the subject works in private or public sector, which would leave some open space for people who are public functionaries being accused for the same offense also. Even though the subject may be a public functionary, in such a case, he would respond under Article 164/a or 164/b.

Another category of subjects are included in the articles 259, 260 and article 319/a. These articles are about state employees whom are closely linked to their function or job position. Article 259 has as a subject the person who performs public functions. Given that this term was very subjective and closely linked to the system of government of different countries, the penal convention of corruption did not come out with a definition which would define this term, leaving space to the countries themselves to define it. Another convention came in, which made a clear definition of the public employee.

<sup>158</sup> Ligji Nr.9131” Për rregullat e etikës në administratën publike”

<sup>159</sup> V.K.M.,Nr. 714, dt. 22.10.2004.

This convention would define it as: “Any person who holds a legislative, executive, or judicial position, whether he/she is appointed, elected, permanent or temporary, paid or unpaid, despite the length of the persons position, any other person who exercises a public function, including a public agency or public enterprises, or whom performs a public service, any other person defined as public servant, or exercises public functions or provides public services as it is defined by the domestic law”<sup>160</sup>.

Regarding the subjects of the Article 260 of the penal code, elected local officials includes chairman of city hall and municipalities as well as the representative council member whom are elected only by the people, or society. The rest of this article includes the high officials of the state, for which there is no clear definition nor limit of how far down goes the rank of a high state official employee.

However if we analyze and refer to the judicial practice we can create a kind of categorization. In the first row we include the highest state dignitaries like the President, members of the Council of Ministers, the President of the Assembly, main secretaries together with the chairmen of the cabinets, chairmen of the main institution and parliamentarians. Another category includes the central leaders appointed from the civil service and their general secretaries. On the other hand the lower limit could decrease even more if we look the position or function that had the person who have been accused and committed the offense, relating this with the adoption of the new changes in the law, who may create or change even other institutions with main traits. Such may be the head chairmen of ALUIZM, an institution which was established by a special law and that has a great interest and value on the area which it covers.

The subjects of the article 319/a are somehow more limited, since the justice system has well been defied when we talk about the prosecutors and judges. While other employees in the justice system could be also judges and prosecutors secretaries and chancellors. The other subjects of corruption could be general subjects like any citizen.

A fundamental importance in the fight against corruption is the ILDKP – Inspektorati i Lart<sup>o</sup> i Deklarimit dhe Kontrollit t<sup>o</sup> Pasurive (High Inspectorate of Declaration and Audit of Assets), which serves as an overview of the high officials assets, by making it harder to benefit and enjoy the properties gained illegally. But exactly because of the special position of some subjects, this makes it harder to be persecuted and this has a direct influence on the level of corruption on this subjects.

### 3.1. Immunity as an obstacle on the war against corruption.

One of the basic principles of the Constitution of the Republic of Albania is the principle of equality; according to it every citizen is equal before the law<sup>161</sup>. But this is not absolutely true since the Constitution and the Code of Criminal Procedure set out a number of constraints or limits, which bind the accusation to take approval from higher organisms of the state, before starting to persecute a high figure of the state or a judge, whom have immunity from the penal process. The immunity of judges in the Supreme Court is same with the one that a parliamentarian has. They can not be persecuted without the approval of the assembly, unless they are caught with strong facts, which is this case the Constitutional Court would be notified and make a statement in 24 hours for the arrest. For the judges of the Court of Appeal they may be persecuted only with the prior approval of the High Council of Justice.

The same situation is repeated for the subjects of the Article 260, as we already mentioned includes high officials of the state and parliamentarian. Article 73 of the Constitution of Albania notices that: “A deputy may not be criminally prosecuted without the authorization of the Assembly. Authorization is also required when he is to be arrested. A deputy may be detained or arrested without authorization when he is apprehended during or immediately after the commission of a serious crime. In these cases, the General Prosecutor immediately notifies the Assembly, which, when it determines that the proceeding is misplaced, decides to lift the measure. For issues contemplated in paragraphs 2 and 3, the Assembly decides by secret vote”<sup>162</sup>.

<sup>160</sup> Konventa e Kombeve të Bashkuara, ratifikuar me ligjin Nr.9492, dt.13.3.2006

<sup>161</sup> Prof.Omari Luan,Prof.Dr.Anastasi Aurela, E drejta kushtetuese, fq.70,ABC, Tiranë 2010.

<sup>162</sup> Prof.Omari Luan,Prof.Dr.Anastasi Aurela, E drejta kushtetuese, fq.228,ABC, Tiranë 2010.

As we can see the prosecution of a subject who has immunity becomes quite difficult, especially in the cases where the political will infiltrates the justice system and makes the case to be prosecuted with objectivity by violating the standard of justice.

These are not the only subjects who benefit from immunity, since the constitution has allowed for many other high state subject to benefit from this privilege. Therefore it is considered necessary that even if the immunity would not be withdrawn at all during the penal process, at least must be limited to a group of subjects as deputies and judges, especially judges. This probably would decrease the corruption in the justice system since if we remove their immunity it would be easy to prosecute them as subjects of corruption. Except the immunity problem, the judicial practices has noticed another problem as the competition of offenses.

### **3.2 The competition of corruption with other offenses.**

The dispositions of corruptions often compete with other cases where the person has been accused other types of offenses. The most typical case is the passive corruption of public officials in relation to the misuse of office. There are a lot of different opinions regarding the competition of these 2 offenses, some of these opinion do not even accept the existence of this competition. This is due to the fact that the main argument is the the misuse of office is the main accuse and corruption is included in this accuse. Therefore it is not seen as necessary for the subject to be accused for both of these offenses. Another opinion which we are also included, is that the competition between these 2 offenses does exist.

This is due to the fact that these 2 offenses are independent from each other and at the moment that the person has been accused for both of these offenses should be prosecuted for both of them. There is no reason for the subject to be prosecuted for only one of the offenses. To analyze it even better we refer to the Article 259 of the penal code. We refer to the part where it mentions that: "*Soliciting or taking, directly or indirectly, by a person who exercises public functions, of any irregular benefit or of any such promise for himself or for a third person, or accepting an offer or promise deriving from an irregular benefit, in order to act or not act in the exercise of his duty, is punished with a prison term of two to eight years and a with fine from 500,000 to three million Leke.*" In here it doesn't necessarily require that the action be against the law, but just that the action be within the powers and duties of the public official. Of course the public official will refer to the law in order to fulfill to its maximum his duty. For as long as there will be elements of misuse of duty there will be corruption offenses that will compete with it.

The same problems exist also for the corruption of the tendering process, where the state official pulls some strings for the interests of a company, where the state official benefits also. This is a case of passive corruption. We think that it is necessary in these cases also to be accused for passive corruption and for misuse of duty also since these are 2 separate accusations.

### **4. International legal framework about corruption.**

Corruption is not a problem that occurs only in Albania, but it is an international disturbing phenomenon. So the war against corruption has been substantially intensified during the recent years, by allowing the creation of different instruments. We can mention here the Criminal Convention on Corruption of the year 1999 in Strasbourg and ratified by Albania in 2001. In this convention it is determined and aimed the international cooperation as the most effective tool against corruption. Its biggest priority deals with the protection of society from this phenomenon by strengthening the prosecution against corruption as a common political goal for all countries.

Also the convention includes the necessary measures that have to be taken every signed member of the Council of Europe or even other countries who have not signed yet, since this convention is opened to all the countries who wished to sign it. The convention doesn't provide a definition for the public individuals, since the countries who sign it have to come out with a definition which would be applied best at their system. In the framework of the Criminal Convention on Corruption and of the Council of Europe has been created an organization named GRECO (The Group of States Against Corruption) which main role is to monitor the war against corruption and also the implementation of the international instruments that contribute to this war.

Another international instrument is the Civil Convention on Corruption established by the Council of Europe in the same year with the Criminal Convention on Corruption (1999, Strasburg). Due to the fact that it is a civil convention, its priority is in solving financial problems arising as a result of corruptive actions, which does not include only individuals corruption but also companies and institutions ones.

According to this convention, states must take the necessary measure to give more importance to the subjects who have suffered, or have been damaged as a consequence of corruption, by compensating them as much as possible of these individuals, companies or institutions<sup>163</sup>. This of course would be possible if you would fulfill the necessary conditions appointed in the convention as well. Even here a very important position has the cooperation between countries as the best way to add and raise professionalism.

This convention different from other conventions provides a clear definition about corruption. Another important instrument on the war against corruption is United Nations Convention against Corruption, which was approved in 2003 and adapted in Albania in 2006. This convention also provides a definition of what could be called public person, but also does not limit this definition and gives some space to the countries themselves to make a more acceptable definition for their system, if it would be possible. In the terms of international cooperation the convention provides a series of elements such as extradition, transfer of sentenced persons, transfer of procedures, joined investigative commissions and mutual legal assistance.

It is important to mention here the Resolution (97) 24 which says: "20 Principles of the War against Corruption" and Recommendation R (2000) 10 "Code of Conduct of Public Officials", because they have given a valuable contribution in the putting in practice the above conventions.

### Conclusions.

After we went through a general summary on corruption as a phenomenon and after we analyzed the specific dispositions which are provided by the currently used penal code, of course also by keeping in mind the limitations of our paper we came to these conclusions.

The perception of corruption in Albania in recent years has increased significantly, translated this into a poor legal performance, also with different gaps in the legislation system as a theory and as a practice also. We might say that the failure in the practice of the legislation is way more catastrophic.

Also another concerning problematic situation is the one that has plagued our lawmakers, which try to show that they have a lot of cooperation with the international countries and create and promise laws to fast and unsuitable for the situation of Albania at the moment. As it is known Albanian politicians are limited by the adoption of conventions on law, or adaption of laws that are served from other countries, where the reality is quite different and it does not adapt to the situation of Albania. So the politicians must be careful in the adaption of the foreign legislation and the the war against corruption toward high official states in Albania, which have never been sentenced guilty and so making their employees to do the same as them.

There should be a clear diagnosis about which subjects will be included as a public functionary and in the same way to provide with a clear definition of what the term employee in the justice system means, since it has been abused a lot with these two very important terms. This will require a strong will to fight and actually win the war against corruption which Albania suffers so much from.

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**SECTION IV: E-MARKETING, E-BANKING & E-COMMERCE****THE APPLICATION OF E-MARKETING AND ITS IMPACT AT COMPANIES  
MANUFACTURING OF DRINKS IN THE KOSOVO MARKET**

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**Abstract:**

*The electronic marketing In recent years is being applied more and more in the production sector in Kosova market. This has come as a result of low expenses, and the use of information technology by the population. Promoting products through E-marketing in manufacturing companies, in this case those of drinks in the market of Kosova is considered as a very convenient and a quick form to get to the customer. This research will bring different ways of promotion through E-marketing, which are being applied by manufacturing companies, particularly those producing drinks in the market of Kosova. What are the costs required by the application of these promotional form? How much do companies applying E-marketing save from their budget? How much do companies benefit during the application of E-marketing ? etc are some of the questions in this research. Case study in this research will be the company producing drinks in Kosova "BIBITA" which applies E-marketing in all its promotional campaigns. The purpose of this research is the sensibilization of manufacturing companies on the opportunities offered by E-marketing to promote their products. This scientific paper applies quantitative and qualitative methods of research. These two methods serve us to analyze the facts related to the promotion of drinks in the Kosova market via E-Marketing. Resulting recommendations in this research relate to the concrete and advanced and advanced E-marketing forms to manufacturing companies. How necessary is the application of E-marketing, which are opportunities for companies to save their budget, how are new consumers won through E-marketing etc, all those will be shown on this research associated with case studies.*

**Key words:** E-Marketing, market, products, company, internet

**JEL Classification:** M31.

- **Introduction.**

In modern conditions of business development, which is increasingly moving towards globalization has increased the importance of location factor in the world of Internet as well as advertising products and services through various websites and it has increased the importance of electronic marketing in general. E-Marketing is a form of execution of marketing activities through intensive application of information and communication technology (Internet technology).

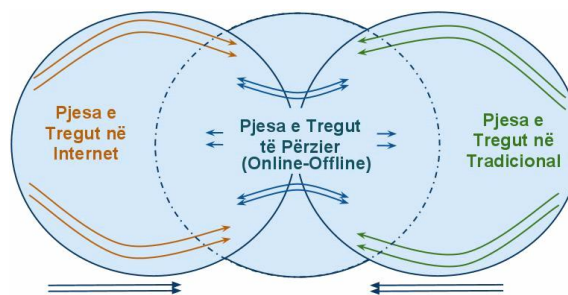
These two technologies are used in the performance of all marketing functions: - information about the - market research- market policy development of the product and service - sales policy. Information about the market is a function of marketing which aims to provide an overall picture about the market movements. Today the Internet offers a very fast and efficient way of collecting relevant information in the field of marketing.



While marketing as a very attractive area, in contemporary conditions of business development has reached the peak of its global business success, we can say that in Kosovo it has only made the first steps to develop in a professional manner, even if such a thing is still missing. This is because the professionalism does not come by itself, but it must be reached through work and experience. At this time, with a very tough competitive space, the most critical or crucial function to cope with the market and this competition is the development and advancement of professional marketing. One of the most prominent authors in the field of marketing, Chaffey (2007), defined internet marketing as "the application of digital technologies which form the network channels (web, mail, database, and mobile / wireless & digital TV) to contribute to marketing activities aimed at profitable attracting and maintaining of customer. P.R. Smith (2003) stated that online marketing "is simply marketing on the internet – being close to customers by establishing connections with them, keeping them happy and satisfied in the network. E-marketing includes dynamic dialogues, continuous feedback and a range of new tools". All authors, with the same or different words, agree that network advertising builds on digital technology (named as electronic technology, the Internet or information technology).

- **APPLICATION OF E-MARKETING AND ITS IMPACT ON THE MARKETS**

Internet and computer technologies have not only distorted market signals, but also have changed the significance of key traditional business factors. The Internet offers new marketing opportunities, changing the interconnection and interaction between marketing functions, adding new marketing tools, new instruments, and so on. In this way, involvement in electronic commerce because of these changes, has relatively become easier. The Internet has enabled the reconfiguration of existing industries which have been closely associated with high communication costs, high costs for gathering information, and high transaction costs. Finally, the Internet has created a new trading place, the virtual place where in business as a whole exists parallel traditional market and fulfills the needs of the same customers in general.



Part of the internet market      Part of the mix market ( online-offline)      Part of the tradicional market

**Table 1.0** the impact of E-marketing (internet) on the market.

During the last ten years the importance of the Internet has grown significantly, becoming more than a significant business opportunity – it is an inalienable technology. The success of the first-movers in electronic business, such as Yahoo!, Galileo CRS (www.galileo.com), Amazon.com, eBay.com, Google.com and others, has completely changed traditional way of doing business.

These companies became the market leader for a short time by selling products and / or virtual services, acting as sale intermediary, selling advertising space on the Internet, offering "everything for free", being a place in which others can carry out their activities and many other actions; most of their activities had nothing in common with the traditional market activities.

Key factor in electronic markets is the distribution which links their order and consumption. Therefore, factors such as the place in which the company is established (that means the server), and the place where the product is stored are not important. Is the information, which is at the forefront and "meets" the needs and desires of consumers.

Moreover, changing the meaning of concepts such as "Internet site", has affected the meaning of other concepts such as product planning, distribution planning, capacity planning, and others. This change has increased the freedom of doing business and planning activities of the companies, without adversely affecting customer satisfaction. From a business standpoint, the concept of competition has changed as an electronic company is competing all other companies, whether electronic or traditional all over the world.

The Internet has enabled and facilitated the penetration and movement of companies across different types of markets. Thus, growth and their market segments vary relatively easily and relatively quickly.

Because Internet technologies, the dynamic change in both traditional and electronic market is very high. As we can see on the picture presented, in order to maintain their stability, companies began to move in expanding the existing market segments (eg Google Inc. expanded itself on the internet by buying Youtube.com), and also moving towards traditional market segments (eg Google Inc. was introduced in traditional market by presenting mobile phones "Android Mobile"). In this way, both traditional and electronics companies began to move toward the two types of markets, being traditional -electronics traders.

Because of the Internet, now the competition is global, so the risk of being (suddenly) non competitive is very high. Only a few large companies manage electronic market, but this is not a signal for a long survival if these companies do not change their business model alongside changing customer requirements, thus shaping success. Thus, the configuration always has two aspects: 1) the expansion of market segments in the type of the existing market, whether electronic or traditional, and 2) the movement and strengthening to a particular position in the new market, whether electronic or traditional. Nowadays successful companies move in both directions.

Even in the Republic of Kosova impact of E-Marketing is quite large in manufacturing companies. Most of them are already oriented towards online advertising, always considering the speed of information transmission, fast communication and in long distances, as well as lower costs that are available to these companies through E-marketing.

- **APPLICATION OF E-MARKETING BY THE COMPANY "BIBITAGROUP"**

By the research conducted in companies manufacturing drinks in Kosova it shows that more than 70 percent of them do apply Electronic Marketing, on the other hand they try to avoid the large ely traditional marketing.

As a case study in this research is taken the company manufacturing drinks Bibita (Bibita bita Group), and is considered as one of the most serious and most competitive companies in the Kosovo market. The market potential for Bibita Group activity is approximately 2 million customers, while this unit transformed in litres amounts up to 800 million liters.

Actual participation of drinks by Bibita company is 0.5%.

Around the market, 5%, is distributed in hypermarkets, supermarkets, warehouses, and small stores (General Grocery).

Since in Kosova there are several factories producing drinks, Bibita Group always tries to bring innovations and be different in many respects always in favor of the customer and products that it offers

The activities of the analysis of critical control points and product quality management system products, Bibita Group in early 2009 has achieved to be certified with HACAP and ISO 2200:2005 standards. So the purpose of Bibita Group to offer the best original products was and will remain a priority

In its operating market, what makes the Bibita Company unique is the last word of technology which was installed at the beginning of 2009, and that consistently gets renewed and brings innovation.

The latest technology for manufacturing drinks in German "Krones", enables the company produce carbonated and non-carbonated drinks, in all existing containers.

On the other hand when we look at Bibita company in terms of e-Marketing application, we clearly see its goal for online advertising. Although the company's existing website is not yet used for sale, on the other hand the functions that it performs generate income, and at the same time save the company's budget shared for marketing. Through this web site [www.bibitagroup.com](http://www.bibitagroup.com), it offers customers and web site visitors more visual and attractive promotion, then are posted all the advertising the company Bibita has so far realized.

Warnings for proposals that will be held according to the schedule provided, job advertisements, etc all these columns that almost every day accept tens CV. However it is worth mentioning that the company now plans to change business strategy paying more importance to the online form.

As a promotional form that is already regular in the Department of Marketing at this company is the ongoing promotion of drinks through the website, which contains special spaces for new products (New Products), and visual disclosure of all other drinks in certain spaces of the web page.

Special form of promotion that the company undertakes in the context of E-marketing is the newsletter form, where the company each month publishes its newsletter (catalog) with multiple information on product assortment and content. This online newspaper sent to all e-mail address list that the company owns (database of 2,500 e-mail), including the company's customers, associates, and customers.

The company also give special importance to the promotion of its products through Facebook, where it constantly publishes innovation in assortment, as well as numerous information on products. Also as in the website also on Facebook, the company has published video advertising videos, which it has accomplished so far.

- **COMPETING MODELS THAT CAN BE IMPLEMENTED BY MANUFACTURING COMPANIES IN KOSOVA**

Since this era is characterized as an era of globalization, then to be more powerful in the market manufacturing companies in Kosovo must use advanced forms of distribution, sales, and products which it plans to bring in the future in the market.

In order to have everything under control, at the same time to be in direct contact with the customer, manufacturing companies should use disposition capabilities that their websites have and also use social networks which at this time are considered as a perfect opportunity to be closer to the customer.

Most companies manufacturing drinks in Kosovo (Bibita, Fluidi, Devolli Group, Laberion, etc.) have their available products displayed in their websites including sales prices, content, and other information, so why not have the final execution that of selling through these web pages. What companies will benefit is direct contact with the client, saving 3% (standard profit percentage applied by drinks manufacturing companies in Kosovo) which in most cases get sales managers for a product unit, as well as the amortization of vehicles, fuel, etc.

All these expenses required to put into service the website in sales function, contain a solid cost in relation to the benefits that this service brings.

**Tabela 1.0** Expenses for implementation of e-Commerce system

	Processing current web page: <a href="http://www.bibitagroup.com">www.bibitagroup.com</a>	Salary of IT manager	Total
<b>Annual expenses</b>	2000 €	4800€	4800€

Investment in infrastructure	Investment in technology	Secondary warehouse	Vans	vehicles	Total €
		2	15	4	
400.000 €	850.000€	80.000€	270.000€	56.000€	1.656.000€

*Table 1.1 The highest expenses Bibita company has had till now*

*Table 1.2 Investment in traditional marketing 2008/2009*

	Television	Radio	Newspaper	Bilbord	Sponsorships
<b>2008</b>	9800€	4000€	1900€	5500€	2000€
<b>2009</b>	10050€	4820€	2300€	7200€	1300€
<b>Total</b>	19859€	8820€	4200€	12700€	3300€

According to the data presented in the table resulting from the research done, it is clearly shown the importance of electronic marketing, given the huge impact that it has initially in reducing advertising costs, saving time, possibility of being closer to the customer and enhance the image of the company (good will).

- **FINDINGS AND RECOMMENDATIONS.**

Drinks manufacturing companies have invested quite a lot in web sites and their Content spaces, which clearly shows that they do not exploit the opportunities that they really offer. In this case, the web page of Bibita Group is seen as a good opportunity to build distribution capacities (sales), an issue which clearly shows that there are some shortcomings.

Drinks manufacturing companies are recommended that with the big spenders, this case hypermarkets which have administration and functional departments begin cooperation through E-marketing and E-bussines, that means selling in this market segment entirely through the web site.

Because the web sites of these companies possess detailed offers with product assortments, it is recommended that the abovementioned companies previously sign a contract with cooperative companies in this regard, over the price, discount, and then orders (selection of products by them), all payment forms are carried out electronically.

Manufacturing companies to achieve this form of distribution and sales must previously negotiate existing commercial banks in Kosovo with countries that wish to operate, so that all transactions without problem be realized through E-banking.

Benefits both in time and cost for manufacturing companies after the introduction of this form that provides E-marketing are quite large. They will save money, which so far has spent in the application of the traditional form of distribution and sales:

Cost savings for managers, who regularly visit hypermarkets (their salaries, fuel, vehicle depreciation). Above all, in this regard it is time that remains saved, always bearing in mind that everything will be done at the optimum time.

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	Managers	Fuel	Amortization	Total expenses for 1 year
<b>1 Month</b>	2100 €	480 €		
<b>1 Year</b>	25200 €	5760 €	600 €	<b>31020 €</b>

**Table 1.3** Costs that can be saved through the application of E-marketing

In the table in the column of the number of employed managers to visit hypermarkets is 3, while their monthly salary is 700 €.

Fuel is included for 3 vehicles. Cost for a vehicle during a month is 160 €.

Depreciation basis is considered regular vehicle service, with no other costs (damages) which takes place 4 times a year, or every 10000km, in this case milage will be twice less, and servicing will take place twice a year. Price for a car service is 100 €.

**FACTORS OF E-COMMERCE THAT AFFECT MANAGERIAL ACCOUNTING: CASE OF ALBANIA**

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**Abstract:**

*The aim of this paper is to define the impact that will have application of e-commerce in managerial accounting in Albania. The prime objective of this study is to reflect the effect that has brought application of e-commerce in the world countries in accounting field for define the changes and effects that will have application of virtual commerce in managerial accounting in Albania. Now, from financial international institutions application of e-commerce in promoted like one of the ways to overcome economic crisis. But, except the effects in other economic fields, application of virtual commerce affect also managerial accounting. In this context, primary in the study I will analyze the factors of e-commerce that have influenced in managerial accounting in the countries that already apply virtual commerce for determine the changes that may occur in Albania. For take reliable results from this study I will analyze also the accounting experts' opinions about the effect of e-commerce application in their work. In order to reflect only the impact in accounting field and to not complicate the analysis in this paper I will not be focused in the effect that cause virtual trade in other areas of the economy.*

**Keywords:** *E-commerce, accounting experts, Albanian businesses, professionals organizations, managerial accounting*

**JEL Classification:** *M41.*

- **Introduction**

The end of 1960s and early of 1970s is known from researchers like the period when e-commerce have the first manifest (Kenneth C. Laudon, Carol G. Traver, 2003). However, e-commerce in the manner that is conceived in that period not understands the virtual form for doing business of nowadays. Especially in period 1960-1970 information technology was used for fast transmission of documents in distance principally from military (Kenneth C. Laudon, Carol G. Traver, 2003). Year 1990 will mark the patent of biggest communication system that nowadays we call internet/www. This period is known like the internet epoch. Since those times are do continuous efforts for raise of web pages security inserting security protocols that have do possibility not only secure transactions of information through internet but also extensively use of electronic payment service.

After this period e-commerce is converted in a preferred form of doing business in which are involved and take profits not only developed countries but also developing states. Due to, considerable profits realized from e-commerce application; problematic that is presenting classic business's form through physical obligated presence; deepening even more of economic crisis, the countries and international financial institutions' focus is concentrate in utilization of information technology and in advantages brought by this technology.

Revolution brought by e-commerce application is felt not only to businesses but also to persons, organizations and governments (Callioni, 2004). Biggest profits realized form e-commerce, compared with other revenues, have attracted intention and all forces of her users in change of work strategy.

Companies, in frame of successes application of virtual commerce, have urgent necessary to implement also new management process, to change their business culture, to follow new procedures for their employment's management and to construct well-structured and secure online payment systems (Well, 2005). All these changes have sensitively affected one important discipline, management accounting.

- **The Problem of the study**

The motive of this study is to reflect the effects that will have e-commerce application in information accounting system and especially in management accounting in Albania. Questions that the study intends to give an answer are:

- What effects will have management accounting from application of e-commerce in Albania?
- How may confront Albanian economists the changes that will bring e-commerce application form businesses that operate in Albania?

### 1.2 The importance of this study

This study is important because aim to reflect the effects and the changes that will cause e-commerce application in management accounting factors in Albania. Because attentions of all countries is concentrated yet in information technology utilization and in investigation of possibility for apply e-commerce, is important to be done preliminary studies about the consequences that will have Albanian business for this commerce's form, especially in accounting field. That will bring fastest and more efficient confront of negative effects and prearrangement of key actors in this commerce model.

### 1.3 Study's hypotheses

- Ho: E-commerce application don't have important effects in management accounting in Albania
- Ho: Albanian economists aren't in condition to confront the effects that will cause e-commerce to management accounting in Albania.

- **Literature review**

"Management accounting change" has been widely used as an expression (see, for example, Burns and Vaivio, 2001), encompassing two types of development: the adoption of new tools and techniques which potentially enhance accounting practice, on the one hand, and, on the other, change in the role that the accountant performs, towards acting more in an advisory capacity integral to managerial decision-making rather than solely as a provider of information. Conceivably, both types of management accounting change may be observed simultaneously in a given organization, indeed it has been suggested that they may be subject to the same normative pressures (Granlund and Lukka, 1998a), but empirical evidence suggests that they are not mutually dependent.

Granlund and Lukka (1998a) argue that from an international perspective "drivers of convergence have started to dominate those of divergence" (p.155) as regards change in management accounting practices, and suggest that at least some of these drivers are shared with role change. However, they note that "particularities" of the organization constitute countervailing forces which may result in diversity among organizations characterized by, for example, type of business activity, size etc. and the possibility of such diversity is supported by evidence of variation in the importance of study topics among management accountants operating in different sectors and countries (Cooper, 2006).

In another study, Julie Hicks (2004) argued that e-commerce are increasing as more companies are developing a web presence and conducting business on the Internet. The accounting profession is affected in many dimensions by e-commerce. Management accountants must be aware of the company's strategy and how the Internet fits into the company's business.

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The increased technology and change in which global business is conducted will expand accountants duties and offer new challenges. Accountants must be informed about various e-commerce strategies in order to advise management on the best and most profitable way to enter into the world of e-commerce (M. A. Alsharayri, 2011).

Ihan, Veyis (2003) argued that advancements in information technology (IT) have enabled companies to use computers to carry out their activities that were previously performed manually. Accounting systems that were previously performed manually can now be performed with the help of computers. Therefore, improvements in the information technology have facilitated the use of cost and management accounting procedures. While some aspects of the "new economy" reflected an unrealistic bubble, many firms continue to be driven by intangible assets, the highly competitive global economy, and increasing technological change to forge changes in what accountants have thought of as their "traditional" accounting responsibilities. In many cases, accountants and financial staff are leading the way in changing their internal roles (S. K. Widener, 2002). The expansion of accountants' duties beyond traditional budgeting and reporting is occurring rapidly and is creating numerous opportunities for academic management accountants to conduct innovative research (S. K. Widener, 2002).

Regardless of the form of e-commerce, Foster and Lin (2004) list ten challenges for those developing e-commerce websites to consider: market/business sector, products/services, value chain, innovation and technology, customer focus, role of government, managerial issues, administrative/hierarchical structure, cost/performance and risk/reward. Foster and Lin (2004) contend that many e-commerce ventures failed during the dot-com boom because of a lack of planning and a proper grounding in traditional business planning techniques.

Venkatraman (2000) indicates that a business strategy that fails to recognize the importance of the internet is destined to fail. And ultimately, all business strategy will become synonymous with e-commerce strategy (Venkatraman, 2000).

Thankfully, computerized information systems, specifically database systems, have progressed to a point where it is economically feasible for organizations to track just about any kind of information. Now the real challenge for current and future management accountants is to organize the immense amount of data that can be provided to support decision making without creating information overload in managers and executives. In this process, management accountants should understand how to use the most current technology. Today's technology allows management to track performance information that goes beyond the cost-based information of historic general ledger systems.

The competence of e-commerce covers effective database management, sufficient financial supervision, and optimizing inventory control. Firstly, effective database management promotes the overall automation of enterprise flows and provides real-time operation information of an enterprise (Wen, 2007). Secondly, sufficient financial supervision is a brand-new financial management mode based on Internet and e-commerce. Development and construction of an enterprise's online financial management system mainly contains the following four parts: feasibility analysis of implementing online financing, system programming and design, implementation, operation, assessment, maintenance, and improvement of system (Manvi and Venkataram, 2005). Finally, in the labor intensive environment of an e-commerce operation there needs to be a quick means of measuring the value added (i.e., a producer's perceived utility by the customer) by employees as it relates to inventory items or their cost (Chan, Dillon et al., 2002).

Many other studies reflect that e-commerce have impact in management accounting in the countries where this business's form is apply.

- **Aspects of management accounting that are influenced from application of e-commerce**
- Use of JIT method for inventory holding. Businesses that apply e-commerce use for inventory holding buy system based in client's request. This method decrease the costs of excessive inventory holding and other costs like storage, protection, risk of damage, etc.
- Decision- making for investment isn't based more in comparisons of alternatives about building's costs, equipments and machineries but in investment for information technology with high transmission's capacities, in vigorously transmission's networks and in effective's software.



- A success of new products is depended from right marketing as well from business's image. Since clients can view the products only virtually their trust must to be very high in manner that they to be converted in buyers. The problem become biggest when we talk for new products.
- Planning and budgeting process's costs are changed from virtual sales not accompanied with physical presence. Building' cost will be substitute with website cost when will been realized virtual sales. Other costs will been software's costs, online transaction's costs, costs of network's maintenance, etc.
- Accounting decision- making is based more in technological and computer knowledge. Absence of these knowledge cause problems for realizes an efficient and profitable decision.

- **Situation in Albania**

Till yet Albanian businesses apply especially classic form of business with obligated physical presence while apply e-commerce only in seller's role. This causes more difficulties for Albanian business's situation because liquidities move only in one hand, from insight to outlight Albania. Only touristic agencies use actually e-commerce in seller position.

In this difficult situation Albanian businesses suffer from markets and liquidities' absence. For resolve these problems they have three alternatives:

- To try to raise buyers operating only in existing markets
- To expand the markets creating agency and branches in other cities or other countries
- To expand market creating virtual branches

Each of these alternatives has costs and profits for businesses.

#### 4.1. First alternative- To operate in existing markets

Activity's field chosen and the manner decided for realize this activity often not offer possibilities to businesses that operate in Albania to diversify their markets and buyers. However, the reasons of initiatives' absence for business's expansion and limitation of business's activity only insight Albania must to be related with two key factors:

- First with 50 years absence of private activity in Albania
- Second with short experience of Albanian businesses, only 21 years in market economy.

In this situation, Albanian businesses have two alternatives: to close the activity or to try to find new clients. Data taken from Albanian Statistics Institute and National Centre of Businesses Registry for five last years show that a considerable number of businesses, having development perspective, have closed their activities. Some others, hoping that situation will improve, tent to survive trying to find new clients. For this category of businesses, that try to find new clients, costs and profits are shown in table below:

**Table 1: Costs and profits for businesses that choose to operate only in existing markets**

Costs	Profits
<ul style="list-style-type: none"> <li>• To reduce profit's rates through price's reductions in order to attract new clients.</li> </ul>	<ul style="list-style-type: none"> <li>• Price's reduction may to raise the sales</li> </ul>
<ul style="list-style-type: none"> <li>• Exist the risk of receivables especially in permanent clients.</li> </ul>	<ul style="list-style-type: none"> <li>• Results of sales will raise inventory turnover avoiding old products</li> </ul>
<ul style="list-style-type: none"> <li>• The raise of promotion's costs for attraction of new clients.</li> </ul>	
<ul style="list-style-type: none"> <li>• Raise of penalties' value from fiscal institutions due to non-payment in time caused from absence of liquidities.</li> </ul>	
<ul style="list-style-type: none"> <li>• Raise of losses</li> </ul>	

The main risk of this alternative is especially raise of losses when their effects aren't they expected. Losses that will have businesses are: losses in time and financial losses. Losses in time include the time during which businesses do efforts for improve the situation, efforts that in this case result hopeless. While financial losses include all new costs that undertake business when this alternative is apply.

#### **4.2 Second alternative - To expand the markets creating agency and branches in other cities or other countries.**

This alternative is used from businesses for elude close of activity and for decrease expenses of operating only in existing markets. Businesses choose this alternative although has more high costs that prime alternative because also their profits are highly.

Costs and profits from creation of agencies and branches in other cities or countries are shown in table below:

**Table: Cost and profits from branche's creation in other cities or countries**

Costs	Profits
<ul style="list-style-type: none"> <li>• Cost of branch's registry like business</li> </ul>	<ul style="list-style-type: none"> <li>• Raise of possibility for selling products or services</li> </ul>
<ul style="list-style-type: none"> <li>• Cost of building necessary for branch activity</li> </ul>	<ul style="list-style-type: none"> <li>• Business' promotion in a broadly range than it local</li> </ul>
<ul style="list-style-type: none"> <li>• Cost of creation of necessary conditions for work in a new building</li> </ul>	<ul style="list-style-type: none"> <li>• Exploration of possibility for profit from lower costs of some services</li> </ul>
<ul style="list-style-type: none"> <li>• Cost for employers that will work in branches</li> </ul>	<ul style="list-style-type: none"> <li>• Quickly sales without necessary of market intermediators</li> </ul>
<ul style="list-style-type: none"> <li>• Cost for promotion in order to present new businesses' environments</li> </ul>	<ul style="list-style-type: none"> <li>• Raise of permanent clients' number</li> </ul>
<ul style="list-style-type: none"> <li>• Transportation cost</li> </ul>	
<ul style="list-style-type: none"> <li>• Cost for charging of new businesses' environments with necessary quantity of inventory</li> </ul>	
<ul style="list-style-type: none"> <li>• Investment in quality of products and services in order to attracts the buyers</li> </ul>	
<ul style="list-style-type: none"> <li>• Personal relationship after sale with clients for maintain them or for expand the clientage created</li> </ul>	

Only a little part of businesses, that tent to apply this investment alternative, have possibility to create branches in other countries, while other part of businesses realize their investment insight Albania. Cost for creation of branches oversight Albania is superiorly than the same investment realized in Albania. Investment in new branches is most profitable alternative than the first alternative, but also the costs are high. For this reason only big businesses and a little part of medium businesses that have sufficient liquidities, have possibility to apply this alternative.

#### **4.3. Third alternative - To expand markets creating virtual branches.**

The development that has arisen nowadays information technology creates for businesses the possibility to utilize alternatives that this technology offers.

One of these alternatives is also e-commerce. High profits that have provided countries that apply e-commerce have influenced the raise of other countries' efforts for doing reality this business' alternative. The reason that does this alternative more attracting is that with low cost that physical branches' creation to archive more profits. Also, this alternative offers for all businesses the possibility to expand their market in other countries, possibility which can't realize when physical presence is necessary. Costs and profits of investment n virtual branches are shown in table below:

**Table 3: Costs and profits of investment in virtual branches**

Costs	Profits
<ul style="list-style-type: none"> <li>• Cost for computer purchase and other necessary equipments</li> </ul>	<ul style="list-style-type: none"> <li>• Raise of possibility for realize the sales of products and services</li> </ul>
<ul style="list-style-type: none"> <li>• Costs of network' installment and maintenance</li> </ul>	<ul style="list-style-type: none"> <li>• Application of JIT method for inventory reduce the costs of inventory</li> </ul>
<ul style="list-style-type: none"> <li>• Costs of web page construction for business</li> </ul>	<ul style="list-style-type: none"> <li>• All sales are done with cash payment and this make zero the receivables and the risk of non-payment</li> </ul>
<ul style="list-style-type: none"> <li>• Costs of software's purchase and installment necessary for apply e-commerce</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction of personal relationships create the possibility to answer to many buyers in the same time</li> </ul>
<ul style="list-style-type: none"> <li>• Costs of PayPal account creation for realize payment through internet</li> </ul>	<ul style="list-style-type: none"> <li>• Take of requests 24 hour in 24 in all days of year</li> </ul>
<ul style="list-style-type: none"> <li>• Cost of time for promotion of webpage in social networks with high number of users</li> </ul>	<ul style="list-style-type: none"> <li>• International business' knowledge</li> </ul>
<ul style="list-style-type: none"> <li>• Shipment costs when are payee from business</li> </ul>	<ul style="list-style-type: none"> <li>• Profit for reduction for expenses like: lower number of employers; reduce of rent's costs, elimination of costs for personal relationships after sales, etc.</li> </ul>
<ul style="list-style-type: none"> <li>• Cost for qualitative service and promotion for buyers' attract</li> </ul>	<ul style="list-style-type: none"> <li>• Possibility for high profit's rates due also to costs' reduction</li> </ul>
<ul style="list-style-type: none"> <li>• Difficulties for create and conserve the image</li> </ul>	<ul style="list-style-type: none"> <li>• Most clear competition between businesses because their information is shown in business WebPages</li> </ul>
<ul style="list-style-type: none"> <li>• Difficulties for trust creation</li> </ul>	<ul style="list-style-type: none"> <li>• Better display of products or services and full information showed for products or services</li> </ul>

Based in all these profits that create e-commerce, this business' model is converted in a dominant model in manner in which business tent to expand their investments. Adaptation and known of developments that has raised information technology is considered like one of the factors for virtual expansion of businesses through internet.

Although remain much more for doing in this direction, we must to say that investment in technology in Albania is an positive step towards elimination of barriers in manner that Albanian businesses to tent to apply third investment's alternative; to be part of virtual commerce also in seller position.

- **Analyze of questionnaire directed to Albanian economists**

For giving one answer a hypotheses raised in this study, in this part of material we done the conclusions of statistical analyze realized with data taken from questionnaire directed to Albanian businesses. For testing the hypotheses is used ANOVA analyze.

- *Ho: E-commerce application haven't important effects in management accounting in Albania*

**ANOVA**

	Sum of Squares	Df	Mean Square	F
Between Groups	1272.4	4	318.1	3.004345
Within Groups	2117.6	20	105.88	

From ANOVA analyzes we can see that  $F_{\text{factual}} > F_{\text{theoretic}}$  ( $F_{\text{theoretic}} = 2.87$  s.d). In base of these conclusions we can say that zero hypothesis is rejected, so e-commerce application has important effects in management accounting in Albania.

- *Ho: Albanian economists aren't in condition to confront the effects that will cause e-commerce to management accounting in Albania*

**ANOVA**

	Sum of Squares	Df	Mean Square	F
Between Groups	1171.6	4	292.9	4.888184
Within Groups	1198.4	20	59.92	

From ANOVA analyzes we can see that  $F_{\text{factual}} > F_{\text{theoretic}}$  ( $F_{\text{theoretic}} = 2.87$  s.d). In base of these conclusions we can say that zero hypothesis is rejected, so Albanian economists are in condition to confront effects that cause e-commerce to management accounting in Albania.

**Conclusions.**

- E-commerce application cause important effects to management accounting. Studies done by researchers indicates that e-commerce cause effects in many aspects of management accounting like, inventory, cost, decision- making, investment, budgeting, etc. Also statistical analyze realized in base of Albanian economists' answers indicate that e-commerce application will have important effects in management accounting in Albania.
- Due to economic crisis situation of businesses that operate in Albania is declining especially in direction of liquidities and markets' absence. For confront these problems businesses have three possibilities: 1) To try to raise buyers operating only in existing markets; 2) To expand the markets creating agency and branches in other cities or other countries; 3) To expand market creating virtual branches.
- If Albanian businesses will apply e-commerce, ANOVA analyzes, realized in base of Albanian economists' responses, point that Albanian economists are able to confront the effects that will cause that in management accounting in Albania.

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20. **Annexes**
21. *Questionnaire*
22.
  - In which category You belong?
23.
  - Private businesses' economist
  - Public institutions' economist
  - CPA
  - Accounting expert
  - In which level from 1-5 is information that You have from e-commerce?
  - 1-None      2-Little      3-Medium      4-Enough      5- A lot
  - If e-commerce will be applied in Albanian businesses will have that effect in management accounting, according to Your opinion?
  - YES                      NO

- If yes, which from management accounting factors showed below will be affected from e-commerce application?
  - Inventory
  - Cost
  - Decision- making
  - Investment
  - Budget
  - All factors
  - Other specify \_\_\_\_\_

- Choose + in level that e-commerce affects management accounting's factors. (according to your opinion)

1. Factors	1. 1-None	1. 2-Little	1. 3-Medium	1. 4-Enough	1. 5-A lot
2. Inventory	2.	2.	2.	2.	2.
3. Cost	3.	3.	3.	3.	3.
4. Decision-making	4.	4.	4.	4.	4.
5. Investment	5.	5.	5.	5.	5.
6. Budget	6.	6.	6.	6.	6.

1.

- In which level, according to You, Albanian economists are able to confront effects that will cause e-commerce application to management accounting's factors? Mark + in table below.

2.

1. Factors	1. 1-None	1. 2-Little	1. 3-Medium	1. 4-Enough	1. 5-A lot
2. Inventory	2.	2.	2.	2.	2.
3. Cost	3.	3.	3.	3.	3.
4. Decision-making	4.	4.	4.	4.	4.
5. Investment	5.	5.	5.	5.	5.
6. Budget	6.	6.	6.	6.	6.

1.

**Thank You!**

**AN EMPIRICAL ANALYSIS ON MARKETING AND CUSTOMER-ORIENTATION FOR E-COMMERCE FROM THE FIRM' CUSTOMER'S PERSPECTIVE. THE CASE OF ALBANIA AND MACEDONIA**

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**Abstract:**

*Electronic commerce has not been as successful as expected by many companies in the business-to-consumer sector. Theories from information systems and strategic marketing are integrated to develop a framework for understanding the direct, mediated, and moderated influences of contextual marketing and customer-orientation strategy on site satisfaction. The present study is an initial, exploratory step in empirically investigating the associations between the perceived importance of contextual marketing and e-business customer orientation strategies, and user satisfaction with Internet storefronts. It also studies the link between off-line business strategy (market/customer orientation) and on-line commerce development. Departing from the simple linear association approach, it investigates the moderating role of privacy concerns and site design complexity and the mediating role of perceived site value. The framework of the study integrates business theories such as contextual marketing and privacy concerns in information systems, customer orientation in strategic marketing, and site value in advertising. Empirical testing shows that customers' perceived contextual marketing and customer-oriented strategies are associated with site satisfaction and loyalty. Departing from the simple linear association approach, the study also investigates the moderating role of privacy concerns and site design complexity and the mediating role of perceived site value. It finds that the influence of contextual marketing and customer-orientation strategy on site satisfaction is moderated by the perceived complexity of the site design but not by consumer privacy concerns. These influences may also be mediated by perceived site value. Overall, the contextual marketing approach of providing personalized, real-time information to customers at the point of need will obtain competitive advantage in e-commerce.*

**Key words :** consumer behavior, contextual marketing, customer orientation, Internet marketing, privacy concerns.

**JEL Classification:** M39.

**Introduction**

Electronic commerce has not been as successful as expected by many companies in the business-to-consumer sector. With more than \$10 billion invested on the Web, large companies find that less than 1 percent of strategic customer on-line profile is useful. This does not mean that e-commerce is futile and there are no e-commerce winners (e.g., 1-800-contacts). As Aufreiter, Ouillet, and Scott note, the fundamental factor that sets Web winners apart is superior marketing in obtaining customer knowledge and satisfaction.

Echoing this view, Kenny and Marshall hold that the key to attracting repeat visits and customer loyalty is contextual marketing, which they define as the practice of providing personalized information to customers at the point of need in real-time. Thus businesses may enhance Web users' satisfaction and loyalty, materializing enormous e-opportunities, by providing contextual information to customers in real-time. Given the potential importance of contextual marketing, it is surprising that scholars have not yet empirically investigated this subject in the literature.

### **Contextual Marketing**

According to Kenny and Marshall, contextual marketing refers to the extent to which e-businesses use the ubiquitous Internet to provide customers with relevant information in the right context and in real-time. Contextual marketing is important because users are already information-overloaded. What they need most is relevant information provided in real-time at the point of need. Empowered customers are in control in the information age. They opt in only to the most relevant messages on their screens. In fact, most consumers who go on-line for a specific purpose tend to be impatient. If a banner ad is not relevant to a customer's information search, it will not be successful. Someone searching for National Football League results will see an on-line promotion of life insurance as irrelevant and out-of-context either way, unlikely to generate satisfaction or purchase intention/decision.

An interesting example of contextual marketing on the Internet is Johnson & Johnson's Tylenol Web advertising campaign. Whenever the stock market (i.e., the Dow Jones Industrial Average) drops by more than 100 points, banner ads for Tylenol pop up on on-line brokers sites.

Thanks to the ubiquitous nature of the Internet, marketers have never been so empowered to effectively and efficiently achieve the goal of marketing delivering the message for the right product (headache reliever) to the right customer (on-line brokers) at the right time (collapse of stock market). At a minimum, Johnson and Johnson's campaign may reinforce the brand image and promote Tylenol awareness in real-time, thereby ultimately leading to purchase intention and brand loyalty.

The Internet is becoming ubiquitous and will eventually be accessible from everywhere. Ubiquity will allow businesses to remain in contact with their customers 24 hours per day. Advanced technologies (e.g., wireless and mobile technologies) and the Internet are reaching customers whenever and wherever they want. The tools of contextual marketing may include wireless phones, personal digital assistants, interactive Web-connected kiosks, electronic wallets, and many other access technologies. Mobile devices and Internet access will let contextual marketers link real-life situations to virtual information and offerings.

Contextual marketing strives to find out who the customers are, where they are located, and what they are doing. The firm should actively understand its customers and actively deliver its message at the appropriate time and place.

From the firm's perspective, contextual marketing is active and dynamic. From the customer's perspective, however, it may be passive and reactive. The customer passively receives information presented at a given time and place, and either responds or ignores it.

Companies that master the complexity of the ubiquitous Internet and contextual marketing may gain substantial competitive advantages: more efficient targeting of market segments and offering a more valuable product at a premium price. Contextual marketing gives companies more ways to connect to their customers and opportunities to better exploit such relationships.

Real-time marketing refers to the extent to which the firm can offer products and services at the customer's location, in real-time, based on the customer's choices and actions. As McKenna notes in discussing the switch from a firm-to-customer approach to a customer-to-firm approach, marketers once used to target customers via broadcast but now need to invite them in via dialogue.



Aided by the emerging technologies, marketers may initiate real-time dialogues with their customers and provide them with interactive services. In the real-time world, traditional marketing connections to customers (e.g., focus groups, consumer surveys) are not enough to build customer loyalty and brand. Instead, companies need to engage, via information technology in a continuous dialogue with customers about product development, experience with the product, service support among suppliers, distributors, and the like. Dialogue with consumers is important in that it is the way firms can achieve context and ultimately obtain greater customer loyalty and superior performance. The time-value or time-sensitivity of information has been described as “the most significant factor in managerial decision-making” in an off-line environment. In the dynamic, turbulent electronic market, the value of information depreciates quickly and, thus, its time-sensitivity should be even greater. This means that capability for real-time communication and contextual marketing may become a key issue of strategic planning and a source of competitive advantage for e-business to gain customer repeats visits and satisfaction. Therefore, the first hypothesis states:

*H1: User perception of the importance of contextual marketing is related to satisfaction with Internet storefronts.*

In off-line markets, according to Kohli and Jaworski, market orientation may lead to positive customer attitudes and behaviors. Senior management reports that customer satisfaction, positive word of mouth, and repeat business are all outcomes of a firm’s strategic customer orientation. Therefore, Kotler asserts, customer orientation promotes customer satisfaction. In the same vein, if a firm in the virtual market space is committed to meet its customers’ real needs wherever the customers are and whenever they have a need, its customers are more likely to perceive that the firm is practicing a customer-orientation strategy, and thus will feel satisfied and become loyal to the sites. Therefore:

*H2: User perceptions of the importance of customer-orientation strategy is related to satisfaction with Internet storefronts.*

Departing from the simple linear association approach, the discussion that follows will explore when and how contextual marketing or customer orientation matters, given the moderating role of privacy concerns and site design and the mediating role of perceived site value.

Based on the exchange theory, Ducoffe predicts and supports the mediating role of on-line ad value in determining attitudes toward Web ads. By the same token, for e-commerce exchanges to be evaluated positively in the post-purchase stage, buyer and seller must both give and receive value. Site value, therefore, is believed to mediate the associations between perceived importance of contextual marketing and customer orientation and perceived satisfaction with Internet storefronts.

*H3: Site value mediates the relationship between the perceived importance of contextual marketing and satisfaction with Internet storefronts.*

*H4: Site value mediates the relationship between the perceived importance of customer-orientation strategy and satisfaction with Internet storefronts.*

When users are very concerned about their privacy, they will be less likely to provide true and detailed information to Web business. This reduces the effectiveness of contextual marketing and customer orientation strategies. Thus contextual marketing and customer orientation strategies will be less likely to draw positive attitudinal satisfaction from users with high privacy concerns.

*H5: Users’ privacy concerns moderate the relationship between the perceived importance of contextual marketing and satisfaction with Internet storefronts.*

More specifically, user privacy concerns weaken this relationship.

*H6: Users' privacy concerns moderate the relationship between the perceived importance of customer orientation and satisfaction with Internet storefronts.*

More specifically, user privacy concerns weaken this relationship.

Contextual marketing and customer orientation strategies will be less likely to generate positive attitudinal satisfaction among users surfing complicated sites.

*H7: Perceived complexity of site design moderates the relationship between perceived importance of contextual marketing and satisfaction with Internet storefronts. More specifically, perceived complexity of site design weakens this relationship.*

*H8: Perceived complexity of site design moderates the relationship between perceived importance of customer orientation and satisfaction with Internet storefronts. More specifically, perceived complexity of site design weakens this relationship.*

## **Method**

Data for this study were collected with an intercept survey method in Albania and Macedonia. Several research interviewers ( students ) were recruited and trained for the purposes of this project. They were instructed that the subjects had to be individuals familiar with the Internet through at least one year of on-line experience. From 240 interviews, 178 questionnaires (valid response rate of 74.16% =178/240) were collected and deemed complete and useful for the purposes of this research. A similar intercept- based survey methodology can be found in the literature.

Among the 178 subjects interviewed, 51 percent of the Internet users were female and 49 percent male. The respondents ranged in age from 19 to 53, with a mean of 23 years. Most of the users (80%) connected to the Web using local Internet service providers (e.g., Buffnet), and 15 percent used on-line service providers (e.g., AOL). On average, the interviewed users spent seven hours per week on the Web and had more than four years of on-line experience. In terms of shopping on-line, all the subjects had some purchase experience. More than 75 percent of them reported having made at least three purchases via the Net.

Since the research was limited to business-to-consumer e-commerce, respondents were instructed to report their evaluation of each statement based upon their experience with Internet storefront sites selling books, CDs, computers, traveling, and similar items. The level of analysis with storefront Web sites is in line with the existing e-commerce literature. After all, customer attitudinal perceptions of the Web as a whole have been utilized in the literature. In particular, Ducoffe concluded that a general approach to Web advertising, rather than a focus on a specific on-line ad, would help to determine whether any generalizable criteria account for consumers' valuations of and attitudes toward Web ads.

All the measurement scales in the final questionnaire were multiple items with Likert-type seven-point scales, anchoring at 1 ( strongly disagree) and 7 ( strongly agree).

The perceived importance of contextual marketing was measured by a new scale developed in accordance with the established scale-development procedures suggested by Churchill and later revised by Anderson and Gerbing. In particular, a series of focus groups and interviews were conducted for scale-item generation, scale purification, and scale validation. For instance, to achieve the face validity of contextual marketing, the domain of the construct was carefully specified after consultation of published works on the theory of contextual marketing and the theory of real-time marketing. Qualitative interviews were conducted with some open-ended questions in a semi-structured and undisguised questionnaire. As a result, a pool of 28 items was generated in order to capture the wireless, ubiquitous, relevant, personalized, contextual, and real-time concepts included in the contextual marketing domain. Exploratory factor analysis (maximum likelihood with varimax rotation) was then done on the items using a separate sample of 79 respondents in a pretest.

To achieve better internal consistency reliability and various types of validity (e.g., convergent and discriminant validity through the use of confirmatory factor analysis), the measurement was purified with this independent sample of 79 respondents.

The number of items was finally reduced to six for the formal survey of the 178 respondents. The validity of the scale is discussed in detail at the end of this section. Great care was taken to achieve the construct face validity of the key measure of the perceived importance of contextual marketing.

The resulting measure for contextual marketing seems justified in that the contextual marketing practice, by definition, is characterized by utilizing multiple access points, such as wireless phones, PDAs, kiosks, and e-wallets, by proactively reaching customers wherever they are, by focusing on the right context and real-time value, and by being there whenever and wherever your customer is ready to purchase. As a result, the final six-item scale assesses Web user perceptions of the importance of using wireless phones that connect to the Internet, developing features that come to me in real-time, using kiosks in malls to find shopping discounts, using wireless devices to shop on-line, using e-wallets when checking out, and developing banner ads that pertain to personal interests and needs.

The scale for customer orientation of e-business was developed based on the existing measures in the literature. In the strategic marketing literature, the customer orientation scale is a well established, widely accepted, and very influential construct. It has four items: assess the extent to which e-businesses should be concerned with customer satisfaction, build a long-term relationship with shoppers, put more emphasis on adding value for shoppers, and commit to serving user needs.

Privacy concerns were assessed through an existing five-item Likert-type scale. The scale of site value consisted of three separate Likert-type items. It was a new scale developed on the basis of the existing measure of ad value.

Grounded in exchange theory, ad value refers to an overall representation of the worth of advertising to consumers, or the extent to which advertising is useful, important, and valuable to them. Conceptually, ad value could be the basis for site value in that these two constructs both try to capture the degree to which perceived benefits are delivered to consumers. Empirically, as reported in the advertising literature, the ad value scale achieves the desired reliability and face, discriminant, and convergent validity. The ad value scale was generalized by Chen and Wells to create an important e-commerce effectiveness metric: the widely used scale of attitude toward a site. Site value strives to assess the degree to which users agree that a site is valuable, useful, and important to them.

The measure of site-design complexity consists of four items, developed on the basis of the three-item Likert-type scale of site design by Szymanski and Hise. This measure assesses Web users' perceptions of statements like try to avoid navigating complex Internet Web sites.

Following Anderson and Gerbing's guidelines, all the measurement models were evaluated with multiple criteria: unidimensionality, reliability, construct validity, and convergent and discriminant validity. Evidence was found for the internal consistency of all the constructs except complexity of Web design. As reported Cronbach's alpha was 0.82 for contextual marketing, 0.84 for customer-orientation strategy, and 0.84 for privacy concerns.

Site value and user satisfaction with Internet storefronts were also found to possess sufficient reliability, because Cronbach's alpha was 0.93 and 0.92, respectively.

Confirmatory factor analyses (CFA) were employed to test the measurement model with all the constructs. The CFA results supported the unidimensionality, convergent validity, and discriminant validity of the six-factor measurement model after dropping one indicator of the contextual marketing construct. The loadings of all the items on their corresponding constructs were significant at  $p < 0.05$  ( $t$  ranges from 3.10 to 28.81, demonstrating adequate convergent validity). Owing to the insignificance of the modification indices and estimated residuals from CFA, unidimensionality was also achieved.

In addition, the discriminant validity of the measure model was supported by checking the pairwise correlations (correlations range from 0.04 to 0.52, different from 1.0).

### **Analysis and Results**

Hypothesis 1 predicts that the perceived importance of contextual marketing is associated with satisfaction with Internet storefronts. As reported when site satisfaction is the dependent variable, the estimated coefficient of contextual marketing in model 1 is 0.17 ( $t = 2.45$ ,  $p < 0.01$ ). Therefore, H1 is supported. The regression results also support H2 in that the coefficient of customer orientation is 0.42 ( $t = 6.25$ ,  $p < 0.01$ ).

The study found that the associations between perceived importance of contextual marketing and customer orientation and e-satisfaction are moderated by the complexity of site design but not by consumer privacy concerns. These associations may carry out through the delivered value to Web users.

### **Managerial Implications**

This study has several implications for firms that wish to build a successful future on the Internet. First, electronic marketers should understand that Web users are already information-overloaded. What they need most is relevant information provided in real-time at the point of need. This means that contextual marketing is important for the success of e-businesses. The winners in e-commerce will be the firms that can touch customers directly and individually, in real-time, whenever they are ready to purchase. Such firms will have to become direct marketers, retargeting and tailoring their messages to different customers in different contexts. Contextual marketing will give companies a better chance to reach customers and improve their financial performance by selling products at the point of need at the right place and time.

Second, e-businesses, like off-line businesses, should adopt a customer-orientated strategy. Only Web sites that build e-business models based on meeting customer needs and wants will survive and prosper. Ultimately, superior marketing skills and commitment to customers' long-term satisfaction will determine the future of Web businesses. The winning companies will be the ones that master database-marketing tools and understand their customers' current and potential needs at the point of need.

### **Theoretical Implications**

A limitation of this study is that it only investigates the associations between perceived importance of contextual marketing and site satisfaction from the perspective of Web users. Future research might fruitfully evaluate these factors from the perspective of Web businesses. New views on e-practices and strategies will make it possible to generalize the study's findings. The importance of customer orientation for e-commerce has been largely ignored in the literature. The present study is an exploratory step in extending the theory of market orientation into an on-line business situation. Webb, Webster, and Krepapa note that only a few studies evaluate market-orientation strategy from the standpoint of customers. The present study alleviates this deficiency by evaluating the perceptions of Web users.

Additional research in the context of e-commerce may shed light on the synergy between the customer orientation of a marketing concept and the customer resource life-cycle model. There is a great need for empirical evidence to test the theory of customer relationship management for enhancing competitiveness and creating a strategic advantage. Given the theoretical importance of e-satisfaction, future research should empirically explore its possible consequences in the areas of purchase intensity and frequency and of complaint behavior. The study introduces site value as another measure of Web business effectiveness based on the ad value theory in the advertising literature. Future research is needed to model other antecedents and consequences of site value (e.g., [1]). Finally, one may express concern about the broad scope of the items in the contextual marketing scale.

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**TRAFFIC SOURCES FOR TRAVEL RELATED WEB SITES IN ALBANIA**

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**Abstract:**

*Travel and Tourism is one of the main industries in Albania with 21.8% total contribution to GDB in 2011. The Internet as new and highly interactive medium enables Albanian travel providers to reach and communicate with numerous prospective clients all around the world and significantly increasing their revenue. According to latest studies, the most important traffic sources for web sites in most industries are search engines and social media sites like Google and Facebook (respectively). There are different strategies and methods available to web site owners for reaching internet users regarding these sources in order to increase the number of website visitors. The main purpose of this paper is to identify the most important traffic sources for Travel related Websites in Albania and give directions to web site owners where to focus their future Internet marketing effort.*

**Keywords:** *Tourism, Internet Marketing, e-Commerce, Social Media Marketing, Search Engine Marketing*

**JEL Classification:** *L81, L83, L86, M15, M31.*

**1. Introduction**

The travel and tourism is regarded as one of the biggest industries in the world generating an estimated 11% of the global gross domestic product (GDP), employing 200 million people and serving 700 million tourists worldwide. The number of worldwide tourists is expected to double by the year 2020 (Roe & Urquhart, 2001). Albania after its democratization, as an emerging tourist destination, notes a substantial growth in this industry following the implementation of the “Tourism Development Strategy” in 2003 and especially after the establishment of the National Tourism Entity in 2005 which role was to increase worldwide promotion of Albania’s tourism (Ministry of Tourism Culture and Sports, 2007). The number of tourists that visited Albania from the year 2006 to 2010 rose from 0.9 million to 2.3million per year (Matja 2012), what is approximately 26% average annual growth. According to World Travel & Tourism Council (2012) the direct contribution of travel and tourism to GDP in Albania in 2011 was 6.2% and is expected to grow by 5.4% per year and reach 7.0% of GDP by 2022. In addition, the total contribution (including wider effects) of travel and tourism to GDP in 2011 was 21.8%. The World Bank (2009) in its report states that Albania's tourism sector is still in its infancy (according to the product life cycle concept), and has potential for further growth.

On the other hand, the Internet with its growing population has technologies which provide the travel enterprises with an unprecedented level of connectivity and the ability to communicate efficiently and effectively with global customers. Electronic commerce (e-commerce) which operates on the backbone of the Internet could help the travel and tourism organizations generate additional revenue by reaching the markets they could not access using traditional systems. Adoption and usage of e-commerce in the developed world has produced tremendous results with revenues in the travel and tourism industry set to increase dramatically (Briggs 2001; Werthner & Ricci 2004; Maswera, Dawson, Edwards, 2009).

The Internet and E-commerce can also help travel enterprises in developing countries to reach potential customers and increase revenues (APEC Tourism Working Group, 2002; Khan, 2002; Kim 2006; Hinson, 2007). In parallel, a recent research shows that web presence of Albanian travel organizations (and companies) is insufficient (The World Bank, 2009). The positive trends regarding the Internet and the travel industry and also the benefits that e-commerce can bring in travel and tourism should encourage Albanian enterprises to implement and exploit web solutions in order to generate and grow income in this sector. Besides establishing online presence and implementing e-commerce solutions for travel related websites another more important challenge is to increase website traffic (Maswera, et al., 2009) by implementing efficient online marketing strategy. Many studies show that largest external traffic sources for web sites in many industries, including travel, are search engines and social media sites (SeeWhy, 2011; Sterling, 2012; Reeves 2011; Cacai, 2012), where Google is a leading search engine with contribution of 91.6% of all searches (StatSounter 2012a) and Facebook is a leading social media with 65.7% of social media referrals to web sites (StatCounter 2012b).

The main objective of our research in this paper, through analysis of current position of Albanian travel related web sites and comparison with global and regional sites, is to identify the most important traffic sources for these websites and to give directions to web site owners where to focus their future Internet marketing effort and develop appropriate online marketing strategy.

## 2. Methodology

The first step in the research was to identify, as much as possible travel related Albanian websites. This sites include various tourism organizations, travel portals, travel destinations, attractions, hotels, resorts, beaches, travel agencies, tour operators etc. (Airlines were excluded). To discover these sites different sources were used like Google Search, Facebook Search, Alexa.com, Dmoz Directory, local web directories and relevant tourism websites. Discovered web sites that were ranked from most visited to least visited using the Alexa Traffic Rank provided by Alexa.com. Other collected data for the websites using Alexa were; upstream clicks (which sites did users visit immediately preceding the site), search referrals and number of incoming links. The reach was calculated from relative reach on 1 billion users on daily bases. Other data collected was the Google PR from the Google Toolbar and number of likes on Facebook fun pages of the analyzed websites. The same data was collected for the most prominent travel related websites on global level and in Greece, Croatia, Macedonia and Montenegro in order to make comparison to the Albanian web sites.

Regarding the data collected from Alexa.com we must point out that there is a dispute among Internet marketers about its accuracy and also a disclaimer by Alexa.com itself. The Alexa web ranking functions as a panel of customers and collects data from the Alexa Toolbar installed by several million Internet users around the world (Alexa 2012) and some other (unstated) sources. Having that in mind its clear that results can vary compared to real data, especially for sites with low rankings (100,000+) as stated in the disclaimer. Since the goal of the research is not to accurately rank websites and measure incoming traffic sources but to give general perspective of the current situation and identify future possibilities we find the data from Alexa suitable for this type of research.

## 3. Findings

During the research, more than 100 Albanian travel websites were investigated and more than 120 sites from the other selected countries. The ranked and analyzed web sites are given in the following tables. (Table 1. and Table 2.).



**Table 1. :** Albanian Travel Related Websites Rankings

	Web Site	Alexa Rank	Reach	Click Up-stream %		Facebook Likes	Search %	Page Rank	Links
				Google	Facebook				
1	edialtour.com	322892	3600	27.0	3.7	48777	21.2	4	249
2	albaniabookinghotel.com	386129	2300	23.1	/	2	14.8	0	36
3	albania-hotel.com	492833	2800	31.9	/	634	39.5	4	163
4	radiotravel.al	569430	1700	15.2	/	2397	3	2	52
5	plazh.com	621776	1710	28.7	17.0	136222	10.3	2	29
6	vas.al	712916	1480	18.4	6.0	12620	2.7	3	47
7	albaniantourism.com	938915	1900	/	/	328	22.2	6	512
8	savatours.com	1455621	790	31.3	/	25891	25.8	2	30
9	iliria-agentur.com	1473863	850	/	/	430	23.7	3	124
10	lolitours.com	1804981	480	31.0	/	696	7	1	12
11	uniontravel.al	2089271	440	48.8	/	690	25.9	3	17
12	hotel.al	2418883	430	33.3	/	N/A	21.6	4	32
13	globaltravel.al	2538767	350	28.6	/	4709	21.3	2	7
14	united-albania.com	2865704	400	/	/	N/A	21.7	5	157
15	adriatikhotel.com	2913475	300	/	/	1383	40	3	40
16	albania-holidays.com	2994487	350	/	/	634	10	3	49
17	albaniaholidayhomes.com	3147228	250	/	/	47	12.5	1	9
18	pasha-holiday.com	3150886	310	36.0	/	N/A	14	0	4
19	outdooralbania.com	3328493	250	/	/	N/A	19	4	90
20	choosealbania.com	3503445	270	/	/	N/A	11.7	2	7

**Table 2. :** Albanian Travel Related Websites Rankings Compared to Global and regional travel sites

	Web Site	Alexa Rank	Reach	Click Up-stream %		Facebook Likes	Search %	Page Rank	Links
				Google	Facebook				
<b>Global</b>									
1	booking.com	159	5610000	20.6	2.6	467417	21.2	N/A	37387
2	tripadvisor.com	240	4126000	26.0	3.7	192463	28.8	8	89907
3	expedia.com	409	2537000	14.6	2.0	1404324	11.5	8	23130
4	priceline.com	670	1469000	11.4	<1.60	225200	10.2	7	11845
5	kayak.com	789	1475000	18.6	3.0	78311	12.2	7	10207
<b>Greece</b>									
6	greeka.com	32328	47000	39.0	2.1	9756	36.1	6	2316
7	travelplanet24.com	38678	37500	39.9	2.9	29510	30.5	4	284
8	pamediakopes.gr	47041	32200	44.4	3.9	7981	30.5	5	376
<b>Croatia</b>									
9	croatia.hr	50668	31100	26.7	3.3	785667	27.5	7	4682
10	adriatic.hr	57038	25400	25.3	4.0	8021	18.2	4	637
11	uniline.hr	69085	21600	37.6	/	1778	32.3	5	479
<b>Montenegro</b>									
12	cipa-booking.me	271359	4100	7.8	/	35	3	3	96
15	visit-montenegro.com	350873	4800	24.3	/	1632	33.6	6	871
18	montenegro-traveler.com	475968	2500	25.0	/	557	23.6	4	101
<b>Macedonia</b>									
13	savana.com.mk	306767	3900	20.6	8.0	8553	11.9	3	86
17	atlantis.mk	407001	2700	17.0	8.3	5139	7	3	42
20	ajdenaodmor.mk	506726	2400	11.0	32.8	14458	5.4	2	21
<b>Albania</b>									
14	edialtour.com	322892	3600	27.0	3.7	48777	21.2	4	249
16	albaniabookinghotel.com	386129	2300	23.1	/	2	14.8	0	36
19	albania-hotel.com	492833	2800	31.9	/	634	39.5	4	163

The Table 1. represents the 20 most popular (most visited) Albanian travel related websites and Table 2. represents 5 most visited websites on global level and 3 most visited web sites in selected countries in the region including sites from Greece, Croatia, Montenegro and Macedonia. The sites are ordered according to the Alexa Traffic Rank of the given websites. Since the Alexa Traffic Rank only represents the site's order by popularity the next column (Reach) is given and it represents approximately estimated number of daily visitors a site receives, calculated on a base of 1 billion users.

Having in mind that the percentual reach is estimated based on Alexa's pool of internet users the figures might vary from real daily visitors but are useful, since sites with different rankings can be compared. The next columns, Upstream Clicks, show which websites users visited immediately before the given site. These figures do not represent only referrals (clicked links) but can also include switching sites without following links.

The research showed that some sites can have different sources of traffic but the most present and most significant are Google and Facebook, and therefore we present Upstream Clicks only for these two sites. The column about Facebook Likes, represent the number of Facebook users that clicked "like" (followed) a site's fun page on Facebook. In some cases certain sites have a fun page and a group page. In that case the total sum of users in both pages is presented. The column named as "Search %" shows the percent of visitors a site received from search engines that besides Google can also include searches from Bing, Yahoo, Ask and others. Anyway, other search engines really show up in the Upstream Clicks. Other reason for variations in the Upstream results and Search results comes from the fact that Upstream links are not always a link clicks, and also because Google on the same domain (under different subdomain) hosts other services like Gmail and Google Plus.

The last two columns of the tables represent the link popularity of the web site. The higher the number of the Google Page Rank (from 1 lowest to 10 highest) and the more inbound links to a site means that other webmasters give a credit to a site by linking to it. The Page Rank (PR) concept is introduced by the founders of Google, Sergey Brin and Larry Page in 1998 and it quantifies the inbound links that come from other sites (directly and indirectly) based on a specific formula (Brin & Page 1998). The toolbar representation of the actual PR (from 1 to 10) is measured on logarithmic scale what means that sites with PR 2 has much more inbound links than double of links to sites ranked with PR1. The number of links presented in the tables does not include all inbound links to a site but counts only one direct link that comes from certain domain. For that reason, the number of links and PageRank are obviously not in correlation. The PageRank of a site and inbound links in general show two things. The quality, usability, relevancy and importance of a certain site observed by other webmasters, and/or the internet marketing effort of the site owner what should result in more links, higher PR and further in increased number of visitors that come through those links directly and by improved rankings in search engine results.

Presented results in the tables and all relevant data gathered by the research, show that Albanian sites are ranked low due to low number of visitors. (According to our data, based on a three sample sites, real daily visitors could be 6 times lower than the Reach presented in the tables). That means that top rated Albanian sites might have around 600 daily unique visitors and the sites ranked around the 20<sup>th</sup> place might have less than 50. The sites that are not presented in the list have even lower amount of daily visitors. In comparison with sites in the region (Table 2) can be noted that Albanian websites have around 10 times less visitors than the top sites in Greece and Croatia. The rankings of Albanian websites are comparable with those of the neighboring countries, Macedonia and Montenegro. Observing the data we can consider that only the top 7 sites have competitive number of visitors compared to the rest of the sites. Another information to note is that most of the analyzed Albanian sites do not put much effort to increase Facebook likes. Five of the top 20 sites don't even have a Facebook profile, and two have insufficient number of likes. Only 4 sites have respectable number of likes what results in increased incoming clicks seen in the click upstream. Regarding the number of links it is notable that only 6 sites have inbound links coming from 90 or more domains.

Regarding the traffic sources observed through the click upstream and the search percentage we can present the following. The percent of visitors that come from search engines to Albanian travel sites varies from 3% to 40% with 19.2% on average. These figures are similar with the websites selected for comparison where the average percentage of visitor that came from search engines is 19.8%. The highest amount of referral traffic (upstream clicks) comes from Google and from Facebook. Some particular sites might have some other referrers like Youtube.com, Twitter.com and others but they never overpass the referrals from Google and might be slightly higher than Facebook in certain cases. The traffic that comes from the Google domain to Albanian traffic related sites is 20.9% on average and the traffic that comes from Facebook is 2.4%. The presented figures are very similar with the selected sites for comparison where the visitors coming from Google are 20.2% and visitors coming from Facebook are 2.6%.

When analyzing these data we must have in mind that highest volume of traffic to most web sites is internal (direct and email traffic) what means that majority of the visitors to websites are mostly returning, sometimes even up to 80% (SeeWhy, 2011; Reeves 2011).

#### 4. Discussion

The findings of the research showed that there are numerous Albanian travel related websites, reach in content and with modern and appealing design at first glance (with few exceptions). The analysis didn't go deep to discover the web site types and their functionality and usability regarding the online customer services and online reservations and transactions.

At first glance, the presented figures might lead to a conclusion that Albanian travel sites are comparable to the sites in Montenegro and Macedonia but further analyses reveal that 9 of the Albanian top 20 ranking websites are travel agencies that mostly target domestic tourists and 8 of them favor/promote foreign destinations. Six of these agencies have only Albanian language version of the site. Only 4 of the top 11 rated sites target foreign visitors and favor Albania as travel destination. All this means that the rankings of the top rated sites rely on domestic visitors searching for foreign travel destinations. The situation is similar with the Macedonian web sites but the deeper analysis shows that there are much more Macedonian sites that outrank the top 10 Albanian sites. Another important thing is that Macedonia has no sea and therefore the domestic offer is limited to few destinations attractive for tourists. On the other hand the Montenegrin sites mostly target foreign visitors and promote domestic destinations.

Previous studies and also this research suggest that most important web traffic sources for external (new) visitors are the Search Engines represented mostly by Google with share of 91.6% of search referrals, and the Social Media Sites where Facebook has the leading role with 65.7% of social media referrals globally. When we compare the leading sites head to head we can estimate that Google brings 8 times more traffic to web sites than Facebook. These findings also apply to Albanian web sites but only when we compare relative figures. Absolute figures, on other hand show that Albanian Sites underachieve in acquiring visitors even compared with countries like Macedonia and Montenegro that are also promoted as newly discovered tourist destinations.

Owners of websites who want to increase visitors to their websites could practice different and various online marketing strategies. Regarding the two most significant sources of web traffic, Google and Facebook, internet marketers have several options. First of all they should decide whether to use paid advertising since it is the fastest and most simple way to reach the potential customers. Paid advertisement can be used on each of these sites or on both simultaneously. Anyway, website owners should be careful when using paid advertisement since they can generate losses due to inexperience and/or the vigorous competitors. Other marketing possibilities widely adopted by webmasters and site owners that produce results is to practice Search Engine Optimization (SEO) and Social Media Optimization (SMO). The SEO is a set of methods and techniques that aim to increase the position of a site in organic (unpaid) results of the search engines in order to increase the number of incoming visitors (Sirovich & Darie, 2007; Jones, 2008; Rognerud 2008 ). On the other hand SMO is a set of activates that increases visibility of a site in the social media what, on long run, bring more visitors, trust, authority and also stagginess the brand of the company (Jones, 2008).

This research paper can be used as a starting point for further, more detailed studies that will also discover the reasons behind the current situation and rankings of Albanian web sites and also to give more specific recommendations for website owners. Anyway, the general conclusion that comes out of this paper is that Albanian travel related websites aren't utilizing the potential of the internet as a modern medium and its reach of an enormous pool of tourism consumers worldwide (or consumers on specific targeted markets).

#### 5. Conclusions

The results from the conducted research lead to a conclusion that Albanian travel related websites do not exploit the available web traffic sources on a satisfactory level.

Among many factors that might be reason for such low ranking of websites could be: lack of internet marketing initiatives, inappropriate online marketing strategy, inadequate quality of websites and web content, poor online and offline travel services, immaturity of the Albanian travel industry, unfamiliarity of global tourists with Albania as travel destinations etc. All travel organizations, separately or by joint forces, should constantly work to improve all these factors if they want to achieve better results on long term and increase revenues in the travel industry.

Regarding the internet marketing effort, the focus should be placed on improving web quality and services, and acquiring and retaining new visitors globally, or on selected target markets. Since Google as a search engine and Facebook as a social medium are the most important single web traffic sources, Albanian Travel related websites should focus their online marketing efforts towards these major players in the Internet Marketing world. In order to reach the biggest pools of internet users, one approach is to lunch paid promotion on one or the both sites which are also leaders in the online advertising. When using paid advertisement, companies should carefully set goals and closely observe the results (the Return on Investment) if they don't want to end up losing money. Other approach or strategy for web sites owners is to practice Search Engine Optimization (SEO) and/or Social Media Optimization (SMO) in order to improve rankings in search engine results and/or to increase the visibility in the social media. Both, paid and free online marketing campaigns can be practiced simultaneously for best results. In addition, webs sites should continuously work on the the functionality and quality the site and its content in order to retain the acquired visitors.

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## E-BANKING AND ITS ADOPTION IN ALBANIAN BANKS

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### **Abstract:**

*A strong banking industry is important in every country and can have a significant affect in supporting economic development through efficient financial services. In Albania the role of the banking industry needs to change to keep up with the globalization movement, both at the procedural level and at the informational level. This change will include moving from traditional distribution channel banking to electronic distribution channel banking. Given the almost complete adoption of e-banking in developed countries, the reason for the lack of such adoption in developing countries like Albania is an important research that will be addressed by this paper. In recent years, the adoption of electronic banking (e-banking) began to occur quite extensively as a channel of distribution for financial services due to rapid advances in information technology (IT) and intensive competitive banking markets. Despite this growth of IT worldwide, Albanian banks continue to conduct most of their banking transactions using traditional methods. Understanding the reasons for the lack of such technological innovation in developing countries such as Albania will develop a fruitful research. This paper will address what are the enablers and the inhibitors of e-banking adoption in the Albanian banking industry. In this study, four perceptions issues were explored: relative advantage; organizational performance, customer relationship and ease of use. From an analysis of 16 semi structured interviews, the findings revealed that all these four perceptions issues jointly provided an excellent understanding of what were the enablers and inhibitors of e-banking adoption.*

**Key Words:** e-banking, adoption of e-banking, enablers and inhibitors of e-banking.

**JEL Classification:** E59.

### **The Adoption of e-Banking.**

Daniel (1999) described electronic banking as the provision of banking services to customers through Internet technology. Other authors (Daniel, 1999; Karjaluoto et al., 2002) indicated that banks have the choice to offer their banking services through various electronic distribution channels technologies such as Internet technology, video banking technology, telephone banking technology, and WAP technology. Karjaluoto et al. (2002) also indicated that Internet technology is the main electronic distribution channel in the banking industry. In more detail the author described e-banking as an online banking that involves the provision of banking services such as accessing accounts, transferring funds between accounts, and offering an online financial service. Wang et al. (2003) claim that in the 1990s e-banking was under-utilised as business organisations used it only to market their products and services. Thornton and White (2001), who examined customer orientations and usage of financial distribution channels in the Australian financial industry, found that more recently most financial institutions, faced with competitive pressure after the introduction of deregulation in 1983, have rethought their strategies to take full advantage of Internet technology. Tan and Teo (2000) note that the challenge to expand and maintain banking market share has influenced many banks to invest more in making better use of the Internet.

The emergence of e-banking had made many banks rethink their Information Technology (IT) strategies in competitive markets. They suggest that the banks that fail to respond to the emergence of e-banking in the market are likely to lose customers and that the cost of offering e-banking services is less than the cost of keeping branch banking. This notion was also confirmed in a study (2004) who examined the role of e-banking and indicated that the majority of banks that adopt e-banking had taken advantage of Internet technology to establish web sites but few offered e-banking services. He suggested that if the Saudi Arabian banking industry wished to be successful in the global economy it would need to integrate Internet technology into its banking strategy. Despite the fact that Internet technology acceptance is growing worldwide, Albanian banking industry are yet to adopt fully Internet technology.

#### **The Theory of Reasoned Action (TRA)**

Fishbein and Ajzen (1975) developed the Theory of Reasoned Action in 1975. They later refined it with empirical evidence to support its validity and reliability (Ajzen and Fishbein 1980). In summary they postulated that: an individual's behavioural intention is the immediate determinant of behaviour, their attitude and subjective norm are mediated through behavioural intention and their behavioural and normative beliefs are mediated through attitude and subjective norm.

#### **The Theory of Planned Behaviour (TPB)**

After identifying some problems with the Theory of Reasoned Action, specifically that it was designed to predict and explain behaviour based on the assumption that this was under a person's volitional control, Ajzen (1991) came up with a modification: the Theory of Planned Behaviour. To achieve this, Ajzen extended TRA by adding another construct called Perceived Behavioural Control, which refers to an individual's perception of the "... presence or absence of requisite resources and opportunities" (Ajzen and Madden 1986 :457) required to perform the specific behaviour.

#### **The Technology Acceptance Model (TAM)**

TAM is a theoretical model that was developed to evaluate the effect of system characteristics on user acceptance (Davis 1986 :7). In a similar fashion to the TRA, TAM assumes that a computer user generally acts quite rationally and uses information in a systematic manner to decide whether to adopt, or not to use this technology in the workplace. Davis identified three major determinants of TAM that relate to cognition and effectiveness and were suggested by previous research studies. He began with the TRA and adapted this as a basis for causal links between perceived usefulness, perceived ease of use, attitude towards using technology and behavioural intention to explain technology adoption.

#### **The Diffusion of Innovations (DI)**

The theory of Diffusion of Innovations as described by Rogers (1995) is well known. Rogers describes diffusion of innovations as: "... *the process by which an innovation is communicated through certain channels over time among the members of social systems. It is a special type of communication, in that the messages are concerned with new ideas*" (Rogers 1995 :5). A decision not to adopt an innovation relates to the rejection of the available new idea. However, in order to explain the rate of adoption of innovations Rogers suggests measurement of the following perceived characteristics of innovations:

- (1) relative advantage
- (2) compatibility;
- (3) complexity;
- (4) trialability; and



(5) observability.

Rogers (1995) postulated that the adoption of innovations is influenced by these five characteristics, and that they can explain the rate of technology adoption.

### **Research Issues and Methodology**

#### Research Issues

The literature suggests a number of factors that could enable or inhibit the adoption of information technology (IT). First, IT diffusion literature (Tornatzky and Klein 1982; Moore and Benbasat 1991; Rogers 1995) highlights the importance of perceptions of relative advantage in determining the adoption of new technologies.

Rogers (1995) suggests that the rate of adoption of a new innovation is related to (perceived) relative advantage: the greater the perceived relative advantage, the faster the adoption.

Second, the desire to improve organizational performance is seen to be an enabler for technological change. If Internet technology could be used to improve its performance, a bank would be able to gain advantage in a competitive environment, and many authors (Kettinger et al. 1994; La and Kandampully 2002; Soliman and Janz 2004) argue that IT has the potential to achieve this.

Third, any chance to improve the relationship with customers is also pointed to by researchers (Julian and Ramaseshan 1994 :29; McKenzie 2001) as a reason for business to adopt new technologies. An important question, however, is how a bank could enhance its customer relationships through Internet technology adoption and the literature suggests that this should be considered in relation to customer trust, commitment and satisfaction. Jabnoun and Al-Tamimi (2003) examined perceived services quality in commercial banks in the United Arab Emirates, emphasizing the importance of service quality to maintain market share, concluding that customers value human skills the most in service quality.

More recent studies (Khalfan et al. 2006; Al-Sabbagh and Molla 2004 ) conducted in the Albanian banking industry, reported that security concerns have been one of the major issues in the e-banking adoption. Finally, the importance of ease of use in determining successful IT adoption has been highlighted in much previous literature (Davis, Bagozzi and Warshaw 1989; Moore and Benbasat 1991; Taylor and Todd 1995). An examination of these factors then became the basis of this research project as shall be elaborated below.

#### Methodology

Sixteen interviews were conducted with strategic, tactical and operational managers at each of ten major banks in Albania. Data was gathered through semi structured interviews with the managers, and available internal and public reports were used to facilitate understanding for this interesting study.

Interviews were based on issues identified from the research issues literature to explore in-depth the major enablers and inhibitors of e-banking adoption in the Albanian banking industry.

#### Research Findings

The study found that bank managers' perceptions of four concepts: perceived relative advantage, perceived organizational performance, perceived customer/organizational relationship and perceived ease of use provided a broader understanding of e-banking adoption in the Albanian banking industry.

The first construct: Perceived Relative Advantage (PRA) construct relates to the degree to which bank managers think that Internet technology might help their bank gain advantages in the industry.

From the literature three major issues emerged relating to the perception of relative advantage: convenience of services; innovative use of IT; and management of banking services. Most respondents from the Albania banks expected that Internet technology could enable them to offer more convenient services to their customers. As one of the managers put it:

... I think that's one of its advantages, obviously. One of the key challenges for us, though, is around making sure that we are up all the time in terms of no down time in service, which sometimes is incredibly hard to do given the amount of traffic that we have through our site.

In regards to innovation of ideas – innovative use of IT, responses raised concerns on: rapid development of ideas, culture, sophistication/ customization of services, Internet security and online marketing. Most respondents thought that rapid development of innovative ideas was a concern associated with the issue of their creativity in offering banking services to their customers. They took the view that rapid development of innovative ideas could be highly achieved through Internet technology adoption. From the broad question related to management of services respondents raised several concerns: easy to follow up requests/complaints, Internet security, awareness/knowledge about Internet technology, consistent quality service, business process re-engineering, and convenience of available service. In response to the issue of management of services, respondents noted that it was easy to follow up requests/complaints, Internet security, awareness/knowledge about Internet technology, consistent quality service, business process re-engineering, and convenience of available service.

The second construct: Perceived Organizational Performance (POP) is associated with how much a bank manager thinks Internet technology could improve their organizational performance. Three issues: profitability; market environment and employee productivity were utilized to explore this construct in depth. From the broad question related to profitability, most respondents indicated two impediments: high technology investment cost and the need for economies of scale for Internet technology use are inhibiting the rate of E-banking adoption. As one highlighted:

This, for the reason I was saying to you, if you make, you know, a major investment and which cannot be compensated in the short term because you can't increase your passes, and it's not going to be up, so the competitive market for those who are likely to be beaten at the same time and you cannot reduce your major costs for the Bank. It is still far, and another thing, you will not be able to do, you know, to affect, to reduce, and, your manpower cost.

Productivity of employees was another issue of interest. Most respondents expected that their business efficiency could be improved on the Internet. As one manager put it:

Yes, I think definitely. Going back to what I said before, if we adopt the Internet we would be able know our customers and we would be able to react quickly and we would be able to respond much more quickly too.

The third construct: Perceived Customer/Organizational Relationship (PCR) relates to how a bank manager perceives Internet technology adoption in terms of improving the relationship with their customers. In the literature, three major issues emerge related to the perception of customer/organizational relationship: customer trust, customer commitment, and customer satisfaction. Most respondents were concerned about the problem of Internet security as bank customers cannot put their full trust in Internet technology due to possible fraud and privacy violation problems.

The Albanian banking industry recognizes the difficulty of solving this problem but believed that Internet security management is possible through continuous surveillance and maintenance of their database.

One respondent noted: In terms of security, I think that's a concern that all customers have, about Internet banking and the safety of their information and their funds. I think it's always at the back of their mind.

On the other hand, respondents saw the Internet as an obstacle to customer loyalty because they believed that people could do better than machines and it seems that the Albanian banking industry is mostly relying on human capital to deliver their banking services.

In addition, most respondents favored the view that Internet technology could reduce conflict between the bank and its customers and hence improve customer satisfaction.

The final construct: Perceived Ease of Use (PEOU) measures how easy a bank manager believes that Internet technology is to use. The literature suggests that if technology is perceived to be easy to use then the rate of adoption will increase. The research threw up three major issues related to perceived ease of use: easy to navigate, easy to learn and easy to manage. The difficulty of navigating on the Internet was highlighted by Albanian bank managers, one of whom used the following example to demonstrate the problem of lack of awareness/knowledge about Internet technology amongst customers:

As I said, in Albania here we still haven't started but we think that it will not be that easy for us compared to other parts of the world because they are well ahead of us. It will take a little bit of time because we need to train people how to use the Internet.

This difficulty then acts to slow down the process of adoption. Participants raised several concerns about how easy it is to learn Internet technology including fear of new technology, web-site design and user friendliness, but most respondents agreed that Internet technology was easy to learn.

The last issue related to management of financial transactions on the Internet. In summary, the enabling and inhibiting factors to adoption of E-banking in Albanian banking industry are shown in Tables 2 below:

**Table 2:** Enablers and Inhibitors of E-banking in Albania

Albanian banking industry	Enablers	Inhibitors
<b>Perceived Relative Advantage</b>	-Convenience of service (convenience of available service and convenience of location) - Innovation of ideas (rapid development of innovative ideas) - Management of services (easy to follow up requests/complaints)	None
<b>Perceived Organizational Performance</b>	Productivity of employees (business efficiency)	Profitability (high technology investment cost and the need for economies of scale for Internet technology use)
<b>Perceived Customer/Organizational Relationship</b>	Customers' satisfaction (reduce conflict)	Customer trust (Internet security) - Customer commitment (customer loyalty)
<b>Perceived Ease of Use</b>	Easy to learn (increased automation of process)	Ease of navigation (lack of awareness/ knowledge about Internet technology and accessibility of service)

## Discussion and Conclusion

This study explores in depth the adoption of e-banking in the Albanian banking industry. Four existing research frameworks were considered in the development of a framework for this study including: TRA, TPB, TAM and DI. The literature also suggests a number of issues that contributed significantly in identifying what the enablers and inhibitors of e-banking adoption are including: PRA, POP, PCR, and PEOU. These four issues were jointly investigated in order to solve an existing problem in the Albanian banking industry as well as to provide insights into e-banking adoption. From an analysis of 16 semi-structured interviews, the findings of the study show that e-banking in Albania is moving very slowly.

The results revealed that all four issues jointly provided an excellent understanding of what were the enablers and inhibitors of e-banking adoption in the Albanian banking industry. Most bank managers contributed significantly with their interesting beliefs and experiences and provided excellent understanding to this study.

The findings of this study were consistent with the findings of Moore and Benbasat (1991) and Davis et al. (1989) and the supporting literature on TAM and diffusion of innovation (Rogers, 1995), especially in PRA and PEOU. Moreover, the findings of this study (e.g., PRA, POP, PCR, and PEOU) could be utilized to solve existing problem in the Albanian banking industry. This study extends TRA, TAM, TPB and DIT by including two new constructs not previously considered, namely: POP and PCR. It also extends these models by examining these four perceptions jointly in the Albanian banking industry. The implication for practitioners include: development of telecommunication infrastructure; customers education; and awareness of security and privacy issues.

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**E-MARKETING**

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**Abstract:**

*Marketing is a process that has existed forever, in one form or another. Its roots date since the first attempts of human beings to exchange goods and services. Humans firstly used marketing to convince others to trade. With the passing of years, new ideas were arisen that effected also in the marketing development. Marketing methods have passed through a lot of changes and improvements, and its efficiency has increased a lot. With the creation of internet, new frontiers have been opened before marketers. Internet makes possible for the companies to reach more customers than ever before, and in the simplest way that could ever be imagined. This leads to a today's marketing world more challenging than ever. In this paper, we will introduce e-marketing and try to explain why did it become one of the fundamental trade methods nowadays, and we will make a list of pros and cons of this kind of marketing and its differences from traditional marketing method. We should notice that e-marketing, as the product of the collision of old marketing strategies with the new modern communication technologies, has become a really important method for every sector of today's marketing. Despite its not so small disadvantages, e-marketing profits are becoming so high that a lot of companies are transferring their businesses completely to the Web.*

**Keywords:** marketing, internet, technology, trade.

**JEL Classification:** M39.

**Introduction**

*“Setting up a website is like building a storefront on a dead-end street. If you want any shoppers, you must give them a reason to come.”Dr. Ralph F. Wilson*

The development in information technology (IT) and communications has changed the way people lead business today. During the latest years, many businesses have been using the Internet and other electronic media for their marketing purposes, giving the chance for Electronic marketing to grow very fast and dynamically.

The rapid enhancement of the Internet and electronic communication has created fast growing new electronic ways for marketing. That is the reason why the internet and other electronic media are playing now a very significant role in managing of marketing activities due to its special characteristics as a market and as a medium.

We are aware that e-marketing has become an essential part of successful conducting of marketing. In order to understand better the factors that lead to such a revolution in marketing we will try to introduce e-marketing, by explaining its growing importance as a marketing method.

Further in this paper there will be presented the benefits and the disadvantages of using e-marketing as a more sophisticated way of conducting marketing. Then there will be explained the differences of e-marketing from the traditional marketing. In the end, we will shortly present the situation of e-marketing in Albania and its future perspectives.

- **Why did e-marketing become a fundamental method of marketing?**

In order to understand the reasons of the rapid growth in importance of e-marketing, we should first understand what is e-marketing. It has not been reached to a single concept of electronic marketing. Different researchers have given different definitions of this term. Strauss and Frost (2001) defined it as: "The use of electronic data and applications for planning and executing the conception, distribution and pricing of ideas, goods and services to create exchanges that satisfy individual and organizational objectives", whereas Smith and Chaffey (2005) defined it as: "Achieving marketing objectives through applying digital technologies". Despite the various definitions of e-marketing, E-Marketing Association has adopted the definition of Strauss and Frost, thus making it the official definition of e-marketing.

Starting a business or even expanding an already existing one can be difficult, time-consuming and sometimes even stressful. Certainly a well planed business strategy is fundamental and the most important part of the strategy is a marketing strategy. In these last years, online promotion of businesses has become a necessity thus, internet marketing is definitely the best way of promotion due to the numerous strategies that it offers.

The essence of marketing is to deliver your message and make others interested in what you offer. This looks quite simple but, actually it is not. There are a lot of companies that fail to make it even though they make a great effort to promote themselves. One of the reasons they do not succeed is because not enough people were interested in what they offered because not enough people got aware of their existence in the first place. This is the reason why brilliant e-marketing strategies are essential for every company willing to succeed.

The greatest advantage of e-marketing is that you do not have to spend time looking for your target audience because what you need is already there. All you need is to find a way to reach them and transfer them your message. Luckily there are various ways to do so and every company can find a way that fits their needs and their budget.

Another reason why e-marketing has become such important in business is because of its flexibility. Companies can use websites, articles, emails, blogs and forums in order to get their message across. There can also be used different mediums for the promotion like audio, text, images or even video. So many available options help in increasing creativity of people and creativity in marketing is always productive and beneficial.

Another important thing about e-marketing is that it is interactive. On one hand, companies can chase their clients and find them more easily, and on the other hand, clients can compare different services and products more quickly.

And to conclude, e-marketing makes it possible for companies to target their audience accurately and efficiently. Targeting your clients is an essential step without which success is not possible. After targeting costumers, e-marketing allows you to deliver your message and start benefiting.

- **Pros and cons of e-marketing**

- **Advantages**

Internet has become an essential tool for many businesses. Businesses with online presence and promotion have a great advantage over those who have not started their business online yet because it helps companies in getting a wider audience. But as all marketing methods, e-marketing has its advantages and disadvantages too.

Starting with the advantages of e-marketing, the most important one is the cost. Gathering mail addresses, printing and sending promotions to consumers can be expensive, especially when the business is international, while with e-marketing companies can reach their consumers and email to them totally for free. By e-marketing companies can reach a broad range of audience with a very low cost. The only investment needed is for the Internet connection.

Not only the companies, but also consumers benefit from e-marketing because it is easy to stay in line with the new products and services and you can purchase them in a matter of seconds without even having to go out of the house. Thus the whole process of reaching, deciding and purchasing goes on very quickly.

Reaching people with e-mail marketing is much faster than reaching them with standard mail. There are needed at least two days for a standard mail to reach the clients, while with an email you can reach people in just a few seconds. Mass emails can be sent to people in a few minutes while it could take weeks, or even months to send millions of letters.

Another advantage of e-marketing is tracking. With e-marketing companies can easily track their emails and learn the number of deliveries, which ones were received, which addresses are no longer useful, and the number of clicks if links were included. This makes it easier for the businesses to understand how useful their campaign was and can help companies to improve their future deliveries.

Last but not least, the advantage of e-marketing is that there is no territorial restriction. It is very easy and fast for a business to reach a global market. Since internet reaches every part of the world, businesses can reach a global market in just a few minutes and with a very low cost.

- **Disadvantages**

Despite the great number of advantages, e-marketing has its disadvantages too. One of these disadvantages is the lack of trust. This is due to the fact that e-marketing is done via the internet only; people cannot see your products and cannot interact with people of the company. Costumers do not have the possibility to physically see the products thus it takes time for them to trust your company.

Competition is another disadvantage of this method of marketing. Since there are a lot of businesses that use internet as a way of promotion and marketing, there is an overload of information. This means that costumers have a variety of choices and companies are in a tough competition. So companies must work very hard to succeed.



Another disadvantage of e-marketing is that it is time consuming. It takes time to build web pages, to find people's email addresses and also to write the emails that will be sent to those people. Even though it is not so time consuming as sending mails, still it takes a lot of time. Because you may release new products and every time this happens, you will have to write new emails, and to send them to all people again.

One of the biggest disadvantages is that people may take your emails for spam and they will complain about them and your emails may finish in the blacklist. This means that you will send emails but no one will receive them because they will be automatically delivered to the spam box. It is easy for people to ignore these kinds of emails. Because of the large number of emails they receive every day, and because they are not familiar with the sender, there is the potential risk that people will take them as spam or they will think they are spam and instead of opening them, will immediately delete them.

Many products that are sold through internet are usually falsely promoted. Thus people cannot be so sure of what they are buying. Although in the recent years there has been an improvement in the product quality, there are still the so called "empty boxes" which actually have nothing in it.

One more disadvantage of e-marketing is that emails are still considered as an impersonal way of contacting and this can give people a negative impression of your company. People do not like having their inbox filled with emails every day and mass emailing may leave customers a bad reputation about your company. Also, once the email is sent, any mistake in it cannot be fixed, so this will also lead to a negative impression about your business.

As a conclusion, e-marketing has become a very common way of selling and buying products and services all over the world. It is very advantageous and profitable, but it has its disadvantages too. Thus a company before deciding whether to promote their business via e-marketing should take into consideration the weight of advantages and disadvantages and then choose what is in the best interests of its business.

- **Challenges of e-marketing**

Every online fulfillment operation comes across four main challenges: "controlling customer data, integrating on-and off-line orders, delivering the goods cost effectively, and handling returns". Also e-marketing doesn't make an exception.

As the arrangements augment and information technology is used in a more expert way for delivery purposes, e-marketers "risk losing their consumer data". In this kind of economy where knowledge is not only power but also a source of money, e-marketers need to have a strategy of how to put a balance between the profits of fulfillment and the confidentiality of their clients' data.

Companies that reach a high volume of orders must decide the level of integration they need. If the system is totally integrated, Internet orders will be automatically transmitted through a processing center and carried to the supplier's manifest. For example, an integrated system with full ERP (enterprise resource-planning) capabilities would eliminate the problem of retarding in key fulfillment operations as data entry, inventory and packing.

With the rapid growth of the businesses, every operation challenges e-marketers to deliver the goods quickly, cheaply and in a convenient way. To solve this technical problem new sorting and scanning gadgets and large delivery tools will be necessary. In order to pass this challenge, e-marketers must resolve the problem of making contact with the receiver, because recipients are not satisfied if the product or service that they purchased takes too long to appear. And this is not an easy mission although it can be accomplished if a good strategy is used.

The last but not least challenge of e-marketing is handling returns. If e-marketers want to succeed, they must match the high standard of service that some physical marketers manifest related to returns. It is known that at present, they do not match these standards.

Few e-marketing companies design their packaging for easy compensation. Customers often have to find new packing materials, make some calls to arrange reimbursements and physically take packages to delivery services. These inconveniences create a negative impression about the vendor. Even if e-marketers find a solution for reimbursements, this will have its cost. So the solution should include a strategy of maintaining profitability.

- **Legal issues of e-marketing**

Although e-marketing is legal, it is still necessary to know governing laws related to spam, laws to prevent any deterioration and all other legal problems related to the business. Furthermore, this marketing strategy requires an affirmative reply in order to be able to conduct any actions to subscribe the consumer because it can result to an illegal sale or deception. In order to save your business from being categorized as spam you should seek to some decencies of sending a business marketing email to people and make sure to seek into the valid access.

- **Differences of e-marketing method from traditional marketing method**

During the 1990's market was dominated by Mass Communications. Companies used to deliver their message to a mass audience through advertisements in mediums like radio, television and print. But then a new medium came on the stage. With the creation and development of Internet as an easy and faster way of getting connected with people at any time and everywhere without any territorial restrictions, businesses started thinking of a new method of marketing, the so called e-marketing. Now almost all businesses are passing from traditional marketing to e-marketing because it is a more effective way in most aspects. Below will be discussed the differences between this new method of marketing and the traditional marketing method by comparing the differences in four main aspects of business: product, price, promotion and place.

- **Product**

In traditional marketing product is physically reachable for the consumer whereas in e-marketing it is just a virtual image through a website. The clients cannot see and value the size and quality of the product by seeing it on a website, in the same way as they see it in a physical store. People tend to be doubtful of products they cannot physically reach and this effects their decision of purchasing.

In comparing the variety of products that can be offered through Internet related to those offered in physical stores, there is a notable difference. A larger range of products can be promoted through the Internet. Whereas offering a various number of products in a traditional marketing employs a lot of money and space for storage.

Something that can affect the customers' decision of purchase is the warranty of the product. This influences customers both in traditional and e-marketing, but especially those buying online. People that cannot see and touch the product when buying online gain a feeling of security when they know that the product has a warranty.

Customer service is another issue that makes a difference between these two marketing methods. Providing customer service in e-marketing is more difficult than when the customer visits the store by him/herself. When buying in a physical store the client communicates face to face with the staff of the company whereas when purchasing online the client deals with a fixed service.

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**Price**

As the price of a product is based on the costs of its process in reaching the market, a company using e-marketing has the possibility to sell its products at lower prices since e-marketing is a cost saver marketing strategy.

Another reason of these price differences is tough competition. It takes only one click of the customer to make the difference between competitors in e-marketing.

Payment through Internet creates some security problems since this type of payment is done by credit card. People feel more secure when paying in a physical store because they can assist themselves the payment process, whereas in online purchasing there is a risk when giving the credit card details.

- **Promotion**

The biggest difference, related to promotion, between traditional marketing method and e-marketing is the speed. Speed of sending any type of message to customers is very quick through Internet. And this is very important for the competition in business.

Durability of marketing message is another difference between promotions by traditional method and promotion by Internet. In traditional method, the message can get the attention of people only during a specific amount of time, for example those few seconds when the advertisement appears on TV or on magazines and newspapers. Whereas on the Internet, the message appears constantly on the businesses website and the customer can watch it at any time when he/she visits the company's website.

Another difference is that through the website, a company can use different ways of promotion, not only product promotion but also promotion of the different aspects of the company itself, by giving the customer all the information he/she needs to trust the company. This is not possible with the traditional ways of promotion because these ways can be used mainly for short messages, not messages full of information.

- **Place**

In traditional marketing, companies can decorate the stores in different ways, such as with colors and music, in order to attract customers, while this is almost impossible through Internet since there are just virtual images, no real experience can be created.

The atmosphere of the store is very important for the attracting of customers thus influencing the sales of the products. No one would be interested to enter in an unorganized store full of clothes. Decoration of the store attracts people and gives them an idea of the company and its products. Decoration is easy to manage in physical stores but it is not so easy when using a website. No matter how hard beautiful the decoration of the website will be, it cannot be compared to the feeling one gets when entering into the physical store.

The most important difference regarding the place is that in e-marketing customers can reach companies at any time, whereas in traditional marketing, stores have a time restriction, you can reach them only during their opening hours. Also the number of customers that have the possibility to reach a company's online store is noticeably wider than the number of customers who can reach the physical location of the store.

Nowadays people have the money to spend but do not have enough time to visit the physical stores so they it is easier for them to purchase the products online as in this way they can save time.

Of course there are a lot of advantages in communicating by traditional ways, such as face to face communication, through which the consumer has the opportunity to respond to the offer received.

As a conclusion, both traditional marketing and e-marketing have their own advantages which can be very important for some companies. We reach to the conclusion that some benefits in both sides are not replaceable by marketing through the other method.

- **E-marketing in Albania**

One of the highest priorities of the Government of the Republic of Albania in these years is information and communication technology (ICT), as it is necessary for the economic growth and for reaching higher living standards. The Albanian National ICT Strategy is based on the many individual and sector e-initiatives already being achieved by other development organizations in other countries.

Despite of the achievements that Albania has made in recent years, technological development remains at a considerable level. There is the need to expand the Internet coverage in the whole country and to enhance the network infrastructure. Albania's participation in the European Commission's Framework Program 7, as an important activity that encourages European integration, is helping the country to make some steps forward in this area.

But beside all the efforts, Albania still doesn't have a real ICT structure. Recently Albanian Council of Ministers has taken some measures by creating the "National Agency of Information Society and Electronic Government" (AKSHI), some of the duties of which are the solicitation and support of development of e-business and the solicitation and support of Internet, online services and computer usage by Albanian citizens.

Some of the reasons of the slow development of e-marketing in Albania are the poor communications infrastructure which results in limited access and higher costs. However the step by step integration of Albania in European Union will effect and benefit Albanian business development.

Despite all the problems and barriers Albania has managed to make some developments in this field. The online payment service Pay Pal in cooperation with Visa, have recently accepted Albania in the list of the countries which can make online payments, by simply having an account in Paypal.com. This new service of online payments presents another important step in Albania's development.

### **Conclusions**

It is clear that Internet is playing a more and more important role in marketing. It is turning up as a new way to reach people around the world. It combines the use of both traditional and new methods of marketing to increase its success as a new business method.

The internet makes it possible for the entire sales cycle to be conducted on one medium, almost instantaneously, from informing the consumer about the product to providing additional information and to making the final purchase. It is like one big point-of-sales display with easy access to products and services and with the ability for impulse shopping. Immediately after being aware of the product, consumers can purchase it online, without even having to move out of the house. If used well, internet is really an advertiser's dream come true.

In the upcoming years marketing will become even more global and big consumers will spend even more money online. Companies will need to continue to improve to profit from the opportunities. The success of the companies from e-marketing will depend on how they manage the coming developments.

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## THE EFFECTS OF THE USE OF THE INFORMATION SYSTEMS IN THE UNIVERSITY OF ELBASAN "ALEKSANDER XHUVANI"

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### **Abstract:**

*This paper treats the positive effects of the information system in the case of the University of Elbasan. Today's society is developing in a fast pace towards information society, usage of information systems and information technology. This orientation has brought important innovation in the economy and to the society as a whole. Likewise, the education sector has been subject to these rapid changes. Universities are required to use the information systems in order to increase their transparency, improve their quality of administration, to increase their competitiveness and the quality of academic and scientific processes. This paper treats how the administration of the students is accomplished from the time of their enrollment until graduation, and how these processes are realized through the help of university's information systems. It simultaneously treats in a comprehensive way the areas that have reflected improvement and change in the management of the university's academic and administrative processes. This positive impact is evaluated in terms of a better management of the university campus and buildings, staff recruitment, student admission and registration, academic counseling, administration of student finances, student self-services, e-learning platform, administration of human resources, secretary, and so on. This paper presents also some suggestions in regards to some improvements that can be done in the information system in order to make a better utilization from the user's side.*

**Keywords:** Information, information system, information technology, e-learning, transparency, university campus.

**JEL Classification:** O3.

- **Chapter I : Introduction and Overview**

New technologies have created an information age that is altering how different organizations and universities provide and manage their services.

Orientation of the whole society to Information Communication Technology (ICT) and Information Systems (IS ) has affected the achievement of significant changes in all aspects.

Universities are subject to such rapid changes that have swept the society. Universities, in order to increase their transparency, quality of the management of administrative and academic aspects, they are using massively ICT and IS.

Moreover, UNESCO in their publication “ICT for Teacher Education, A Planning Guide” mentioned that ICT and IS has become critical in all aspects of universities such as teaching, researching and administration. In addition, they are tactical components providing support to all main university services, and in the future they’re set to become a strategic tool for universities.

ICT is seen as an important instrument to support new ways of teaching and learning. It is used to develop student’s skills for cooperation, communication, problem solving and lifelong learning. [11]

Furthermore, ICT and IS represent part of an institution’s strategy. Strategic objectives must become established and decision on where, when and how investment in ICT is going to take place must be made, in order to achieve the objectives in such a way that competitiveness and effectiveness of the university are improved.[9]

Additionally, ICT and IS represent part of an institution’s strategy. Strategic objectives must become established and decision on where, when and how investment in ICT is going to take place must be made, in order to achieve the objectives in such a way that competitiveness and effectiveness of the university are improved.

It is a fact like countless industries before it; universities will be transformed by technology-and for the better. [8]

What is more important, ICT can be used extensively for educational administration. The following are some of the areas where computers can be used for effective educational administration:

- General administration
- Pay Roll and Financial Accounting
- Administration of Student Data
- Inventory Management
- Personnel Records Maintenance
- Library System [10]

Most students have been exposed to computers since the lower grades. When properly integrated into the curriculum and classroom, ICT can allow students to personalize their education, automate many tedious and rote tasks of teaching and managing classes and reduce the teacher’s workload per student, so that they can spend more time on reaching individual students. [2]

Therefore, investment in ICT, which is the core of modern IS - should be designed to decrease the costs, increase incomes, redirect human resource utilization to free faculty (teachers) to derive greater rewards for themselves and the institution.

- **A short overview on the University “Aleksander Xhuvani”**

The University of Elbasan “Aleksander Xhuvani” is one of most important educational and research institutions in Albania with the aim of continuing the excellent tradition of its higher Pedagogical level. This institution has made successful efforts and been confirmed as one of the most serious educational institutions in Albania by expanding infrastructure, enhancing the quality of curriculum, teaching and researching process.

The University has a capacity of:

- 12746 (twelve thousand seven hundred and forty six) students
- 225 (two hundred and twenty five) academic staff and 320 (three hundred and twenty) external academics and
- 85 (eighty five) support staff.

This University is organized in three forms of study: full time, part time and distance learning in the following levels of study:

- First level diploma/Bachelor,
- Professional Master,
- Master of Sciences and
- Ph. D.

In the last decade, the university has gone from a teaching only institution to a researched focused one. The university is represented by five faculties which are: Faculty of Economic Studies, Faculty of Natural Sciences, Faculty of Education, Faculty of Human Sciences and the Faculty of Nursing. It also offers a variety of training courses which are adapted to the requirements of the labor market in the region of Elbasan.

Since its creation, university’s data management and outcomes for students, academic staff, teaching schedules, relevant literature, annual fees paid by students etc, have been carried out manually by using different forms of records for each faculty.

Development of ICT has started before year 2000, where several departments have taken their initiatives by computerizing their activities.

Several other factors affected higher level and oriented use of ICT, where the use of ICT is considered as an indicator of an institution that goes toward the progress. Using ICT lead to effectiveness and productivity of universities in competitive.[6]

Furthermore, provides better management of administrative, academic and research processes.

As a consequence, today’s work industry requires more and more graduates who can be able to use ICT in their work environments.

- **Theoretical background**



Today's society is living in the world of Internet and Information Communication Technology. Over the last decade, ICT has become a major force towards transforming universities in administrative and as well as in pedagogical terms where the main activities as the creation, storage, transmission and application of knowledge, are profoundly affected.

Education and training have faced many challenges in the past years-political, educational, and technological trends such as the European Bologna process, Lifelong Learning and the use of Social Software are just a few of the factors influencing this field.

Administration of a university has always been challenging, simply supporting all the activities of university remains critical and challenging, particularly in management and administration of university, human resources, financial and economic activity, library services, archiving, academic and research processes.

IS is seen in several perspectives by different authors who have studied IS. The literature is awash with definitions and scope of what constitutes an IS. One such definition from e Leading IS Journal stood out quite profoundly, as it resonated with the authors' own personal views of what constitutes an IS. Paul (2007; 194) explains that: "IS is what emerges from the usage that is made of IT delivery system by the users". [13]

Laudon (2011) explains that "An Information System can be defined technically as a set of interrelated components that collect (or retrieve), process, store, and distribute information to support decision making and control in an organization".

Eccles (2003) explains that "IS is not simply about computers – it's about how businesses can make the best use of computer technology to provide the information needed to achieve their goals.

Therefore, the core of an IS is the management of the information viewed as a set of practices which allow to use information in decision making and the quality of service delivered by organization.

According to Haag (2009), IS deals with planning for, development, management, and use of information technology tools to help people perform all tasks related to information processing and management.

So IS deals with the coordination and use of three very important organizational resources – information, people, and ICT. People use ICT to work with information.

Effy Ozz (2009), defines information as "data, manipulated through tabulation, statistical analysis, or any other operation that leads to greater understanding of situation".

Cornford (2001), suggest reasons why is information a key element for our age in the following statements:

- Information is produced and used for decision-making in modern organizations.
- Information is more and more traded as a commodity.
- The ability to use information resources has a profound impact on the shape and structure of organizations and industries, and their ability to compete and thrive.
- Information is now widely held by governments and companies and is central to our ability as citizens to participate in society.

In essence, University Information System (UIS)-is a system which serves for the collection, processing, analyzing, publishing, distribution and making available the information in the improvement of administrative and academic activities.

For this purpose, Fredriksson and Gajek (2009) believe that communication and general administration are the two main areas in which UIS is used in the management of universities. It is evident from the above that administrative activities in universities consist of student administration, staff and resources administration, communication and general administration.

UIS is a vehicle for delivery of information around university campus and the most important component in the whole cycle is information.

Jagar and Lokman (1999) in a paper to the European Conference on Educational Research proposed these functions of ICT in education:

- Learning about ICT so that students can use ICT in education, future occupation and social life.
- Use ICT as an assisting tool e.g. making assignments, collecting data and documentation, communicating and conducting research.
- Use ICT as medium for teaching and learning, as a tool through which teachers can teach and learners can learn.
- Use ICT to organize and manage universities.

The number of students and professors in the university is growing enormously, consequently the flow of data and information in the UIS becomes larger, and therefore the complexity of problems associated with university activities will increase as a result in order to fully manage it is necessary the use of UIS. UIS provides a better and qualitative management of administrative, academic processes, impacts on improving equitable access to the university information and procedures, improving the quality of education, extensive use of ICT and UIS in education and science.

- **Infrastructure of University Information System**

In order to modernize and to fully manage in a very precise manner administrative and academic activities, the university has taken a very important decision by implementing IS. As mentioned above, the university is composed from 5 faculties which are located in different areas in the city. Implementation of IS is performed by realizing the connection with the internet network protocol TCP/IP to all users. This is an open system, in the sense that is possible to realize access via personal computers equipped only with Internet Browser MSN Internet Explorer, Mozilla Firefox.

The IS uses a centralized database that serves to maintain operational data. This database is installed in a central database server and all users are included in a web-server environment via Web LAN / WAN.

The IS is structured on an architecture consisting of:

- The database server which is the main component that provides logical storage of data.
- Application Server which provides full implementation of logic.

The IS includes 2 security levels of application:

- First security level is on role-based security determines the function of the user's role.
- Second security level defines restriction in access data (user-based security) where the system allows the administration of data access for particular user.

The UIS is created as the integrated system, aiming to computerize all university processes ( study process, science activities, management and administration of universities, human resources, financial and economic activity, library services, archiving etc.).

IS allows for individual users to avoid the different use or interpretation of the same data where all data is stored in a centralized database.

The IS is based on University's computer network where the fiber optic lines connect the faculties in order to ensure quick and reliable transmission of the information.

Moreover, the software is web-enabled where all users of IS ( academics, students, administrative staff) can access the system using only a web browser, with access rights specified in the security system, depending on the data which will have access, windows, menus, reports that they have the right to access

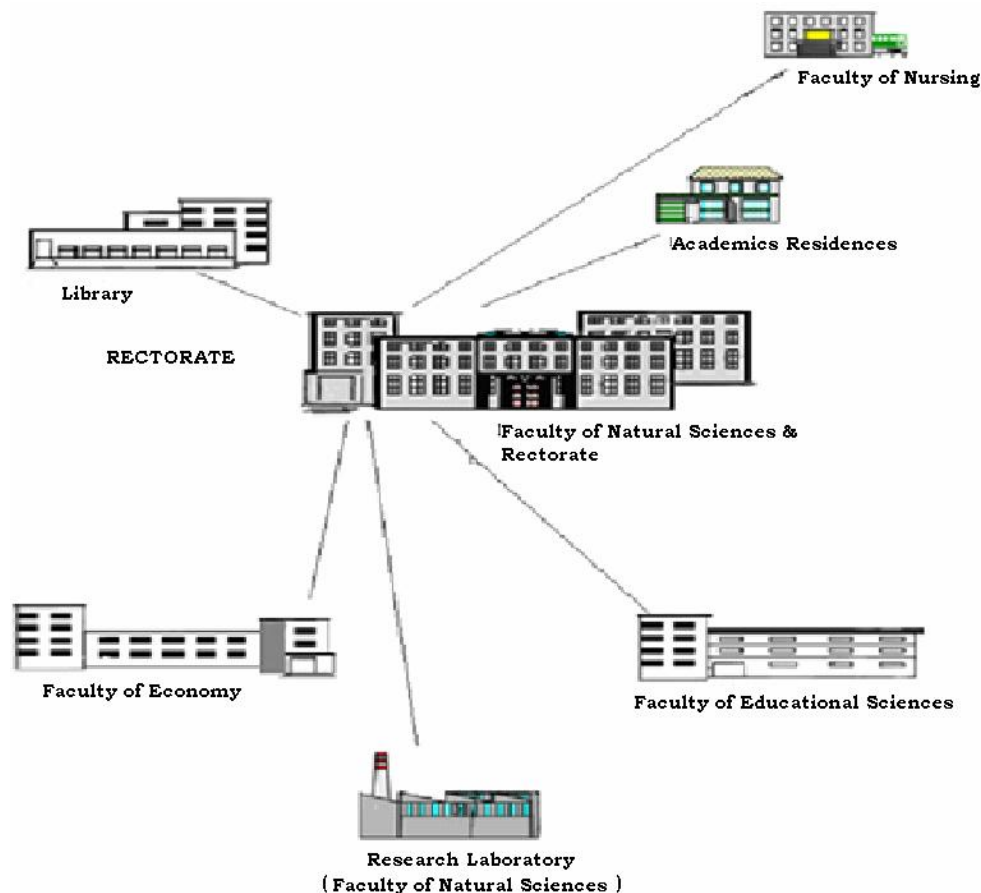


Fig.1. Structure of University of Elbasan "Aleksander Xhuvani"

## 2.1 Purpose of IS

Since the University liberalization the number of students attending the University of Elbasan “Aleksander Xhuvani” has increased dramatically over the years. As a result the registration process takes enormous time. Thus from the moment that the students must be registered and until they will sit on their desks a whole administrative process must be followed. It begins with registration by the secretary of the university where student present a number of documents. However even after registration a permanent register for grades should be developed, fees of students must be received and teachers should be evaluated. As this is not enough all this process must be realized manually. As mentioned above, since its creation university’s data management has been carried out manually by using different forms of records for each faculty. Likewise, data collection and generation of statistics required by the Ministry of Education and Science have been carried out manually/

Another purpose for implementing the IS is to enable electronic management of all processes in all units as:

- Rector
- Human resources
- Finance
- Departments
- Curricula
- Chancellor
- Secretariat
- Students
- Professors

The main processes realized using IS are:

- Recruitment and admission.
- Student registration.
- Academic advising.
- Student finance.
- Student self-service.
- Facilities management (Campus).
- Statistics.

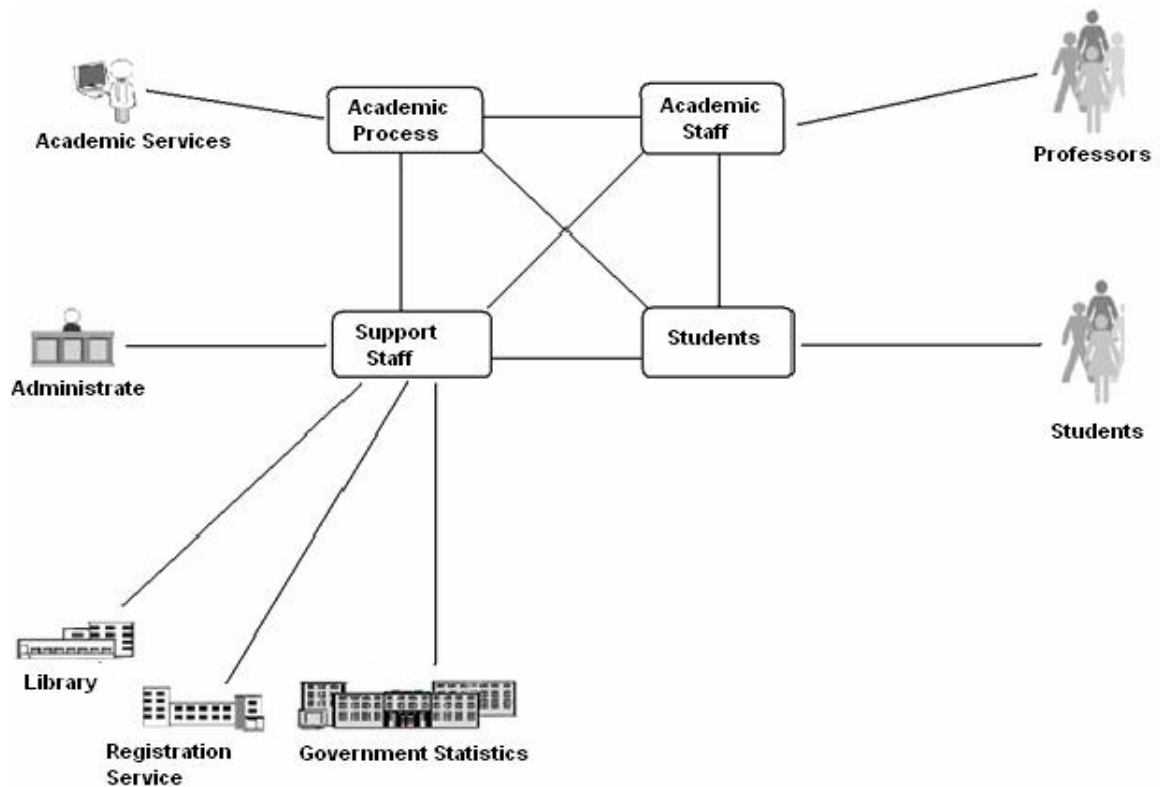


Fig.2. Processes that manage IS

Other reasons that University of Elbasan decided to implement IS are as follows:

- Provides access to enormous quantities of information available through the internet and on-line databases.
- Eases the limits of time and space for educational activities
- Brings the best lecturers to students via multimedia so that “those of the best will drive out those of the merely good.”
- Makes the teaching and learning enterprise more outcome-oriented, which enhances the ability of institutions to stimulate experimentation and innovation.
- Increases learning productivity, especially in areas of “codified knowledge and algorithmic skills”
- Empower the students to have greater control over the learning process and benefits associated with active learning and personal responsibility

## 2.1 Benefits

Elbasan's University administration promotes ICT and IS as a crucial part of higher education for the university and its students. IS is widely used across the university by playing the role of a nervous system in the operation.

A number of processes have improved as a result of the use of the IS at the university who simultaneously contributed to creating an environment more transparent and attractive to students where we can highlight:

- Campus and Buildings Administration

A database with personal info has been created in order to identify the students of the university, their benefits also to manage the events within the campus. Simultaneously, gives the possibility to fully manage university's assets.

- Recruitment and Admission

Allows students to apply through self-service including automated processes such as evaluation of application, download results of test setting recruitment categories, download the application from the test data etc.

- Student enrollment

Registration of the students enables the university to track and process all academic information. The main beneficiaries in this case are students themselves who raise the level of service and transparency. Since the moment of their enrollment, students are provided with personal student card which made possible through acquisition of all services provided by IS such as:

- Performance Review from Students.
- Consultation on the Dates of Exams.
- Consultation on the Grade List.
- Consulting the Calendar Plan.
- Register for exams and taking the appropriate stamp. The student can register only if has passed the class, or has not been penalized for absence, or from the secretary, administrative staff or has not paid the financial obligations.
- Applying for grade improvement
- Registering for the following academic year.
- Consultation on the student's financial situation.
- Consultation of the curricula
- Academic Advising

There are policies that a student must follow in order to graduate. As the student progress toward graduation, academic consulting analyzes courses completed by the student, determines what requirements are still not realized by the student, using data from enrollment of students and their requirements registered during their academic consultation.

- Student Finance and Administration

Here are defined financial obligations that must fulfill each student for attendance in the learning process, creation of invoices, payment plans, collection and reflection of these actions in the general ledger. In the same time, it also helps in the management of the human resources of the University.

- E-learning platform

E-learning platform enables a communication between teachers and students or among students. Through this platform professors make available their materials to students, duties and other forms of assessment.

This platform is used to clarify uncertainties student's have via on-line communication, in order to communicate between them by sharing materials, discuss issues related to different subjects and also to share different ideas.

This platform is used by students to communicate with their professors and perform various tasks. E-learning platform enables professors to see how much time students have spent reading the lessons online in the subject matter, the actions that they have done, tasks that are performed etc.

E-learning provides access to enormous quantities of information which is made available through internet and on-line databases. In addition, eases the limits of time and space for educational activities by bringing the best lecturers to students via multimedia. As a result "those of the best will drive out the merely good".

Moreover, E-learning makes teaching and learning experience more outcome-oriented by enhancing the ability of institutions to stimulate experimentation and innovation.

Furthermore, it increases learning productivity, especially in areas of "codified knowledge and algorithmic skills".

Empowers students to have greater control over the learning process and benefits associated with active learning and personal responsibility.

- University Competitiveness

A criterion for assessment of university's activities in relation to other universities is competitive capacity. For this purpose, board evaluators will take the necessary academic information needed through IS. The assessment carried out in this manner impacts on the University's ranking in comparison with other universities in Albania, consequently it is also a determinant for the ranking for the quality of the university.

- Administrative Costs

As the administrative costs have been reduced, the IS has the potential to facilitate administrative procedures and bringing transparency to the financial-economic activities. In this manner, it also enables the Ministry of Science and Education and other institutions to observe the processes inside the university and provide accurate information, which affects the prestige of university. This transparency is valid also for the society and university's community.

## CONCLUSIONS

To sum up, there are some conclusions that derive from the use of the information system in the university as follows:

- The use of UIS made administration more efficient and raised the overall quality of education. The teachers now, spend less time on administrative tasks and as a result they have more time for teaching and preparing materials.
- Students can use IS in education, future occupation and social life. The use of IS positively affects students learning, increases their interest and satisfaction.
- Students can communicate online with their professors, perform various tasks, apply through self-service including automated processes such as evaluation of application, download results of test setting recruitment categories, download the application from the test data etc.
- Students' management process has improved starting from their enrollment, attendance, the development of examinations and until their graduation.
- Empower the students to have greater control over the learning process and benefits associated with active learning and personal responsibility.
- Creation of a central database has resulted in the improvement of university's management by the heads of departments, deans and rector as in academic terms also administrative terms.

But at the same time some problems are noticed in the use of IS, which must find a solution in the future:

- Students need more support to gain ICT skills through training and making resources available. Training of staff and students is not formalized as a result of the poor literacy rate of many students.
- The freedom of the department in keeping some information private will be lost in a centralized, common file concept type of system. Once an item of information is entered into the system, it is available to all areas.
- To meet students' needs, the establishment of the printers is a must in order for them to make prints of the materials obtained from the IS.
- More effort is require in order to use IS as intermediary through which teachers can teach and learners can learn.

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**A NEW TOOL FOR ELECTRONIC FINANCIAL REPORTING**

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***Abstract:***

*In this study we are going to explain the universal format for financial reporting, XBRL.*

*We will analyze this issues:*

- *The history and development of XBRL*
- *Three important markup language*
- *The components of XBRL*
- *The benefits for users and prepares*
- *The relationship between Adobe and business reporting*

*Also we will explain the impact of XBRL in Albania in the near future. How it will be adopted by our financial environment.*

*The methodology used in the preparation of this paper will be that of the utilizing the foreign and national literature , and the utilization of the questionnaires .*

*The conclusions and the recommendations will be the final part of this paper.*

**Key words:** *development, advantages, disadvantages, benefits for user and prepares, Adobe PDF, markup language, business intelligence.*

**JEL Classification:** *G00.*

## INTRODUCCION

Extensible Business Reporting Language, better known by its acronym XBRL, is an XML-based markup language for the purpose of electronic corporate financial reporting. Basically speaking, in an XBRL-compliant report, each financial and non-financial line item is enclosed by a pair of XBRL tags, which describe the meanings of the enclosed item. These tags provide semantic information to the reports and makes the financial reports not only human readable but also computer comprehensible.

Leveraging the power of the computer and the internet, XBRL provides the financial community a standard of electronically and automatically prepare, publish, exchange, and extract financial statements. It is expected that XBRL will have widespread effects on financial reporting. The beneficiaries of XBRL include but are not limited to accountants, company decisions makers, creditors, financial analysts, and regulators.

*First*, for accountants, preparing financial reports can be facilitated with XBRL. Financial information needs to be keyed into the computer system only once. XBRL-ready accounting software can generate financial reports in different formats, such as for SEC filing, loan application, or corporate web reporting. It greatly reduces the manual input burden and entry errors.

*Second*, for financial statement users, the publication and exchange of financial reports can be simplified. Because XBRL-compliant reports use standardized tags, the reports can be conveniently exchange between different software and computer platforms. The financial statement users can view an XBRL report as easily as browse a web page.

*Third*, since XBRL-compliant reports are computer comprehensible, the financial information contained in these reports can be reliable and automatically extracted through XBRL-enabled applications for financial analyses.

XBRL is royalty free and can be integrated with market-available software, which reduce the cost of using XBRL to a minimum

Microsoft, together with Price Waterhouse Coopers and NASDAQ, has developed pilot XBRL application called "Excel investor's assistants" that can be imbedded in Excel. It can switch financial reports between traditional, Excel and XBRL formats with only a few mouse clicks. Ratio analysis, which can be represented in charts and diagrams can be completed in just a few seconds. SAP and PeopleSoft have also added XBRL functionality into their ERP (Enterprise Resource Planning) packages. XBRL-compliant financial reports can be created automatically since all the required financial data are available within the ERP system.

## A BRIEF HISTORY OF XBRL DEVELOPMENT

Table 1. Timeline for XBRL history and development

Time	Achievements
04/1998	Charles Hoffman began to investigate the possible use of XML for financial report
06/1999	Business plan for XFRML was created with the support of AICPA. Later XFRML changed its name to XBRL.
10/1999	First XBRL was held and the development of CI taxonomy was launched. XBRL committee had 12 members
07/2000	XBRL specification 1.0 and CI taxonomy was released
02/2001	Morgan Stanley was the 1 <sup>st</sup> company to tag its financial information in XBRL.
12/2001	XBRL specification 2.0 was released
03/2002	Microsoft became the 1 <sup>st</sup> company that report its financial data in XBRL
07/2002	Microsoft, PWC, and NASDAQ launched the XBRL pilot project
04/2003	XBRL steering committee has 170 members
2004	It was a significant XBRL project all across Asia, China. Was the first capital market that adopt XBRL
09/2006	XBRL US was spun off from the AICPA into the national jurisdiction in the global community
12/2008	The SEC rules were finalized and companies began filing XBRL reports in June 2009

### MARKUP LANGUAGE

- **HTML:** Is the most common form of markup language in use today. Html is used for web pages presentation purpose. All the web pages we can browse are built in compliance with the HTML has a limited number of tags. These tags tell the web browser a wide spectrum of presentations parameters, including font type, font size, font color, paragraph break, and other format information of a web page.
- **XML:** the acronym of Extensible Markup Language, is a more powerful data-centric markup language than HTML. Extensible denotes that XML is extensible to many derivative languages for specific industries or cross industries. Unlike HTML, which uses predefined tags, XML allow users to define tags by themselves. These tags describe the semantics and structure of data in document, which can be understood and processed by computer applications.
- **XBRL:** Is an XML-based markup language for the purpose of financial reporting. It inherits all the attributes of XML and specializes in financial reporting. XBRL provide a standard method for financial community to prepare, publish, extract and exchange financial information electronically. Through XBRL, users can prepare digital financial reports, which include the balance sheet, income statement, statements of owner`s equity, and statement of cash flows. In addition non-financial information such as management notes and auditor`s report, can also be incorporated into XBRL-based financial reports. XBRL is a made up of three technical components specification, taxonomy, and instant document.

### XBRL COMPONENTS

- **XBRL Specification:** aims at standardizing the creation of XBRL taxonomies and instance documents. XBRL allows each user to define his/her own set of meta-data tags.

- However, unless these tags are created following certain uniform standard, information exchange would be inhibited since the tags define by one user's application. XBRL specification is such a uniform standard that provides guideline on how to design taxonomies and instance documents in XBRL. It defines XBRL elements and attributes that can be used to prepare, exchange, and analyze financial reports, ensuring that user-defined tags do not overlap or crash. These elements and attributes include syntax of taxonomies,, semantic of instance documents and semantic of taxonomies.
  - XBRL-taxonomies: XBRL.org defines taxonomies as a "standard description and classification system for the contents of accounting report. Information producers take their accounting information from their accounting system and code it in a standard fashion as described by the taxonomy". Taxonomies are used for different types of business reports. As we know accounting can be divided into several subsets, including financial accounting, management accounting, SEC reporting, IRS reporting etc. Each subsets usually requires a special set of accounting terms, policies and methods for reporting. Additionally, different accounting standards may require different taxonomies. For instance, U.S General Accepted Accounting Principles (GAAP) are different from International Accounting standards (IAS). Therefore, two taxonomies may be needed to prepare the business reports in accordance with these two different standards.
  - XBRL instance document: is an XBRL-coded business report. It can be an XBRL-tagged balance sheet, an XBRL-tagged debt covenant report or an XBRL-tagged SEC 10Q filing. Three component of XBRL constitute the XBRL world. An XBRL instance documents includes the XBRL specification version ID as well as the name and location of XBRL taxonomies. Upon receiving an XBRL instance document in accordance with the matching specification and taxonomies.

#### **XBRL AND BUSINESS INTELLIGENCE**

XBRL has far-reaching implications for the entire business community. XBRL can dramatically facilitate business reporting. These processes of preparing, presenting, extracting and analyzing financial reports can be largely automated using XBRL-enabled applications. Both financial report preparers and users can harvest the huge benefits from XBRL.

- **Benefits for financial report prepares.** Accounting computerization has already alleviated accountant's workload for a large measure. XBRL can further increase the efficiency and effectiveness of accountant's work. XBRL can facilitate the preparation of financial reports. Traditional financial reporting requires multiple inputs of financial data for different types of financial report. Accountants need to input a company's entire set of financial and non-financial data for its annual report to be placed on the company website. These multiple entries of data into the computer system not only waste time and labor but also result in many input errors. XBRL eliminates this redundant task. It would be time saving, effort saving and paper saving for accountants to prepare different business reports for different purpose using different formats. It is comparable to having a word document file that can be converted effortlessly into txt, PDF, and rtf documents. XBRL can be integrated with ERP system, corporate data warehouse and other corporate information systems. ERP system and corporate data warehouse can capture data at the transaction level and feed the data into the XBRL-ready applications. Then the information can be tagged in XBRL using XBRL GL (general ledger) taxonomy. Afterwards, the general ledger level XBRL-compliant report can be further processed consolidated and customized for different user needs. The entire process can be computer automated without human intervention. This practice with further reduce the costs for financial report preparation.

- **Benefits for business report users.**

In addition to facilitate accountant`s business reports preparation, XBRL also streamline the extraction and analysis of business reports for a large variety of financial report users.. These users can include company decision makers, auditors, creditors, financial analysts, stockholders, as well as regulators. Local managers may be interested in the sale volume and inventory turnover ratio. Top decision makers may be interested in the overall profit of the company. Auditors may be more interested in knowing if the company will be able to pay back the loans. Stockholders and financial analysts are usually interested in the company`s earnings, stock dividends and growth potential. Regulators usually pay more attention to if the company has complies with the laws and regulations.

Computerized data extraction in hampered for four major reasons. *First*, not all the companies use the same set of accounting terms. For example “cash” and “cash and equivalents” can mean the same accounting item. It would be easy for human users to identify but will cause confusion for the computer programs. *Second*, what makes things worse, there is no consistency for the report layout and format. The length of annual report can vary from 5-7 pages to 70-80 pages. The inconsistency in accounting terms and report formats prohibits and automation of data extraction and analyses from business reports. However, with the adoption of XBRL these problems can be easily solved. If the financial reports are encoded in XBRL tags, XBRL-enabled computer applications can quickly scan the tags in the report, locate the desired line items and extract the data for analyses. Since these tags are clearly defined standard tags, the computer application will not have any confusion to identifying the needed data. The financial report users only need to inform the application what type of information they are interested in, and the application can extract the relevant information for them automatically. *Third*, financial reports are usually prepared in different file formats by different computer applications. *Fourth*, financial reports can be prepared in different languages, including but not limited to English, German, French, Chinese, Japanese, and Korean. Current financial analysis software suites are language dependent. Most of these applications can only process financial reports in one language, in English. Different accounting standards, regulations and policies have prohibited seamless comparison between financial report prepared under different accounting standards.

## **ADOBE AND BUSINESS REPORTING**

PDF has been the world`s business reporting platforms for years. Adobe provides infrastructure for information sharing that is accepted and used by businesses and governments around the world. Businesses, ledger, investors and regulatory organization routinely rely on intelligent PDF documents to more securely and reliably exchange financial information. Specifically they use Adobe ® Acrobat ® to create PDF versions of financial reports and regulatory forms and free Adobe Reader ® software, which is distributed on virtually every computer in the world to view PDF documents and forms without the expense of acquiring the original authoring application. Adobe also offers information requestors and businesses the ability to capture and exchange information using interactive electronic forms that can exchange data with enterprise systems using industry standard from XML data. Furthermore, advanced forms can be based on industry XML data standards, allowing organizations to leverage PDF as a platform for interoperability and data exchange. With Adobe PDF forms, organizations can also contain and more securely transport multiple file attachments in both PDF and native forms.

## **BRINGING XBRL TO THE ADOBE PLATFORM**

Adobe and Core Filing team up to deliver XBRL solution. Over the years, Adobe has worked extensively with its partners to extend the Adobe platform. To augment its already robust PDF platform, Adobe has teamed up with Core Filing to deliver XBRL extensions. Specifically Core Filing has developed a transformation capability that enables regulators to use schema within an Adobe PDF form. The result is even more comprehensive intelligent PDF forms that leverage Adobe's info-sharing infrastructure to provide businesses and regulators with a well-known, more secure environment that enables XBRL reporting through structured forms, as well as financial statements. Financial data is captured and exchange via Adobe PDF files, which provide high-quality visual representation. XBRL-based forms can be generated automatically; then they can be enhance to align with the organization's look-and-feel guidelines by Adobe Live Cycle Designer, a form design tool. This enables information requestors and businesses to work with a single document that supports both readable Adobe PDF files and XBRL data representation of the information. Businesses users can complete forms manually or import data directly into them in XBRL format. Before submitting information, the forms created using the joint Adobe Core Filing solution can require users to checks. Finally, the information is then passed more securely back to the agency or financial institution for further review and analysis. The easy-to-use solution includes sophisticated drill-down and analysis features, faster and less error-prone data aggregation, and faster more accurate audits and analysis

#### **IMPACT OF XBRL IN ALBANIA**

In Albania accounting rules are in line with the legal requirements of International Accounting Standards, but tax legislation is not in compliance with accounting standards. It is a function of government policy. Representative of the auditing and consulting firms share the same opinion about the future of Albanian accounting, separated from tax accounting. As we prepare to adopt IFRS, we have to review our current system and processes to determine that if they are ready to support the transition in line with jurisdiction's preferences.

In the near future we hope to be part of the European Union as yet are not part of it. In this way the adoption of IFRS will be easier and applicable to financial reporting. And of course the advantages of the use of XBRL will be distinct Albanian business.

Reduction of time and cost, transparency in audit, compliance with regulations, will give a great support Albanian accountants to be orderly and efficient with legal authority and their clients. Will also help investors to have more security and information on investments they made. Large companies are more likely to good management, and control of the management staff and workers. All these advantages will be a great achievement for the Albanian business accomplishment that enables the adoption of XBRL.

#### **CONCLUSIONS**

XBRL can facilitate financial reports preparation, exchange, extraction and analysis. Business report preparation and analysis will be much faster and less costly than ever. Financial reports in XBRL can be easily exchange through the Internet. Data extraction and analysis from XBRL-coded financial reports can be largely automated by computer applications. Financial report users can analyze more efficiently and effectively.

For accountants, since financial reports can be prepared more efficiently with XBRL, it is possible that more frequent and detailed financial reporting will be made. As a result, financial reports will be more transparent and informative. For management, they can know more accurately how their unit performs as compared with other units and previous periods. Better decisions can be made based on the information contained in XBRL reports. For auditors, XBRL reduces the opportunities for management fraud and manipulation of accounting numbers. Auditors can use XBRL to perform audits on high frequency or even real time basis. With XBRL, creditors can closely monitor a large group of client's debt covenant compliances at the same time.

They can make better and faster credit decisions and increase the customer base. For investors, XBRL can help them to follow more companies than before and improve their investment decisions. Mid and small-sized companies can compete with large companies for the capital markets, since the cost of investment analysis will be reduced by using XBRL. Regulators will also have better control of their subjects since XBRL can provide improved monitoring functionality. Adobe and Core Filing provide a more secure and highly manageable environment that makes it easy to exchange financial information more securely. The future of XBRL in Albania will be secure when we are going to enter in European Union and adopt their standard. In that time we will profit the advantages of using XBRL in Albanian business.

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**SECTION V: EUROPEANIZATION PROCESS AND CROSS BORDER ENTREPRENEURSHIP****CHINESE INVESTMENTS IN THE WORLD MARKET AND THEIR PERSPECTIVES IN ALBANIA**

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**Abstract:**

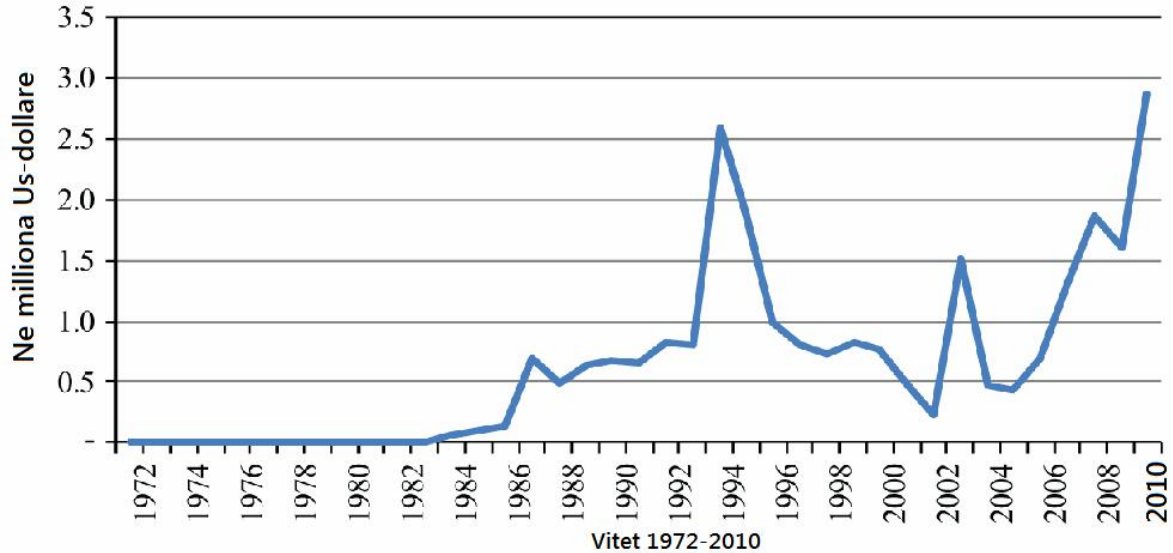
*The goal of this article is that through the gathering of primary and secondary data's from different sources in years, study the performance of Chinese IHD in the world, including here USA, Germany, Australia, Japan, and later on some countries of Europe and Latin America, Africa, their advantages and disadvantages, as well as their tendency of development in our country. Chinese investments have an important characteristic because their specter is very wide. They extend from mines, harbors, industrial parks, production, foods, telecommunications, wood and paper, agriculture, equipments and metallurgy, tourism, not to mention their basis as electronics, informative and communication technologies etc. This fact is very important for countries in development (but even in our country) because it creates development opportunities in many field of economy. Another characteristic found on the study is that countries hosting IHD have given an opportunity to investments in their priority fields of the economy. At the same time by this article can be seen their real situation in Albania, their position in IHD in general and some benefits our country can dispose from this investments. Through this article can be evidenced clearly even the influence of the other countries in the Chinese trade and economy, by investing them also in different sectors of this country. The ratio of IHD between host countries and their investment in China is different and varies between countries, this variance depends on many factors. At the same time, need to be studied and carefully managed, the disadvantages that may have these investments to be as minimal for Albania, as well as sectors where the experience and their intervention can be effective efficient and productive.*

**Keywords:** chinese investments, trade, economy.

**JEL Classification:** DO4.

**I. Chinese investments**

China is considered as one of the biggest foreign investors in the developing world as well as that developed (UNCTAD, 2006). Emerge of China as a source of foreign direct investment has direct roots in its recent economic property which placed China as a major player in global economic and politic (Brookes, 2005). Since the implementation of the market economy model of the late 70's as traditional Chinese

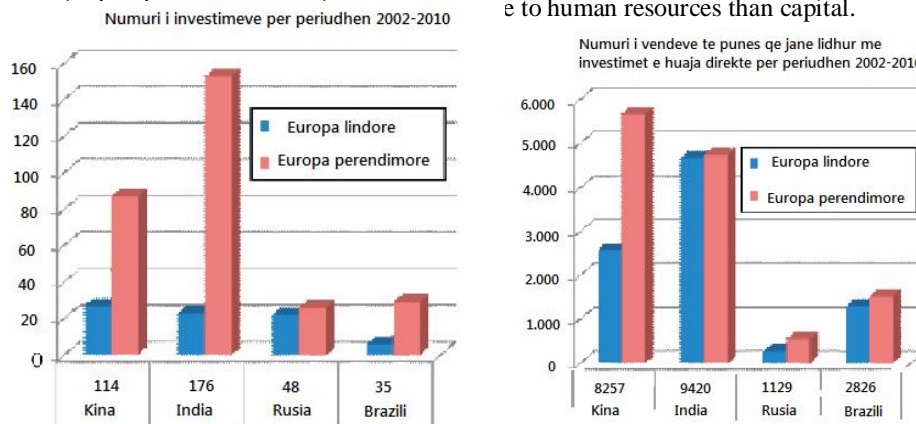


By investing in Europe Chinese manufacturing corporations are showing that they are ready to compete in the global level (Eriksson et al., 1997), and to assume the challenge in "about foreigners" which are a notable element of undertaking risk. (Sethi and Judge, 2009). However, should not leave without mentioning that Chinese FDI are constantly influenced by movements and political considerations including mandates changes to the governments of host countries (Zhang, 2003; Buckley et al., 2007). In recent years, Chinese investments have taken importance even for university studies as result also deepening its ties with the developed countries of Europe, Latin America, Africa etc., through the development of strong investment in these countries. (Deng, 2004; Wu, 2005). However, according to theoretical studies that have been done in various universities shows that Chinese potentials are limited in some countries by Uppsala model in relation to internationalization, according to which firms prefer to invest in countries with similar characteristics, idiosyncratic. (Johanson and Vahlne, 1977). In this sense, internationalization theories assume that changes in cultural, linguistic, institutional level between the investor and the host country increases Costea of doing business, which in the end results in a disadvantage for FDI in general and Chinese manufacturing corporations in particular. According (Child and Rodrigues, 2005) Chinese investments are concentrated mostly in Africa and Latin America because it fits in the policy of the Chinese government for allocation of natural resources as the most profitable as well as the use of Chinese investment for a period as long. (Lawrence, 2002; Dumbaugh and Sullivan, 2005). Psychological distance between China and Latin American countries and even among those of Europe is a threat to Chinese investments according to the theories of internationalization. (Rios-Morales and Brennan, 2006). But on the other hand, the challenge of "responsibility for Foreigners" is also present (Hitt et al., 2007) which suggests that the risk perceived by Chinese firms differ from those of developed countries in the world. (Buckley et al., 2007). Most of today's governments play an active role in the creation of initiatives adopting economic policies to encourage FDI (Blomström, 2001). During the 1980s when China enacted its policy of "opening doors" only state-owned companies were allowed to invest abroad. In the early 90s, Chinese authorities began to encourage international investment (Buckley et al., 2007). In 1999 the Ministry of Foreign Trade and Economy in cooperation with the Chinese government started the policy "Going global" model which aimed to support the globalization of local enterprises (Buckley et al., 2007).

Simultaneously in the framework of policies that will favor Chinese investments were creating wider system database with foreign countries, study the investment environment, market research and other types of information necessary in attracting FDI. (Rios-Morales and Brennan, 2006). In this scheme, part of the strategy was also introduced many training programs in different languages and exchanges with business and businessmen. Jud eats a big boost exports which were a proactive foreign investment. Strategies were established on the basis of economic, political and cultural life for long periods, to guarantee the success of these investments (UNCTAD, 2005). Dunning model categorizes FDI from four different strategies: exploration of natural resources, market research, search for efficiency, and asset search (Aguiar et al., 2007). Strong government support provided to these companies to achieve a high-performance and low-cost financial capital and better exercise their internationalization strategies (Buckley et al., 2007).

## II. The movement of IHD from China to Europe

The growth of IHD presence in developing countries of Europe has identified more recent years. Although many of these modest IHD is where the investment is not regarded as insignificant. Asia is considered as the second most extensive source of job creation in Europe after the U.S. productive investments. Investments in Europe have been mainly by China, India, Russia and Brazil. If you will see the following two figures put them noticed that the number of total investment is 373 divided into different structures according to these four states. As seen China ranked second after India, while total jobs from these investments results in 21,632 jobs. Western Europe has absorbed more investment than the eastern or 79.10% compared to 20.9% in Eastern Europe. At the same time, the data show that jobs in Eastern Europe caught about 40.9% while at the western 59.1%. Since investments in Eastern Europe resulted about 20% this indicates that the more they go to the labor force than for capital or other forms of IHD. This shows



Graf. 2. Number of investment and jobs for the period 2002-2010 for developing countries

Over half of Chinese investment in Europe is concentrated in the services sector of e-commerce, transportation, logistics, textiles, alcoholic beverages, food, chemical industry, etc. (Hay et al., 2010). Although Chinese IHD considered a global advantage based on differentiation of lower costs, they also have disadvantages and should be mentioned that the level of management is considered not so experience than that of other countries such as the USA, etc.. In this perspective, Chinese companies have an average IHD international managerial seniority with a market share of about 7.2 years, while the U.S. more than twice or 16.9 years. (Aguiar et al., 2007). Another disadvantage is the lack of familiarity with the environment and the environment, requirements and regulations have the ownership of European countries etc.. The following table gives a summary overview for some advantages and disadvantages of Chinese IHD.

**Powers (Advantages)**

Labor cost competitiveness  
 Capacity building skills  
 Acceptance for low-cost capital  
 Ambition  
 Motivation  
 Long-term orientation  
 Strategic thought

**Weaknesses (disadvantages)**

Deficiencies in the quality of the product and its quality  
 Inefficient in the use of materials and energy  
 Weak practices for health and safety  
 Hierarchic orientation  
 Making slow decision  
 lack of individualism  
 International inexperience  
 Turnover of employees  
 Lack of marketing skills  
 Limited capacity for innovation.

**Table 1: The advantages and disadvantages of Chinese IHD****III. The Chinese IHD in some important countries of the world**

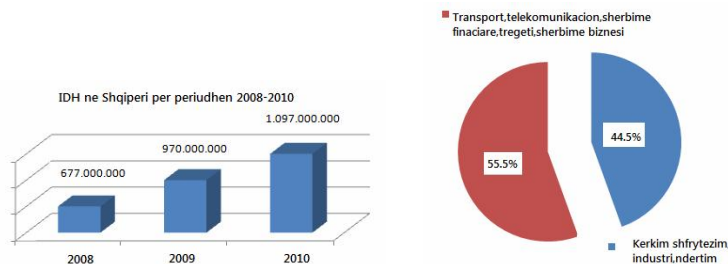
Germany is one of the most industrialized countries not only Europe but also the world. The studies show that Chinese FDI have increased from year to year, and at the same time China is ranked third after the Netherlands and France for imports. FDI Index has recorded an increase from 156 in 2003 to 355 in 2007. While the number of projects with Chinese importance in Germany ranges from 4 in 2004 to 10 in 2009. While their action areas were 8.8% financial services, communications 18%, 12% electronic components, textile 6%, IT and software 5.9%, industrial machinery and equipment 21%, and so on. (Ulrike Handtke, 2009). Chinese investments are also extended to important Latin American countries and in different fields. Devoted to recent investments in Brazil are in the port sector and industrial parks in the area of the coast of Rio which capture the value of investments of \$ 2.2 billion. In July 2011 China gave the first loan Venezuela \$ 4 billion investment by 20 billion planned for the sectors of agriculture, energy and infrastructure. Peru also benefited proposals in the \$ 1.4 billion investment in the field of mining. But also this year, China and Argentina signed a \$ 10 billion contract in the railway sector. Chinese investment in Africa excel not only in natural resources but also in telecommunications infrastructure and technologies for the production of ready products. Also in this continent accounted for nearly 1,600 Chinese companies which operate with different rules and cultures between that exist between the countries of this continent. Canada has built relations with China after 1994 and they were completed after a round during their talks, as well as membership latter WTO (World Trade Organization). The stock of Canadian FDI in China in 2008 according to the data was valued at about \$ 3.58 billion, which included sectors and activities such as: biotechnology, transportation, education, finance, information technologies, manufacturing and natural sources. As in the same year the stock of Chinese FDI in Canada amounted to about \$ 2.75 billion. Interest of these investment sectors included: natural resources, energy, food processing, medicinal, pharmaceutical, natural, and advanced manufacturing. Great Britain in 2009, imported and exported a total of about 811 billion pounds, or about 3.9% of world trade. At the end of 2009 over 652 billion pounds FDI was invested in Britain.

Chinese FDI in the UK are lying in the sectors of coal, information and communication technology, etc.. In 2010 Chinese FDI in Japan is estimated at 1.6 trillion yen, or \$ 19.4 billion investment these lying in the sectors of pharmaceutical, electronics, telecommunications and transport, Softbank, etc. Since the beginning of the 80's until 1987 Chinese FDI in Baltic countries were almost at the same level mutual. Later Chinese investment rates are many times higher than those of the Baltic countries (Sweden, Finland Estonia Latvia) in China. Areas of action include the sectors of metallurgy and production of metals, oil, manufacturing of automobiles, electronics and their equipment, transportation buildings etc.. In 2008 Swedish imports from China were about 2000 million Euros higher than exports to this country. Roof Chinese investment in Sweden reaches for the year 2006 with 32 out of which only 16 or 50% of them are realized in Stockholm. The most important sectors considered trade and services with respectively 27% ICT (information and communication technology) to about 10%, paper, packaging forest tourism, etc.

#### IV. Foreign investment in general and the Chinese one in Albania

##### IV.a.IHD in Albania

IHD flow in Bangladesh has followed a different trend and almost independent of the regional and global trend showing a steady rise in recent years. Specifically: from \$ 325 million were in 2006, have been steadily growing in the years: 2007 - \$ 656 million; 2008 - \$ 677 million; 2009 - \$ 970 million in 2010, \$ 1097. Investments made by economic activity are classified: 44.5% estimated IHD in search use, industry and construction; 55.5% in the service sector, transport, telecommunications, financial services, trade and business services. Increasing participation of foreign companies in the Albanian market is a clear indication of favorable conditions for IHD to continue to be realized in some sectors of the economy such as mineral extraction, energy sector, banking sector and telecommunications.



The Albanian Government is aware that the attraction of foreign direct investment and increase the competitiveness of local companies are essential for sustainable economic development in Albania. During recent years, significant measures have been taken by the government to improve the investment climate, regulatory and institutional reform, increasing the availability of funds for investment, infrastructure development, improving the conditions for free trade and regional integration. Low level of fiscal burden prevailing in Bangladesh, it is not sufficient unless it is accompanied by effective public services. For this reason, the government continues to carry out further reforms in tax and customs administration, land use and construction permits, administrative appeals system, inspection system and e-government. The Albanian government is in the process of continuous improvement of implementation of legislation, tax collection, VAT refund and reduction of bureaucracy"

##### IV.a. Chinese investments in Albania

The history of relations with China starts from 60's with the help the Chinese government then gave to our country, which reflects in different industrial building construction, as in heavy industry up to that light and food, despite the type of technology. Then these relations were weakened by interrupting the middle of the 70's. After years of democracy re-established links with China. During his visit to China in 2009, the country's Prime Minister Mr. Sali Berisha invited Chinese companies and the government of this country to invest in Albania in various sectors of the country. He mentioned that the time for registration of a business has been cut from 40 days to 30 minutes and Nigeria possesses readiness to make available many sectors where they can exercise their experience.

Chinese Foreign Minister meetings in August of this year, with the highest figures state noted advantageous geographical position of Albania. In connection with this point, the Prime Minister expressed his willingness to support the creation of a free zone for Chinese investment, and encouraged investment in port infrastructure. As head of state stressed that Chinese companies are welcome to invest in energy, infrastructure, rail, construction of industrial parks, tourism, etc. Our Foreign minister reaffirms the willingness of governments and countries to expand and deepen this cooperation further, especially in the field of economic and commercial exchanges, increase Chinese investment in our country, bringing new dynamics of these relationships.

## V .Conclusions and recommendations

At the end of this article may conclude that Chinese investments in the world are spread after 90s but are globalized after 2000. They have a different stretch in different places and for different activities and sectors. Greater diffusion have in Latin America and Africa in developing countries which include those mostly Eastern European. Although present in developed countries like USA, Germany, Australia etc. they do not rank at the top of FDI to these countries have even a partial stretch in economic sectors. Chinese investments are spread mainly in telecommunications, construction of ports and industrial parks, IT, mining, natural resources exploit, textile and metallurgical industry, vehicles and various equipment etc. Have the advantage because they can provide a lower cost this as result of low laborers power but possess disadvantages as lack of quality and safety, inefficiencies in the use of materials, slow decision making, lack of innovation, etc.. Given their nature, it is recommended that can adapt quickly in countries with these favorable characteristics for which drawbacks are not very problematic, where more aimed at providing lower cost than the highest quality and safety, etc.. Often may not have many claims to set up their own businesses, but should not be underestimated fact that inadequacy different countries, according to theoretical studies that have been done in various universities shows that Chinese potential are limited in some countries according to the model Uppsala in relation to internationalization.

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- Source from: [www.china-briefing.com](http://www.china-briefing.com)



**POLICIES TO COMBAT HIGH UNEMPLOYMENT AND POVERTY RATES IN KOSOVO**

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**Abstract:**

*Employment and poverty are main and complex challenges for institutions of Republic of Kosovo. Employment generation, poverty alleviation are phenomena that are related to the macroeconomic policies, social policies and other related policies. Based on macroeconomic indicators Kosovo in comparison to other countries in South East Europe has been less from the economic global crisis and has experienced positive GDP growth where the real GDP growth has been 3.9 % in 2011 (KAS, 2011). However Kosovo remains one of the highest poverty rate and with the highest unemployment rate in Europe and Western Balkan. Unemployment and poverty are two indicators that need to be improved from Kosovo Government, respectively from the Ministry of Labor and Social Welfare (MLSW). Existing data reveal that in the last decade the number of jobs created and number of labor market entrants were not matched-too few jobs and high entrance into the labor market which have prevented improvement of employment rate. Development of strategies and efficient policies will contribute to reduce unemployment rate and alleviate high poverty rate existing in Kosovo. According to the latest data, unemployment in Kosovo is estimated to be 45% (KAS, 2010) and the extreme poverty rate is at 8.2 % (World Bank, 2011). Therefore it remains crucial to improve the two noted statistics high by any international standards. Kosovo has young population where one third of population is below 15 years and half of population is under age of 24. The unemployment rate is highest among the two noted age groups. Poverty rate is strongly related to employment status, type of employment, household size, remittances, etc. In this article brief presentation of unemployment and poverty statistics will be provided and will as well present some policy guidelines on how Kosovo could combat the persistent high rates of unemployment and poverty.*

**Keywords:** *unemployment, policies, poverty, strategy.*

**JEL Classification:** *I32: Measurement and Analysis of Poverty; I38: Government Policy; Provision and Effects of Welfare Programs; J18: Public Policy; J21: Labor Force and Employment, Size, and Structure; J64: Unemployment: Models, Incidence, and Job Search.*

**1. Introduction.**

Unemployment and poverty are issues that need to be improved. Creating new jobs in the last decade has been in a very low level, both in a private as well as in public sector. Employment indicators and poverty are influenced by macroeconomic policies, policies which should produce positive effects on job creation and recovery of household income. Almost half of the labor force in Kosovo is unemployed and unemployment is strongly associated with poverty. Unemployment and poverty are also associated with the education level of the population; individuals who are prepared with high level education are less likely to be affected by poverty as well as unemployment. Generalization about the state of labor market in Kosovo should have a higher level of treatment because the informal economy is quite significant.

Main source of data on statistical indicators of the labor market in Kosovo is the Labor Force Survey (LFS) conducted by Kosovo Agency of Statistics (KAS) in 2001 that was based on questionnaire. As a survey was developed only from September 2001-2009, around 4,000 thousand households were interviewed and approximately 22,000 individuals aged 16-64 years. As of January 2012, AFP is conducted through CAPI method (laptop).

Main source of data on income, consumption, and poverty in Kosovo is the Household Budgeted Survey, where as a survey is conducted from 2001 by KAS. Unemployment and poverty is more noted by young age groups as well as those with less educational preparation. Non formal employment is more stressed in the agricultural, construction and tourism sector. The report consists of: introduction, labor market trends and poverty in Kosovo, policies to combat unemployment and poverty and at the end of the report are presented conclusions and recommendations based on the findings of the report.

## **2. Labor market and poverty trends in Kosovo.**

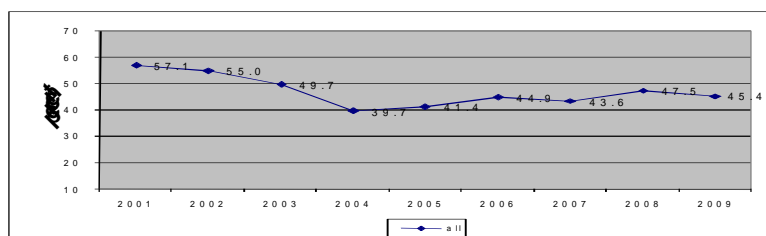
If we compare Kosovo's labor market with entering new labor force than Kosovo is a small market to absorb that entire contingent plus the rest who is waiting from previous years for employment which are around 325,261 job seekers [1]. High rate of poverty and unemployment will continue to make the migration as the only employment opportunity for the youth. Poverty is a broad and multidimensional concept and consumer component only affects one of these dimensions. In analyzing the data were analyzed complete poverty that is considered adequate to meet basic needs and extreme poverty where the population is unable to fulfill even basic needs for food. In an ideal way profile of consumption poverty should be presented by implementing analysis to the other dimensions of poverty and violation such as lack of accessibility to public services, safe living conditions, political voice, the labor and products market as well as other aspects of living conditions. Macro-economic policies should be effective in reducing poverty and unemployment. Kosovo still needs the support of international community for handling a large number of challenges as poverty as well as unemployment. Poverty in Kosovo has not remained the same, there are positive trends. If we compare 2003 to 2010 we have a decrease of overall poverty from 43.5% to 29.2% and extreme poverty from 11.6% to 8.2%<sup>164</sup>, but again although we have decrease the rate of poverty is still high [2]. Evidences shows that poverty is higher among those living in large families, who have a lot of unemployed members and who have low level of education. Therefore to improve in the future the welfare of the population the Government of Republic of Kosovo namely Ministry of Labor and Social Welfare (MLSW) and other relevant stakeholders should develop appropriate policies regarding the reduction of unemployment and poverty in Kosovo where as phenomenon are quite significant.

### **2.1. Labor market trends in Kosovo.**

Since 2001 unemployment rate has decreased, in 2001 unemployment rate was 57.1% and in 2009 unemployment rate was 45.4%, so we have a decrease of 11.7 %, this does not include workers employed in agriculture who produce products for own consumption but not for the market, these individuals are not considered employees. There was an employment increase of 6.5% from 2001-2009; the employment rate in 2001 was 19.6% while in 2009 it was 26.1% [3]. These data you may see in the following graphs where are presented the trends of unemployment and employment rate in Kosovo for 2001-2009 as follows:

#### **Graph 1: Level of unemployment, 2001-2009.**

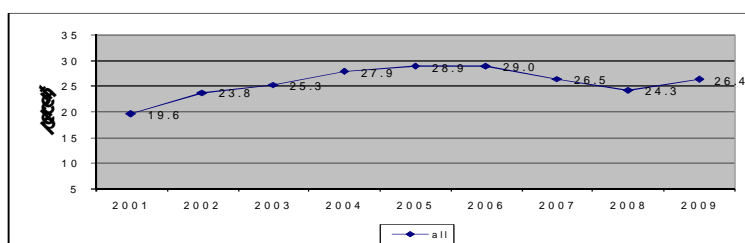
<sup>164</sup> Calculation conducted by World Bank from data base of HBS, World Bank together with KAS is publishing data from 2003.



Source: KAS from LFS 2001-

2009 data

Graph 2: Level of employment, 2001-2009



Source: KAS from LFS 2001-2009

data

## 2.2. Poverty trends in Kosovo

If we compare trends of full and extreme poverty in Kosovo from 2003/2004 until 2010 there have been positive trends<sup>165</sup>. Poverty lines based on food, which are used for the analysis, are identified based on the structure of the composition of the minimum consumer basket, which was developed as a result of the analysis of the household budget for 2002. Extreme poverty line<sup>166</sup> is estimated to be 0.94 Euro or 2100 calories per day for adult individuals, and the line of full<sup>167</sup> poverty is estimated to be 1.42 Euro per day for adult individuals. Through the following table are presented poverty trends in Kosovo from 2003 to 2010 [4]:

Table 1: Poverty trends from 2003 – 2010 in Kosovo

	Absolute Poverty (full)	Extreme poverty (food)
2003/04	43.5	13.6
2005/06	45.1	16.7
2006/07	45.4	16.8
2008	42	18
2008/09	38	14
2009	34.5	12.1
2010	29.2	8.2

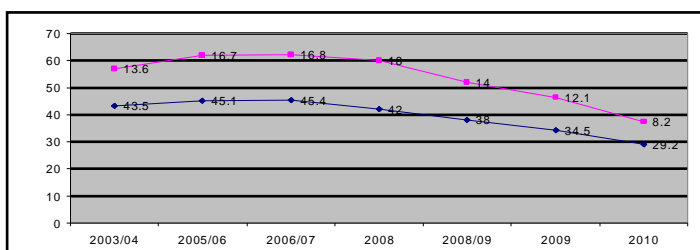
Source: World Bank staff calculations from HBS

Graph 3: Poverty trends from 2003 – 2010 in Kosovo

<sup>165</sup> Comparisons are made from reports published by World Bank and Kosovo Agency of Statistics, from year 2004

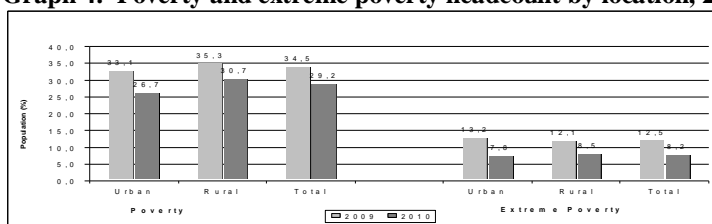
<sup>166</sup> Extreme poverty line represents the food poverty

<sup>167</sup> Full poverty line represents total food and no-food poverty



Based on 2010 HBS it is estimated that 29.2 percent of Kosovo's population lives below the poverty line whereas 8.2 percent of population below the extreme poverty line (graph 3). In 2010 both absolute and extreme poverty was more pronounced in rural areas: 31 per cent of population in rural areas living below the poverty line compared to 27 percent in urban areas-a four percentage points difference. With regard to the extreme poverty 8.5 percent of population in rural areas lives below extreme poverty line compared to 7.8 percent in urban areas. Based on 2010 HBS<sup>168</sup> it is estimated that 29.2 percent of Kosovo's population lives below the poverty line whereas 8.2 percent of population below the extreme poverty line (graph 3). In 2010 both full and extreme poverty was more pronounced in rural areas: 31 per cent of population in rural areas living below the poverty line compared to 27 percent in urban areas-a four percentage points difference. With regard to the extreme poverty 8.5 percent of population in rural areas lives below extreme poverty line compared to 7.8 percent in urban areas.

**Graph 4: Poverty and extreme poverty headcount by location, 2009-2010**



Source: World Bank staff calculations from HBS

Poverty rates dropped from 2009 to 2010 by 5.3 percentage points for full poverty and by 3.9 percentage points for extreme poverty. In both years full poverty rate was higher in rural areas but with regard to extreme poverty there was a swift since in 2009 extreme poverty rate was higher in urban whereas the reverse characterizes 2010 results- poverty rate is higher in rural areas.

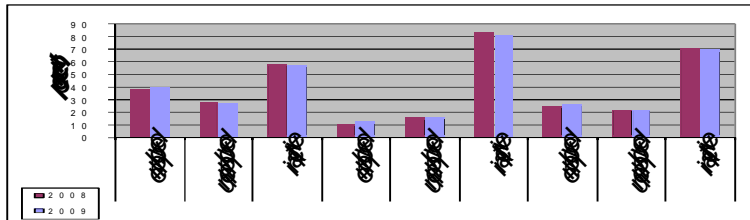
### 2.3. Activity status

A second group of important labor market indicators refers to the actual activity of the population by distinguishing three statuses: employed<sup>169</sup>, unemployed<sup>170</sup>, and inactive<sup>171</sup> (for the respective definitions see Graph 5 above).

<sup>168</sup> HBS, is developed in KAS respectively DSS, every month through this survey are interviewed 200 households or within year 2400 households. Questionnaire consists of basic part, demographic part and the diary.

<sup>169</sup> Employed are those who during the reference week: did any work for pay or profit, or were not working but had jobs from which they are temporarily absent. Family workers were included.

The distribution of males, females and the total population by their activity status is presented in graph 3. Graph 5: Population by employment status and gender, 2008-2009



Source: KAS from LFS 2001-2009

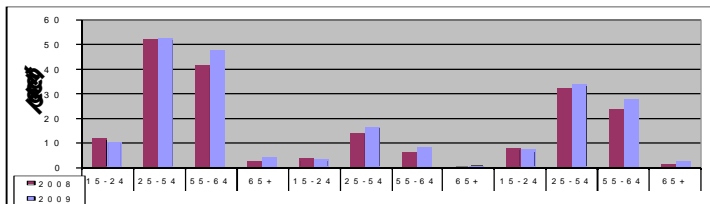
data

The graph shows that inactive persons make up the largest group in the Kosovo population. There are several factors contributing to this phenomenon. Firstly, all persons under 15 are included here by definition and, secondly, many younger people still are in the process of education, while, thirdly, a number of older persons leave the labor force before reaching the working age limit. Fourthly, many women take over the family and household responsibilities therefore they are not engaged in economic activities, and, lastly, some persons of both gender have given up searching for work position because they think none is available.

## 2.4. Employment

In this section, the situation on the Kosovo labor market in 2009 and possible developments since the preceding year will be discussed in a greater detail by looking at specific characteristics of employed persons.

### Graph 6: Employment rates by gender and age groups, 2008-2009



Source: KAS from LFS 2008 - 2009

data

According to the data for both genders, the employment rate is lower for 15-24 age group with only 10.7% to 3.7% for males and females, in part, can be seen that it is due to continue education, but also can be the result of difficulties to achieve the first entry in the labor market. In the older age group population (55-64), however, presented a big difference between men and women. The main cause of this discrepancy may be the tendency of woman to go into earlier retirement. In this graph you can see the level of employment rate of individuals over 65 of age which is 4.6% to 0.8% for males and females while the corresponding figures for 2008 were 2.5% to 0.3% for males and females [5].

<sup>170</sup> Unemployed are those who: had no employment during the reference week, and had actively sought employment during the previous four weeks, and were available to start work within the next two weeks. Persons who already had found a job which was to start later are also classified as unemployed.

<sup>171</sup> Inactive are all those not classified as either employed or unemployed.

### 3. Policies to reduce unemployment and poverty in Kosovo.

The main aim of politics should be to reduce unemployment and poverty and the development of human resources in Kosovo. Improvement of mechanism for identification of poverty and securing necessary information for MLSW and other institutions will play an important role in increasing services for Ministry [4]. Considering that there is a high unemployment rate it implies that there is vast majority of population living in poverty.

Macroeconomic policies respectively social policies should be addressed also to the regional and European market. Policy goal should be to do structural changes in employment and in standard of living, and to establish economic framework and other mechanism for creating new jobs and recovery of household incomes. One of the main political and strategic goals of the Kosovo Government should be the employment of the population capable to work, through economic development, mobilization of human resources, financial, natural resources, open economy, entrepreneurship and free private initiative. Economic sectors that will contribute at most in reducing unemployment and poverty in Kosovo are: agriculture, energy, construction, services, mining etc. priority should be given to reduce long term unemployment while this is very high in the Republic of Kosovo or in percentage 817%, to reduce unemployment by women and also to reduce unemployment by youth group age 15-24. Political action that should be taken to reduce unemployment and poverty in Kosovo should be focused on supporting active labor market policies, undertaking preventive measures for the unemployed, increasing knowledge capacities in line with market needs, creation of new jobs and also improving the gender balance in employment. Measures and actions developed within these policies should be addressed in specific policy directives of the European Union for employment. MLSW should have an important role on the development of active policies on reducing unemployment, creating a legal framework, training of manpower, promotion of employment services. It should be taken into consideration that a significant number of the workforce is employed in the informal economy. Major policy steps that should be taken to improve unemployment and poverty trends are as follows:

- Stimulation of households, especially agricultural businesses and as well as support of small businesses and creation of a friendly environment for opening new businesses.
- Creating custom facilities for inputs,
- Increase the professional skills of the workforce according to the trends of market economy,
- Creating a clear picture on the labor market and poverty indicators,
- Advancing employment programs for temporary employment abroad ,
- Activation producing capacities through the creation of a friendly environment that helps the economic development of the country, helps employment process, reduces the number of poor households and with that also the number of households and persons receiving social assistance,
- Support and develop micro financial institutions in rural areas.

### 4. Conclusions and recommendations.

According to the findings of the report on poverty and unemployment, policies that are taken to improve these very complex indicators in the Republic of Kosovo, I think that macroeconomic policies respectively social policies should be more efficient in reducing unemployment and poverty where they play an important role in maintaining macroeconomic stability of the country as is the case with Republic of Kosovo a country in transition. Social support should be of the high level especially for the population that is unemployed and the population that lives in extreme poverty or full poverty.

To implement social policies to combat unemployment and to fight poverty should be taken a series of activities, where one of them is to create preconditions for employment, increasing capacity building workforce skills in the level of regional and European trends as well as promotion of employment, than developing adequate legislation and its implementation. As another issue that there is still room for improvement is to create a friendly environment for the development of small and medium enterprises as well as entering in the circulation of financial means of pension fund and collected financial means from privatization. Based on findings of this report on poverty, unemployment and policies to improve these indicators I recommend as follows:

- ∅ Improving fiscal policies in favor of domestic businesses with the aim of creating friendly environment, thus creating an attractive environment for foreign and domestic investors.
- ∅ Credit policies should be with favorable conditions for existing businesses and for opening new businesses as well as workforce training should be done based on the demands and trends of market economy.
- ∅ Increase the efficiency of MLSW namely Department of Labor and Employment as well as Department of Social Welfare which operates as departments within the MLSW, to be more efficient in terms of mediation in employment, employment promotion, encouraging employment and other issues related to labor market policies. Department of Social Welfare should be much more efficient in developing and implementing social policies to improve social welfare in Kosovo.
- ∅ To create a unique system on statistical information, on labor market indicators and statistical indicators on poverty. Statistical information to be as much as possible fresh so that decision-making institutions have comprehensive statistical information, consistent and in time.
- ∅ Improving the balance of employment and poverty in terms of gender as well as on the basis of the population age group. If we compare Kosovo with countries in the region and beyond there is a discrepancy in terms of employment or unemployment.
- ∅ International financial support is necessary for Kosovo, taking into consideration that Kosovo is a country emerging from war and as a new state still needs support in investments in all sectors of economy and
- ∅ Combating corruption, it is a negative phenomenon which has affected and effects negatively in economic and social development.

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**SOUTH EAST EUROPE: TRADE LIBERALIZATION, ECONOMIC INTEGRATION, QUALITY, SECURITY AND GUARANTEE OF PRODUCTS AND SERVICES**

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**Abstract:**

*Southeast Europe is a political designation mostly for the states of the Balkans. The strengthening of security and the political situation, intensification of economic relations and co-operation in the areas of human resources, democracy, justice, and battle against illegal activities, it is the intention of these countries to enable approaching the European and Euro-Atlantic structures through the strengthening of good neighborly relations and transformation of the region into an area of peace and stability. This requires trade liberalization, economic integration and quality, security and guarantee of products and services. Trade liberalization is the removal of or reduction in the trade practices that thwart free flow of goods and services and includes dismantling of tariff as well as non tariff barriers. Economic integration is the unification of economic policies between different states through the partial or full abolition of tariff and non-tariff restrictions on trade taking place among them prior to their integration. This leads to lower prices with the goal of increasing the combined economic productivity of the states. Quality of product or service refers to the perception of the degree to which the product or service meets the customer's expectations. Safety is the state of being "safe", the condition of being protected against physical, social, spiritual, financial, political, emotional, occupational, psychological, educational or other types or consequences of failure, damage, error, accidents, harm, any other event which could be considered non-desirable, the control of recognized hazards to achieve an acceptable level of risk, being protected from the event or from exposure to something that causes health or economical losses. Guarantee is anything that assures a certain outcome. Continuous changes in developing economy, technology, environmental regulation and public safety concerns are the main areas where SEE countries are being focused for their common future, using their human and natural resources.*

**Keywords:** trade liberalization, economic integration, products and services.

**JEL Classification:** F15.

**Chapter 1: South East Europe.**

There are four possible definitions of "Southeastern Europe".

1. The Balkan Peninsula south of the River Danube-River Sava-River Kupa line
2. The European territories of the former Ottoman Empire
3. The substantially larger space with a northern delineation that respects actual borders, promoted by the European Union from 1999
4. The European Union co-funded regional development model that adds Austria, the eastern Regions of Italy and southwestern Ukraine.

In this article the last model will be taken into the consideration.

**1.1 Southeast Europe & Southeast Europe transnational co-operation program model.**

Southeast Europe is a relatively recent political designation mostly for the states of the Balkans (1).

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The first known usage of the term 'Southeast Europe' was by Austrian researcher Johann Georg von Hahn (1811–1869) as broader term than the traditional Balkans (2). The Southeast Europe transnational co-operation program "aims to develop transnational partnerships on matters of strategic importance, in order to improve the territorial, economic and social integration process and to contribute to cohesion, stability and competitiveness of the region" (3)

The members include: Albania, Austria, Bosnia and Herzegovina, Bulgaria, Croatia, Republic of Macedonia, Greece, Hungary, Republic of Moldova, Montenegro, Romania, Serbia, Slovakia, Slovenia, and some regions of Italy and Ukraine (4)

No	Country	Area (km2)	Population	GDP (USD)	HDI
1.	Albania	28.748	3.000.000	8.000	0.739
2.	Austria	83.555	8.500.000	49.800	0.885
3.	Bosnia & Herzegovina	51.197	3.800.00	8.000	0.733
4.	Bulgaria	110.994	7.400.000	13.500	0.771
5.	Croatia	56.594	4.300.000	18.200	0.796
6.	Republic of Macedonia	25.713	2.000.000	10.300	0.728
7.	Greece	131.990	10.800.000	26.300	0.861
8.	Hungary	93.030	9.940.000	19.600	0.816
9.	Kosovo	10.908	1.800.000	7.000	N/A
10.	Republic of Moldova	33.846	3.600.000	3.400	0.649
11.	Montenegro	13.812	630.000	11.600	0.771
12.	Romania	238.391	19.000.000	12.500	0.781
13.	Serbia	77.652	7.200.000	10.600	0.766
14.	Slovakia	49.035	5.500.000	23.000	0.834
15.	Slovenia	20.273	2.000.000	28.600	0.884
16.	Some regions of Italy	NA	NA	30.400	0.874
17.	Ukraine	603.628	45.900.000	7.200	0.729

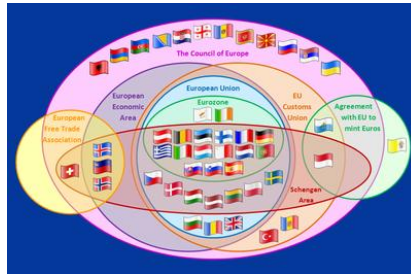
**Table 1.** Main figures of SEE countries (Drawn from author of the article using Wikipedia's data.)

We are talking for an area of about 1.630.000 ml km<sup>2</sup> (without Italian regions) and a population of about 135.5 ml (without population of Italian regions) with a lot of natural and human resources.

## 1.2 Southeast European Cooperation Process.

The South-East European Cooperation Process (SEEC) was launched on Bulgaria's initiative in 1996. At the Bulgaria-chaired meeting in Sofia, the SEE countries laid the foundations for regional co-operation for the purposes of creating an atmosphere of trust, good neighborly relations and stability. A special characteristic of SEEC is that it is an original form of co-operation among the countries in the region launched on their own initiative, and not on the initiative of some other international organization or countries. In that regard, the SEEC seeks to define itself as an authentic voice of SEE, complementary to the Stability Pact, SECI or the Stabilization and Association Process.

The basic goals of regional co-operation within SEEC include the strengthening of security and the political situation, intensification of economic relations and co-operation in the areas of human resources, democracy, justice, and battle against illegal activities. It is the intention of the SEEC to enable its members to approach the European and Euro-Atlantic structures through the strengthening of good neighborly relations and transformation of the region into an area of peace and stability.



**Figure 1.** Supranational European Bodies  
(From: <http://en.wikipedia.org/wiki/EuropeanEconomicArea>)

### 1.3 Business opportunities in the SEE area.

Since the area is full of natural and human resources business opportunities may arise in all sectors, but agricultural production, agribusiness, textile and leather manufacturing, minerals and metals industry, energy and hydrocarbon production and trade, pharmaceuticals, consultancy, etc. are promising sectors. These sectors require investments on achieving competitive advantage towards production specialization. For example Ukraine and Kosovo may be specialized on wheat production, Albania and Greece on olives and olives oil production, Albania in watermelon production, Albania, Republic of Macedonia and Greece on milk processing and wine, Austria on hydrocarbon processing and vehicles manufacturing, Slovakia and Ukraine on minerals, Romania, Albania and Ukraine on fuel reserves and exploitation, etc.

## Chapter 2, Trade liberalization.

With concept of “trade liberalization” we understand today the removal of or reduction in the trade practices that thwart free flow of goods and services from one nation to another. It includes dismantling of tariff (such as duties, surcharges, and export subsidies) as well as non tariff barriers, such as licensing regulations, quotas, and arbitrary standards) (5).

### 2.1 Current situation on trade liberalization.

Recent decades have seen rapid growth of the world economy. This growth has been driven in part by the even faster rise in international trade. The growth in trade is in turn the result of both technological developments and concerted efforts to reduce trade barriers. Some developing countries have opened their own economies to take full advantage of the opportunities for economic development through trade, such as South European Countries, but not for all goods, services, capitals and humans (6). Still between these countries remaining trade barriers industry, agricultural products, etc. because of having comparative advantage.

Further trade liberalization in these areas particularly, by both industrial and developing countries, would help some of these countries escape from low level incomes while also benefiting the high income countries themselves (7).

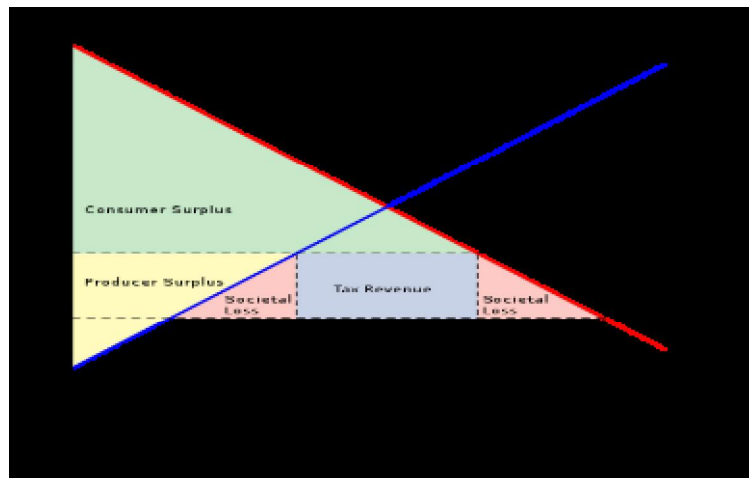
### 2.2 The Benefits of Trade Liberalization.

Policies that make an economy open to trade and investment with the rest of the world are needed for sustained economic growth. The evidence on this is clear. No country in recent decades has achieved economic success, in terms of substantial increases in living standards for its people, without being open to the rest of the world. In contrast, trade opening (along with opening to foreign direct investment) has been an important element in the economic success of Southeast Europe area, where the average import tariff has fallen from 30 percent to 10 percent over the past 20 years (8).

Opening up their economies to the global economy has been essential in enabling South East Europe countries to develop competitive advantages in the manufacture of certain products. Such countries would gain more from global trade liberalization as a percentage of their GDP than industrial countries, because their economies are more highly protected and because they face higher barriers. Although there are benefits from improved access to other countries' markets, countries benefit most from liberalizing their own markets. The main benefits for industrial countries would come from the liberalization of their agricultural markets. Developing countries would gain about equally from liberalization of manufacturing and agriculture. The group of low-income countries, however, would gain most from agricultural liberalization in industrial countries because of the greater relative importance of agriculture in their economies.

### 2.3 Disadvantages of tariffs.

The chart below analyzes the effect of the imposition of an import tariff on some imaginary good. Prior to the tariff, the price of the good in the world market (and hence in the domestic market) is  $P_{world}$ . The tariff increases the domestic price to  $P_{tariff}$ . The higher price causes domestic production to increase from  $QS_1$  to  $QS_2$  and causes domestic consumption to decline from  $QC_1$  to  $QC_2$  (9). This has three main effects on societal welfare. Consumers are made worse off because the consumer surplus (green region) becomes smaller. Producers are better off because the producer surplus (yellow region) is made larger. The government also has additional tax revenue (blue region). However, the loss to consumers is greater than the gains by producers and the government. The magnitude of this societal loss is shown by the two pink triangles. Removing the tariff and having free trade would be a net gain for society (9).



**Graphic 1.** Disadvantages of tariffs. The pink regions are the net loss to society caused by the existence of the tariff.

An almost identical analysis of this tariff from the perspective of a net producing country yields parallel results. From that country's perspective, the tariff leaves producers worse off and consumers better off, but the net loss to producers is larger than the benefit to consumers (there is no tax revenue in this case because the country being analyzed is not collecting the tariff). Under similar analysis, export tariffs, import quotas, and export quotas all yield nearly identical results. Free trade creates winners and losers, but theory and empirical evidence show that the size of the winnings from free trade are larger than the losses (10)

### 2.4 Degree of free trade policies.

The Enabling Trade Index measures the factors, policies and services that facilitate the trade in goods across borders and to destination. It is made up of four sub-indexes: market access; border administration; transport and communications infrastructure; and business environment.

The top 20 countries are:

1. Singapore 6.06
2. Hong Kong 5.70
3. Denmark 5.41
4. Sweden 5.41
5. Switzerland 5.37
6. New Zealand 5.33
7. Norway 5.32
8. Canada 5.29
9. Luxembourg 5.28
10. Netherlands 5.26
11. Iceland 5.26
12. Finland 5.25
13. Germany 5.20
14. Austria 5.17
15. Australia 5.13
16. United Arab Emirates 5.12
17. United Kingdom 5.06
18. Chile 5.06
19. United States 5.03
20. France 5.02

(From: World Economic Forum. "Rankings: Global Enabling Trade Report 2010".)

Between SEE countries, Only Austria is included on the list of top 20 countries with free trade policies. There is still to much work to be done from SEE countries to achieve economic development of countries like Singapore, Hong Kong, Denmark, Sweden, Switzerland, etc, which are on top of the list.

### **Chapter 3. Economic integration.**

In economics, the word “integration” was first employed in industrial organization to refer to combinations of business firms through economic agreements, cartels, concerns, trusts, and mergers—horizontal integration referring to combinations of competitors, vertical integration to combinations of suppliers with customers. In the current sense of combining separate economies into larger economic regions, the use of the word integration can be traced to the 1930s and 1940s (11) Eli Hecksher, Herbert Gaedicke and Gert von Eyern are the first users of the term economic integration in its current sense. Such usage first appears in the 1935 English translation of Hecksher's 1931 book *Merkantilismen*, and independently in Gaedicke's and von Eyern's 1933 two-volume study *Die produktionswirtschaftliche Integration Europas: Eine Untersuchung über die Aussenhandelsverflechtung der europäischen Länder*. (12)

#### **3.1 Economic integration.**

Economic integration is the unification of economic policies between different states through the partial or full abolition of tariff and non-tariff restrictions on trade taking place among them prior to their integration. This is meant in turn to lead to lower prices for distributors and consumers with the goal of increasing the combined economic productivity of the states. The trade stimulation effects intended by means of economic integration are part of the contemporary economic Theory of the Second Best: where, in theory, the best option is free trade, with free competition and no trade barriers whatsoever.

Free trade is treated as an idealistic option, and although realized within certain developed states, economic integration has been thought of as the "second best" option for global trade where barriers to full free trade exist.

### 3.2. Objective.

The increase of trade between member states of economic unions is meant to lead to higher productivity. This is one of the reasons for the global scale development of economic integration, a phenomenon now realized in continental economic blocks such as ASEAN, NAFTA, SACN, the European Union, and the Eurasian Economic Community; and proposed for intercontinental economic blocks, such as the Comprehensive Economic Partnership for East Asia and the Transatlantic Free Trade Area, SEE, etc. Comparative advantage refers to the ability of a person or a country to produce a particular good or service at a lower marginal and opportunity cost over another.

For example: In Albania it is possible to produce both olives oil and shoes with less labor than it would take to produce the same quantities in Austria and / or Slovenia. However the relative costs of producing those two goods are different in the two countries. In Austria and Slovenia it is very hard to produce olives oil, and only moderately difficult to produce shoes. In Albania both are easy to produce. Therefore while it is cheaper to produce shoes in Albania than Austria, it is cheaper still for Albania to produce excess olives oil, and trade that for Austrian shoes or vehicles. Conversely Austria benefits from this trade because its cost for producing shoes has not changed but it can now get olives oil at a lower price, closer to the cost of shoes. The conclusion drawn is that each country can gain by specializing in the good where it has comparative advantage, and trading that good for the other.

### 3.3 Economy of scale.

Economies of scale refer to the cost advantages that an enterprise obtains due to expansion. There are factors that cause a producer's average cost per unit to fall as the scale of output is increased. Economy of scale is a long run concept and refers to reductions in unit cost as the size of a facility and the usage levels of other inputs increase (13). Economies of scale is also a justification for economic integration, since some economies of scale may require a larger market than is possible within a particular country — for example, it would not be efficient for Kosovo to have its own car maker, if they would only sell to their local market. A lone car maker may be profitable, however, if they export cars to global markets in addition to selling to the local market (14)

The degree of economic integration can be categorized into seven stages:

- Preferential trading area
- Free trade area, Monetary union
- Customs union, Common market
- Economic union, Customs and monetary union
- Economic and monetary union
- Fiscal union
- Complete economic integration

These differ in the degree of unification of economic policies, with the highest one being the political union of the states.

### 3.4. Free trade areas, custom union, monetary union, common market, economic union, fiscal union & political union.

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A "free trade area" (FTA) is formed when at least two states partially or fully abolish custom tariffs on their inner border. To exclude regional exploitation of zero tariffs within the FTA there is a rule of certificate of origin for the goods originating from the territory of a member state of an FTA.

A "customs union" introduces unified tariffs on the exterior borders of the union (CET, common external tariffs). A "monetary union" introduces a shared currency.

A "common market" add to a FTA the free movement of services, capital and labor.

An "economic union" combines customs union with a common market. A "fiscal union" introduces a shared fiscal and budgetary policy. In order to be successful the more advanced integration steps are typically accompanied by unification of economic policies (tax, social welfare benefits, etc.), reductions in the rest of the trade barriers, introduction of supranational bodies, and gradual moves towards the final stage, a "political union" (15).

### 3.5. Success factors.

Among the requirements for successful development of economic integration are "permanency" in its evolution (a gradual expansion and over time a higher degree of economic/political unification); "a formula for sharing joint revenues" (customs duties, licensing etc.) between member states (e.g., per capita); "a process for adopting decisions" both economically and politically; and "a will to make concessions" between developed and developing states of the union (16). A "coherence" policy is a must for the permanent development of economic unions, being also a property of the economic integration process. Historically the success of the European Coal and Steel Community opened a way for the formation of the European Economic Community (EEC) which involved much more than just the two sectors in the ECSC. So a coherence policy was implemented to use a different speed of economic unification (coherence) applied both to economic sectors and economic policies. Implementation of the coherence principle in adjusting economic policies in the member states of economic block causes economic integration effects (17).

## Chapter 4. Quality, safety and guarantee

Quality, safety and guarantee of products and services are the main issues related to concerns of consumers in SEE area.

### 4.1 Quality.

Quality in business, engineering and manufacturing has a pragmatic interpretation as the non-inferiority or superiority of something; it is also defined as fitness for purpose. Quality is a perceptual, conditional and somewhat subjective attribute and may be understood differently by different people. Consumers may focus on the specification quality of a product/service, or how it compares to competitors in the marketplace. Producers might measure the conformance quality, or degree to which the product/service was produced correctly. Support personnel may measure quality in the degree that a product is reliable, maintainable, or sustainable.

The dimensions of quality refer to the attributes that quality achieves in operations management.

- Quality supports dependability
- Dependability supports speed
- Speed supports flexibility
- Flexibility supports cost

Numerous definitions and methodologies have been created to assist in managing the quality-affecting aspects of business operations. Many different techniques and concepts have evolved to improve product or service quality. There are two common quality-related functions within a business. One is quality assurance which is the prevention of defects, such as by the deployment of a quality management system and preventative activities like failure mode and effects analysis (FMEA).

The other is quality control which is the detection of defects, most commonly associated with testing which takes place within a quality management system typically referred to as verification and validation. These functions are common in Germany, Japan, UK, and other countries, but between SEE countries only Austria, Slovenia and in some points Slovenia and Greece are aware about the issue. Quality management still remain problematic between private business subjects in Ukraine, Kosovo, Macedonia, Romania, Bulgaria, Albania, etc.

In these countries there are only a few number of companies which apply quality management techniques like Quality Management Systems, Total Quality Management (TQM), Design of Experiments, Continuous Improvement, Six Sigma, Statistical Process Control (SPC), Business Process Re-Engineering, Capability Maturity Models, etc.

#### 4.2. Safety.

Safety is the state of being "safe", the condition of being protected against physical, social, spiritual, financial, political, emotional, occupational, psychological, educational or other types or consequences of failure, damage, error, accidents, harm or any other event which could be considered non-desirable. Safety can also be defined to be the control of recognized hazards to achieve an acceptable level of risk. This can take the form of being protected from the event or from exposure to something that causes health or economical losses. It can include protection of people or of possessions.

Safety is the condition of a "steady state" of an organization or place doing what it is supposed to do. "What it is supposed to do" is defined in terms of public codes and standards, associated architectural and engineering designs, corporate vision and mission statements, and operational plans and personnel policies. For any organization, place, or function, large or small, safety is a normative concept. It complies with situation-specific definitions of what is expected and acceptable (18)

In the world of everyday affairs, not all goes as planned. Some entity's steady state is challenged. This is where security science, which is of more recent date, enters. Drawing from the definition of safety, then: Security is the process or means, physical or human, of delaying, preventing, and otherwise protecting against external or internal, defects, dangers, loss, criminals, and other individuals or actions that threaten, hinder or destroy an organization's "steady state," and deprive it of its intended purpose for being.

Using this generic definition of safety it is possible to specify the elements of a security program. Security also called social safety or public safety, security is the risk of harm due to intentional criminal acts such as assault, burglary or vandalism. Because of the moral issues involved, security is of higher importance to many people than substantive safety. For example, a death due to murder is considered worse than a death in a car crash, even though in many countries, traffic deaths are more common than homicides. Safety measures are activities and precautions taken to improve safety, i.e. reduce risk related to human health (18).

Common safety measures include:

- Chemical analysis
- Destructive testing of samples
- Drug testing of employees, etc.
- Examination of activities by specialists to minimize physical stress or increase productivity
- Geological surveys to determine whether land or water sources are polluted, how firm the ground is at a potential building site, etc.
- Government regulation so suppliers know what standards their product is expected to meet.
- Industry regulation so suppliers know what level of quality is expected. Industry regulation is often imposed to avoid potential government regulation.
- Instruction manuals explaining how to use a product or perform an activity
- Instructional videos demonstrating proper use of products. Root cause analysis to identify causes of a system failure and correct deficiencies.
- Periodic evaluations of employees, departments, etc.

- Physical examinations to determine whether a person has a physical condition that would create a problem.

In some point, it is evident to say member EU stated of CEE like Austria, Slovenia, etc are much better in these issues compare with other SEE countries, which are not members of EU, but this should be taken as an advantage to learn from.

#### 4.3. Guarantee.

Guarantee is anything that assures a certain outcome, but in terms of development the definition of Central Banks about reserves should be taken into the consideration. With this reserve guarantee a period of time which can be guaranteed with monetary reserves for buy of goods and services in case the country's economy fail under several circumstances should be understand. A reserve currency, or anchor currency, is a currency that is held in significant quantities by many governments and institutions as part of their foreign exchange reserves. It also tends to be the international pricing currency for products traded on a global market, and commodities such as oil, gold, etc. This permits the issuing country to purchase the commodities at a marginally lower rate than other nations, which must exchange their currencies with each purchase and pay a transaction cost. For major currencies, this transaction cost is negligible with respect to the price of the commodity. It also permits the government issuing the currency to borrow money at a better rate, as there will always be a larger market for that currency than others.

As per information recorded in Central Banks of CEE countries, most of them have monetary reserves no less than three months, which is a good indicator.

#### Conclusions.

1. SEE countries initiative has improved economic development and politic stability in the region, but there is still too much to be done in terms of business development and using human and natural resources.
2. SEE countries should work on gaining competitive advantage through specialization of production and not simply through keeping trade barriers high, especially in those sectors where they have already fictive competitive advantage like in agriculture and minerals.
3. Quality, safety and guarantee of products and services remain a big issue for the future of SEE countries into the path of integration in EU and Euro-Atlantic structures.

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**COOPERATION BETWEEN THE VARIOUS ECONOMIC SECTORS IN SUPPORT OF A JOINT  
DECISION-MAKING – A CHALLENGE FOR THE INTEGRATION IN THE EUROPEAN  
COMMUNITY**

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**Abstract:**

*In the moment of confrontation with the consequences that the global crisis brings about in the economy of all the countries, our country can not be an exception. The situation in Albania, like in all the rest of the developing countries, is characterized by situations in which even the short-term decision-making take a special importance when they derive from a possible cooperation between the different parts of the private sector. For various reasons, even a simple cooperation between the actors of this sector needs to be arranged in order to have positive effects in favor of the country's economy. Fishing is a typical sector in our country. On one side this sector is presented with small fishing-boats and ships which operate with the purpose of selling fish in possible markets. On the other side, a manufacturing industry continues to grow in different areas of the country. Moreover, this industry continues to develop based on the import of the raw material which is brought from overseas. Such a typical market is that of fish-manufacturing of sardines and anchovies. While there is a manufacturing industry based on the imported raw material, in the Albanian coast there is a considerable amount of the raw material of this type of fish, which unfortunately is not hunted and manufactured in the country. Such a possibility which transmits the power of the synergy created inside the country requires that the necessary measures be taken for the planning of the cooperation of the private sectors. This survey deals with the possibilities that derive from such a possible cooperation and the impact that will result beneficiary for the Albanian economy due to the flow of currency from commerce with the European Community countries and the creation of vacancies into the country.*

**Keywords:** integration, globalization, over fishing, processing sector.

**JEL Classification:**FO2.

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For a country like Albania, which aims to the integration into the European community, the reconstruction and globalization of the economy are main priorities, real challenges and a constant parallel compared to other countries in the region and beyond.

Restructuring itself implies the development of particular sectors as well as the strengthening of cooperation between them in three levels: the public, the public-private and the private ones. While there exist many studied cooperation forms on the two first levels (the public and private-public ones), on the third level (the private one), we find a wide range of forms of cooperation, and many times being occasional depending on the conjectures created by the spontaneous “game” of the market.

The Albanian economy, which is inherited from the social property system on the production tools, used to cooperate among sectors on the basis of the continuous elaboration of the raw material, which was mainly found into the country or even imported as a vital necessity, through the various trading forms, mainly on the basis of reciprocal exchange.

One of the characteristics of this cooperation between different sectors was manufacturing goods, for domestic consume as well as for export, based on the interest of the Albanian state, without counting on real effectiveness or efficiency compared to the goods market.

As a result of such cooperation, different sectors were destined to remain isolated from a real confrontation with the results or consequences that could arise in a relationship with international markets.

This situation can also in a way describe the influence of the globalization process on the Albanian economy. It should be noted that in the conditions of a total political isolation of the country these impacts were reflected in a biased manner which was then camouflaged from the relations to the ex communist block countries.

In fact, it was mainly due to these relations that the majority of the needs of the country were met. While this was reflecting a moveable economy in development in a short term perspective, the facts showed that in a long term perspective the Albanian economy was plunged in a total inefficiency which extended its consequences to a decline of the country's social and economic prosperity. Although we can admit that the globalization processes indirectly affected the Albanian economy, our country was never part of the positive impacts of such processes.

The reconstruction of the present Albanian economy should be firstly regarded as a reconstruction of specific sectors of its branches and the cooperation between them to achieve the manufacturing of competitive goods suitable in both the international and national markets. The necessary elements for the reconstruction of an economic sector of a country can tend towards national and international factors.

In this survey we will focus on the fishing industry in Albania. Except the natural marine and underground water resources as main elements for improvement of this sector, there are other contemporary cooperation methods of fishery which can be determined by international technology and equipments which need to be implemented in country's industry. If we proceed further in the cooperation between sectors as an element in the reconstruction of the economy, consequently the factors that enable this process will all be national ones. In this case, collaboration as a reconstruction of the domestic economy, serves as an element of presentation of competitive domestic goods in the domestic and international market.

Cooperation between global markets and the economies of certain countries today is so huge and complex that the reconstruction and globalisation of the economy in certain countries can be seen as two inseparable processes with combined borders, undetermined by each other.

The integration of economic sectors of a country in favour of the further chain processing of raw materials would increase the value of the national product. Furthermore, the more efficient and effective is a national product, the greater and more present is the role of a country in international markets (globalization).

At this point, the detailed evaluation of raw materials stocks according to the various sectors of the economy is highly important for a country like Albania. The further classification of these stocks according to the ability of being processed into the country is of as much importance.

#### **Fishery and its challenges on 21<sup>st</sup> century**

It is an undisputed fact that nowadays the amount of fish that falls into the nets of fishing vessels is significantly reduced compared to a few decades ago. As a result of uncontrolled hunting reserves, it is being reduced every day and entrepreneurship in this sector is becoming more and more difficult. Whether due to fluctuations in the oil prices lately, either because of uncertainty that presents unskilled hunting, wild fish is becoming more and more a rare food and inaccessible to a large extent the population.

To compensate such a situation, efforts are being made in the increase of fish tanks, which to a considerable extent have replaced in our restaurants or at home its presence.

A similar situation arises in other countries in the region and beyond in the European community. To reflect such situation this community has taken a radical reform to change the situation. At the core of these measures lies a comprehensive reform of the European Union to support a sustainable development of the fishery sector. Gradually seas should be restocked with the quantity of the missing fish, respecting specific time and capacity they need to be reproduced and limiting fishing in certain areas and for certain purposes.

In order to achieve a sustainable supply of fish, processed products of the sea and aquacultures, it is also necessary a fish consumption emancipation. Consumers of fish for different reasons are attracted from a number of fish species, which have influenced on the taste and consequently in their market. This situation leads to over-demand for some fish species in relation to other ones. This over-demand leads to a situation of overfishing, enabling the inability of the reproduction of their reserves in the sea in the adequate quantity and time.

Currently, in the European community, a campaign towards the expansion of consumer culture of fish stocks in relation to the state of their reserves is going on. In this widespread campaign, in addition to the consumer awareness, the networks of trade and fish processing industry sector are also included. In the centre of this campaign lies the principle that all types of fish and fishery products derived from its processing are valid for human nutrition in comparable proportions to each other. In this regard, to ensure a long term sustainable supply of fish to consumers, it is necessary for the consumers to enrich their nutrition culture with other types of fish, whose stocks are more available. To create an idea of the seriousness of the problem in question it is enough to mention some FAO information according to which the 3/4 types of fish stocks are overfished, while in the Mediterranean area these reserves are 82% and in that of the Atlantic 63%.

If we compared the fishing industry situation in our country, we would face similar phenomena, as well as some specific changes that represent some specific conditions in our country. The change in the economic orientation of the country after 1992 was accompanied with the opening market of the fishing industry with other European countries, and especially with neighbouring Italy.

Due to the unlevelled development of the economy and purchasing power of the population, certain types and qualities of fish were directed towards the wealthier markets outside Albania. Slowly, with the formation of a high quality food-chain and culinary services network, a part of these types and qualities of fish began to increase domestic market demand. However, there are also species of fish in the Adriatic and Ionian seas which constitute substantial reserves, but which do not manage to be caught and consumed within the country in the amount that would correspond to the level of these reserves. Let us take as an example sardine, anchovy and mackerel.

*Sardine* is a small blue fish with an average length up to 15 centimetres, which can be found 50-60 meters deep far from the shore for the small length fish and 80-100 meters deep for sardines with a greater length. Areas where sardines can be fished in large quantities are from the Sazan Island to Cape Rodon. This type of fish stocks in the Albanian coast are found to a considerable quantity. Only for comparison purposes it should be mentioned that in the socialist period of the Albanian economy the fishing capacity of this type of fish reached up to 60 boats, while today there is only one such genuine boat found in Vlora and a second one is being prepared in the city of Durres.

*Anchovy* is another kind of blue fish of the same family with sardine that can be fished in greater distance from the coast, between 115 to 160 meters deep. It is found generally in the same area where sardines are caught, in the presence of marine currents, especially in Cape Rodon area.

Besides sardines and anchovy in the Albanian coast in the blue fish species we find another type of fish - *mackerel*, which is usually found in all the areas where the above mentioned types of fish are found.

As it was mentioned above, in our fishing tradition this kind of fish are hunted in considerable quantities by serving simultaneously to the domestic consumer's direct interests as well as the needs of a processing industry, whose products primarily were intended for foreign markets. For various reasons which vary from the forms of organization to the factors of economic convenience, the sector in question seems to be abandoned nowadays.

The above occurrence, contradicts the fact that there are plenty of fish reserves, thus it demonstrated that there is a tendency to head against the recommendations of the European Union and the inherited experience which really existed in our country.

- The need to rebuild the sardine, anchovy or mackerels fishing sector is supported by many factors, which can be grouped into two levels: The first level comprises all factors derived from the need for consistency with the trends of the fishing policies at the European level.  
2. The second level ranks those factors that are determined by the economic development needs of the country, by exploiting its domestic reserves.

According to the first level of factors, Albania from its geographical position can not follow a different policy in the fishery sector, while its waters are part of the same European community. It would be highly inappropriate to think that Albania could have a different policy from that of the neighbouring fishing industry such as Greece and Italy.

In this context, a priority task for a sustainable fishing policy would be the promotion of the values of fish species found in a considerable amount in marine reserves in our territory in order to educate the clientele towards these reserves, with the purpose of a revival of other types of fish stocks reserves which can not cope with the demand due to their overfishing.

The above mentioned types of blue fish are found in substantial reserves in our marine space. For this purpose the education of the population towards their consumption is an emergency need. Methods or tools to be used for this purpose may be different, ranging from television shows, school education and through their delivery in restaurants.

According to the second level factors fishing sardines, anchovy and mackerels should be viewed as an opportunity for the development of the fishery sector. This sector in a view increases the number of workers that can be employed, specifically affecting employment as well as the prosperity of the country in general. In another view, its development produces experienced specialists who are needed to achieve higher standards of fishing, in order to “copy” or import in general the best fishing methods of other countries, to be imposed in the future evolution of technology applications or specialized vessels. It is very likely that fishing inactivity in question may leave the sector without specialized workforce in this area. Education in a later period will be associated with a much higher social cost. Albania should also develop the sardines, anchovy and mackerels processing sector primarily into the country’s marine waters.

Currently in the European community fish processing industry reaches a total value of 20 billion Euros, which consists of approximately 3,700 manufacturing companies with a total of 120,000 employees. Only Italy, our neighbouring country in 2009 had a value processing of 2 008 500 Euros income of this sector, a number of 5343 employees and 419 companies.

Despite the achievements in terms of its mechanization the fish processing sector still remains affected by a considerable percentage of the labour cost compared to the total cost. Especially the processing of sardines and even more that of anchovies will remain affected by this very important fact. Despite the strong trend that Albania is expected to have in the coming years in respect to the increase of the average general salary, it will remain for a long time an attractive location for investment affected by the low cost of labour. In this regard, the processing of fish species found in significant quantities in our waters should be seen as a possibility of increasing the value of the income derived within the country. Also the fishery sector integration process and the fish processing should be carried out at the level of the European Union standards.

Fish processing in previous socialist economy was considered as an employment and export opportunity for the ready-to-serve products. As mentioned earlier in this paper, this sector was developed on the basis of a strong support of about 60 boats that were fishing Albanian coast for fish for domestic consumption, as well as for the processing industry. This processing infrastructure is more or less inherited nowadays in two plants in Vlora and Durrës and another newly built in Copenhagen. Those companies adapted for processing large quantities of fish (sardines and others) tend to work with raw materials provided from different markets, for the reason of being absent on domestic fishery industry or found in very small amounts.

Differences between the provided infrastructure capacity and the quantity of processed fish create the final margin the costs of resources supplied to those used. Such a phenomenon tends to increase the costs of fish processing sector by negatively affecting integration with other sectors of fishery. While the latter tries to sell at the highest cost possible, the processing sector tries to purchase at the lowest cost. To increase domestic integration of these sectors it is necessary to reconstruct the fishery sector which can be achieved by increasing the number of boats and the quality of hunting methods used by them.

1. Simply increasing the number of boats will result in a greater exploitation of fish stocks in the Albanian coast and launching of a greater quantity of fish in the primary market (fish consumption in untreated state). Daily fluctuations between demand and supply of these fish species will create more and more premises to shed a quantity of fish in the secondary market that is that of the processing industry.

The interest of fishing boats to sell to secondary market (processing industry) will always be associated with the quantity sold in a primary market. The greater this amount is, the greater is the interest to sell in the secondary market, because of greater opportunities offered by the primary market to cover the cost through higher prices. Because of the nature of fish consumption in the primary market (which is conditioned by a short period of time between fishing and consumption) the secondary market remains a potential possibility to further increase the income of a fishing boat.

2. Increased quality of fishing methods through technology application improvements used by fishing boats in a different direction will lead to the increase of the quantity of fish in the market without further increasing the number of boats. Such an approach brings cost reduction respectively in the two respective fishery sectors. In such a situation, the possibility of integration of these two sectors will increase through the premises created to the fishery sector to sell at lower prices and to the processing unit to buy at higher prices.

#### Average income of a sardine and anchovy fishing boat

The following part of this article defines the expected balance sheet, costs and incomes statement based on past experiences of this sector for the amount of fishing, as well as some additional observations on fish distribution report for domestic consumption (primary market) and further processing (secondary market) only for Durres, where currently a former processing plant for sardines and anchovy still operates; a plant inherited from the past communist Albanian society.

Besides, the above takes into account the fact that a boat from sardines fishing session except this kind of fish in nets will pick a quantity of anchovy or other types of fish which are usually caught in the sardines fishing area. Vice versa, the same phenomenon can occur when the session aims fishing anchovy. On an annual average a specific structure is taken into account, in which the quantity of sardines constitutes 70% of the quantity of fish caught and 30% consists primarily of anchovy.

- Based on a sale of 50 % of sardines in the primary market and 50% in the secondary market and that of anchovy mainly in a secondary market the annual turnover of a fishing boat will result as it follows:

$$35\% \times 2000 \text{ kv} \times 10.000 \text{ lek/kv} + 35\% \times 2000\text{kv} \times 5.000 \text{ lek/kv} + 30\% \times 2000\text{kv} \times 30.000 \text{ lek/kv} \\ 28.500.000 \text{ lek}$$

- 2000 kv is the average quantity of fish in quintal caught in a year
- 10.000 lek/kv is the sardines selling price in the primary market (100 lek/kg)
- 5.000 lek/kv is the sardines selling price in the secondary market (50 lek/kg)
- 30.000 lek/kv is the anchovy selling price in both the secondary and primary markets (300 lek/kg)
- Expenditure is determined in terms of the main invoice for a fishing session taking in consideration a range of 150 sessions of fishing per year:

Wage earners extras:	10 employees x 100.000 lek/month x 12months	=12.000.000 lek.
Petrol	200 litrs/session x 150 x 145lek/liter	= 4.350.000 lek
Oil	5 litra x 300lek/liter x 150	= 225.000 lek
Maintenance	70 lek/milje x 50 milje/séance x 150 session	= 525.000 lek
Annual amortization	150.000 Euro: 30 years x 138 lek/euro	= 690.000 lek
Other 10%		1.779.000 lek
Total		19.569.000 lek

- Because of different problems such as: weather, technical situation and duration of a fishing session, a boat can fish an average of 150 times a year.
- The price of 150.000 euro considers an average price for a sardines fishing boat prepared at the shipyard of Durres.
- Based on this data, the operative profit compared to the profit tax is equal to  
28.5000.000 – 19.569.000 = 8.931.000 lek.

As it can be noted from this simple balance sheet, a boat can not result to be financially justified to deal with sardines fishing if it only sells in a secondary market. If we would take this fact for granted, an entrepreneur for the development of the respective market with the purpose of cooperation in the processing sector would be very difficult. But as we previously mentioned, Albania is a low-level sardine consumer compared to our own marine reserves as well as to other real facts.

The increase in sardine consumption compared to what we have already discussed is also necessary in perspective of the integration of both sectors when it is conditioned by a primary market. Therefore, the increase of the primary market serves as a condition for the increase of the number of boats that will be used in this type of fishing. The orientation towards this type of fishing is even more important when other fishing vessels that used to deal with other type of fishing turn to the sardine and anchovy fishing, affecting the balance of other types of fishing which have be subject to overfishing for a long period of time whose reserves have decreased under the level of the consumers demand and which also need to be renewed.

### **Conclusions**

The development of fishing and processing sectors mentioned can not be understood without the integration in a wider context, such as that of the European Community. If it is necessary to turn back to a stable fishing strategy based on the renewal of fish reserves in the Albanian market, it is necessary to have an integration of this type of fishing in the European level. This is due to the fact that the reserves of sardine and anchovy are significantly exceeding the need for consumption in our country and this way it is necessary to export a considerable remaining amount to the other European countries. This export, due to a greater possibility of trading and the added value caused by the fish, need to have such a product as an objective. In the conditions when reserves are higher than consumption, the possibility of an increase in processing is higher than that of an increase in consumption. It is obvious that this is true if we would consider a processing factory such as the one we have in Durres, where there are great differences between the sources of provided expenditure and that which is truly consumed by this factory. According to the capacity of the existing constructions of this factory, which was planned for high quantities of fish in the system of socialist property, this plant can process up to 5 tons of sardine or 1.8 tons of anchovy a day and can also employ a workforce of about 85 employees for the sardine processing and a number of 140 for the anchovy processing.

If the quantity of fish to be processed in this factory is increased, the existing relation between the delivered resources and those used will decrease, enabling a reduction in the cost of processing and as a result a greater possibility in purchasing fish to be processed in higher prices compared to the existing ones.

On the other hand, the reconstruction of this type of fishing sector through the use of boats, equipments, and the most modern experiences in fishing will result in a reduction of the fishing cost and consequently a possibility to sell on low prices it in an unprocessed. If these trends are motivated through subventions and small loans for the purchase of boats, it can result in a compliance of the interests with the selling prices of fish from the fishing sector and of its purchase from the processing one.

In a simple comparison of the quantity of fish that a sardine or anchovy boat can fish it results that only to supply the processing fish factory in the city of Durres it is necessary to have at least seven fishing boats or a workforce of 70 fishermen. In this context, both the fishing and processing sectors of sardine and anchovy can be regarded as a great possibility of employment in the future.

The European Community as well as Japan and the USA are the greatest importers of fish in the world. The challenge of our country to manage to export processed products of fish in the community is part of the challenge of our country to be part of this community.

Though it is not part of the European Community yet, Albania is a European country and as a result the sea area is a common wealth of this countries. In this perspective, Albania needs to take the same measures and to apply the same policies as other countries of the community related to the conservation and use of fish reserves.

Fish in general, and specifically sardines, anchovy and mackerels are gaining the status of a polyvalent food, rich in vitamins, saturated acids such as Omega 3, Low in Mercury and Other Toxins, High in Protein and Low in Calories, and other mineral salts. This type of fish is becoming more and more part of the diets suggested because of Cancer Prevention, Cardiovascular Benefits, Cellular Repair, Skin and Hair Health, Strong Teeth and Bones, Eye Health, Weight Loss, Cleaner Seafood. In this context as part of the increase of these reserves, which unfortunately are not exploited in the appropriate quality and quantity, it will be necessary to increase awareness through a campaign in this area.

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**SYMPTOMS AND EFFECTS OF ENTREPRENEURSHIP, INSTITUTIONAL STRUCTURES:  
HOW TO COORDINATE INSTITUTIONALLY?**

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**Abstract:**

*Albania has taken steps towards bringing its legislation into line with the EU standards by approving a new public procurement law. The new law takes into account the principles of non-discrimination and equal treatment, transparency, and legal protection of interests of bidders on public contracts. Direct tendering has been abolished except in cases of extreme urgency and for the purchase of electricity, and criteria to identify abnormally low bids have been introduced. The new e-procurement regulations approved by the GOA in October 2007-2009 paved the way to the e-procurement system implementation at the central and local government level. Contracting authorities are required to publish procurement notices and tender dossiers on the Public Procurement Agency (PPA) website, which can be accessed electronically by the public. However, its application is hampered by technical problems and the insufficient IT capacity of many contracting authorities.*

**Key words:** *Anticorruption activities, Local government, Decisions, Public procurement, Tax administration,*

**JEL Classification:** *M1 M14 M38 M48 M M49.*

- **Introduction**

The Public Procurement Advocate was established as an independent institution reporting to parliament. However, it has no particular executive powers and its functions duplicate the monitoring tasks of the PPA. (C. S George) Decisions on appeals are taken by the same unit of the PPA that is responsible for interpreting the law and giving advice to contracting authorities. Current procedures for handling complaints still do not meet recognized international standards.

Overall, the improvements in the public procurement legislation are advancing while the proper enforcement of the law is still a work in progress. (Hardt 2009; Rieker 2009) Most banks today offer unsecured lines of credit targeted to small business owners. If yours is an established company, you may be able to apply for a credit line amount of between \$10,000 and \$50,000 by completing a simple one-page application, with no business financial statements or tax returns required. Institutionally, the successful implementation of the Northern Dimension Countries relies on using flexible coordination mechanisms. Within the EU, the Northern Dimension is part of the Union's external relations but cuts across all its three pillars: the funding instruments stem from the first pillar of the single market, the objectives come at least partly from the second pillar of external relations and some of the problems relate to the third pillar of justice and home affairs, including management of border regimes. (C. S George)

### 1.1. A pragmatic approach to Europe's neighborhood.

In the contemporary policy debate on Europe's neighborhood, grand designs are transforming into more pragmatic considerations. This process also means that the northern, eastern and southern directions are reemerging as distinct policy platforms. One reason for the re-emergence of such 'dimensional' is the current internal dissonance within the EU.<sup>3</sup> Among other things, this obstructs the Union's ability to take a concerted look at its borders and make decisions on its institutional arrangements pertaining to relations with neighbors, such as the division of competencies, use of funds and setting of priorities 1 (See "The Enlargement Mess", Europe's World, No. 8, [www.europesworld.org](http://www.europesworld.org)). Symptoms and effects, Institutional structures: How to coordinate institutionally? This is a similar question that we want to analyze in this paper research. We are trying to gather data for do an empirical analyze with two important concepts: 1 Implementation of the management balance and 2. The flexibility of banking system in Albania.

## 2. Literature Review and Hypotheses

With an established small business credit line, you can borrow only what you need anytime you need to. You pay interest only on your outstanding balance, and you can usually make interest-only payments each month, which gives you a lot of flexibility in managing your cash flow. As you pay down your line, the money becomes available for you to use again. The interest rate is usually variable and adjusted to reflect the prime rate as published in *The Wall Street Journal*.

**Credit Cards**—Personal credit cards are becoming an increasingly common source of financing for small business owners and self-employed professionals, According to a 1998 survey by National Small Business United, nearly half (47%) of small and mid-sized business owners used credit cards to finance their companies. If you have good personal credit, you can probably secure one or more cards with credit lines of \$5,000 to \$10,000 or higher.

*Tab. 1. The interest rate and management relation. Source: The Wall Street Journal.2008*

As long as you're obtaining a credit card for business financing purposes, consider applying for a business, rather than a personal, credit card. Business cards offer unique features, such as detailed management reports and extensive business and travel services that can make them a useful cash management tool for your company. And using a business card helps you keep business and personal expenses separate.

**The U.S. Small Business Administration (SBA)**—The SBA helps banks make loans to business that normally wouldn't qualify for financing under normal bank lending guidelines. The SBA's Micro-Loan program makes short-term loans of up to \$35,000 available to start-up and growing small businesses. The loans are actually made by banks, which receive applications from borrowers and make the credit decisions them-selves. The average size of an SBA Micro-Loan is about \$10,500.

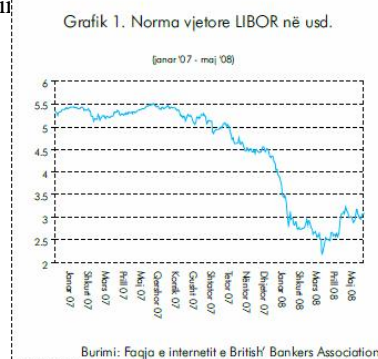
- **Methodology and Research Goal**

### Evaluation Approach and Methodology

The evaluation methodology used for this final evaluation included the triangulation of findings through the concept of “multiple lines of evidence” using several evaluation tools and gathering information from different types of stakeholders and different levels of management. Final Evaluation of the MDG-F Joint Program: “Economic Governance, Regulatory Reform and Pro-Poor Development in Albania”

This study empirically examines the impact of debt management policies on borrowing costs incurred by state governments when issuing debt in the municipal bond market. Based on positive political theory and the benefit principle of taxation, it is proposed that states that adhere to best practice debt management policies transmit signals to the credit ratings, investment community and taxpayers that the government should meet its obligations in a timely manner, resulting in lower debt costs. The donors concurred with this assessment. IDA, starting with the 1998 CAS, considered governance and institution building as one of the central planks of its intervention and identified the need to adopt and implement reforms to build an accountable and transparent state as the most important challenge facing the Government of Albania.

Over the next several years, the Albanian Government, in partnership with donors, emphasized institutional reform and capacity building and developed a comprehensive strategy to strengthen the public institutions for more effective governance. The partnership and business take place worldwide, in a huge diversity of societies and between widely varying organizations. Actually, the business environment has become more complex, with expanding and deepening ties between societies and between the many organizations within those societies. (C. S George 1999) Moreover, many large organizations now see themselves as truly global in scope, not rooted in any one society. The aim of this article is to present an overview of the international environment at local, regional and international levels, from local and national, to regional and international.



Graph 1 Show the annual LIBOR in \$

1. This final evaluation was conducted in accordance with the monitoring and evaluation (M&E) strategy designed for the MDGF. The function to monitor and evaluate the MDG-F was provided in the agreement between the government of Spain and UNDP and states that “monitoring and evaluation of project activities shall be undertaken in accordance with established rules and procedures of UN Agencies, and determined by the Steering Committee, subject to the respective regulations, rules, policies and procedures of the UN Agencies”.

2. The evaluation was also conducted according to the provisions stated in the JP document; including the reporting structure of the JP and the program monitoring framework with its list of indicators, their baseline values and targets at the end of the JP.

The general situation of the public administration is characterized by inadequate quality. Although turnover may have reduced, this is probably because the best people have already left. Motivation is low, and, given the pay conditions, corruption (major and petty) is endemic. The understanding of rule of law in civil society and administration is low, and control institutions (audit, administrative courts etc., are weakly developed and of uncertain status.

The administration functions without adequate checks on its powers. The quality of policy and law is low largely because of inadequate procedures and cross-ministerial checking, low policy capacities in the Ministries, and lack of experience in techniques such as legal drafting, impact analysis. There has been progress in this at least at the formal level (regulation on the Council of Ministers), but the system is not firmly embedded and is exposed to risk. (Charles Polidano 1999) The system still suffers from severe implementation deficits, partly because the policy system does not consider implementation as an issue. These deficits are particularly serious for policy areas where local governments are involved in implementation and where delivery depends on good cooperation amongst the de concentrated services of the central administrations and with local authorities.

*Tab. 2. The relationship between evaluation development and assistance.*

3. The Evaluation developed and used tools in accordance with the M&E strategy to ensure an effective program evaluation. The evaluation provides evidence-based information that is credible, reliable, useful and easily understood by program partners. (Koxhaj Andri 2003) The evaluation was conducted and the findings are structured around the five internationally accepted evaluation criteria set out by the Development Assistance Committee of the Organization for Economic Co-operation and Development (OECD-DAC):

- Relevance relates to the overall assessment of whether the JP addressed identified key priorities and kept with its design;
- Effectiveness is the measure of the extent to which formally agreed expected program results (outcomes) have been achieved, or can be expected to be achieved;
- Efficiency is the measure of the productivity of the JP intervention process, i.e. to what degree the outcomes achieved derive from efficient use of financial, human and material resources. In principle, it means comparing outcomes and outputs against inputs;
- Impacts are the long-term results of the JP and include both positive and negative consequences, whether these are foreseen and expected, or not;
- Sustainability is an indication of whether the outcomes (end of program results) and the positive impacts (long term results) are likely to continue after the JP ends.

During the first years of the reform, the government focused on improving the legislative framework to ensure that its objectives could be achieved. By 1999, and prior to the approval of the credit under review by this ICR, the Government had identified and adopted a large number of measures which provided important institutional capacity to strengthen the public administration. (Charles Polidano 1999) Supported by the Structural Adjustment Credit (SAC), and Public Expenditure Support Credit, the government undertook a number of pivotal actions which defined the framework of reform.

- **Gathering data and aspects of analyze.**

In addition to the guiding principles described in the M&E strategy, the Evaluation Team also applied the following methodological principles to conduct the evaluation: (i) Participatory Consultancy; (ii) Applied Knowledge: the Evaluation Team's working knowledge of evaluation theories and approaches were applied to this mandate; (iii) Results-Based Management; (iv) Validity of information: multiple measures and sources were sought out to ensure that results are accurate and valid;

(v) Integrity: Any issue with respect to conflict of interest, lack of professional conduct or misrepresentation were immediately referred to the client (Arthur W. Hounslow 2003).

### 3.1.2. Development Objectives of Albania.

Albania enjoyed strong economic growth throughout the first decade of the 21st century; accompanied by considerable social progress in such areas as extreme poverty, gender inequalities, health and access to safe drinking water and sanitation. During this time, Albania has also made significant progress in its preparation for European Union (EU) accession in terms of meeting political criteria and establishing stable institutions that guarantee democracy, rule of law, human rights, protection of minorities and regional cooperation. Albania has been noted for its progress in meeting criteria and related standards to approximate its legislation with in line with the Stabilization and Association Agreement (SAA) and European Partnership priorities.

- **2. Micro business financing and credit lines.**

Credit lines are considered as a limit granted to a customer for use within a specific period of time. Credit lines are not used as an 'extension' of a current account of the customer and can only bear debit balances. (Richard Stillman 1983).

#### Tab. 3. Stillman theory for micro business financing

Micro businesses often use working capital to pay short term obligations as inventory or it can be also utilize for long term projects such as renovations or expansion. If working capital dips too low, a business risks running out of cash. The small loans can be used as a fast cash option to caution the periods when cash flow is not available. Cash flow is the micro business life blood and every owner's primary task is to help keep it flowing and use the cash to generate profits. The faster a business expands the more cash it will need for working capital.

### Conclusions and Recommendations.

The assistance and training was also expanded to cover financial operations of the water works of the participating towns. Participating towns, local authorities, and the PIU all demonstrated sound commitment and in implementing the project in a timely fashion. A comprehensive approach to provision of water supplies is required to address competition for scarce water resources. We recommend these conclusions:

- Introducing participatory planning and community-based development processes through the development committees and street representatives working in partnership.
- Creating an enabling environment for private investment in water companies.
- Empowering citizens to pursue their own self improvement promoting privatization of the housing a stock and fostering the development of micro- enterprises
- Ensuring the sustainability of activities initiated
- Promoting the reliability of water system of successful initiatives.

Albanian actors will be reality these points:

- A dynamic local government leadership for protection the health of people
- A coherent strategy acted upon with determination
- A healthy climate of cooperation with business
- Local government's investment initiatives to jumpstart the stagnant economy
- Creative use EU funds to implement local policy
- Efficient municipal administration for conservation of water resources

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**THE INSTITUTIONAL SUPPORT TO SME'S DEVELOPMENT AND ENTREPRENEURSHIP IN COUNTRIES OF SOUTH EASTERN EUROPE**

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**Abstract:**

*Taking into consideration the facts, that current market conditions and economic conditions are characterized by a dynamic technological change, increased competition, uncertainty and risk in the operations, the key for success in development is the dominance of small and medium businesses. Therefore, the small and medium enterprises in a growing number of countries are gaining epithet as a key driver of the economic development, and the performance of the sector of small and medium enterprises has a direct impact for development of national economies. Strengthening and support to small and medium enterprises is required in order to be able to feel their effects as possible, primarily in: employment, increased production, strengthened competition, social and human development. Most of South Eastern European countries still don't take serious the role of small and medium enterprises, for the economic development and consequently they don't have appropriate strategies, full institutional support and other mechanisms for their support as is the case developed countries. Institutional infrastructure and the financial infrastructure are the key link in the development of small and medium sized enterprises. Institutional infrastructure comprises of state, mixed and private institutions that assist entrepreneurship development. The lack of adequate infrastructure has inhibited effects not only for the development of small and medium enterprises but also of the economic growth. The main aim of this paper is the analysis of institutional support to SME's in the South Eastern European countries and proposing a measures and instruments for improving the institutional support.*

**Key words:** SMEs, institutional support.

**JEL Classification:** F63.

**1. Introduction**

Considering the facts that current market conditions and economic conditions are characterized by dynamic technological change, increased competition, uncertainty and risk in the operation, the key to success in the development is dominance of small and medium businesses. Today small and medium sized enterprises are the key drivers for economy development.



That is the reason that economic policies are directed towards development of SMEs.

### 1. Institutional support for SMEs

The entrepreneurial infrastructure is very important in the direction of SMEs support and can be divided into:<sup>172</sup>

1. legal infrastructure that consists of laws and regulations adopted by the public authorities, concerning entrepreneurship and small and medium enterprises.
2. physical infrastructure, which is also called "classical infrastructure" and includes: transport, energy, telecommunication and utilities.
3. Financial infrastructure covers public and private financial institutions such as banks, pension and mutual funds, savings and loan associations, money market and capital market, as well as specific models of financial support like business angels and risk capital.
4. educational infrastructure covers state and law universities, colleges and scientific research institutes which are important source for acquiring knowledge and skills, sharing experiences, getting consultancy, recruiting quality human resources and so on.
5. institutional infrastructure - namely institutional and financial infrastructure represent important linkage for SMEs development. The institutional support includes state, mixed and private institutions that assist the entrepreneurship development. The institution building includes several aspects, such as: giving advices for adoption of new legislation to government departments and ministries, regulatory mechanisms and policies to encourage small and medium enterprises; developing national agencies for promoting and encouraging the SMEs development; creating institutions for SMEs support at local level.

Nowadays, the SMEs are becoming more attractive in the global society, so the building of proficient infrastructure and regulations for their support represents a key element of the national policies in each country.

The previous analyses and experience confirms that the success and development of SMEs is strongly correlated with successfully organized and diverse institutional infrastructure. It is eminent the fact, that SMEs development is closely associated with the strong support of relevant institutions providing assistance in the area of information technology, consulting, training and permanent improvement, financial support, etc..

The main task of institutional support is to provide education, consulting, information and so on, for permanent operation and growth of SMEs. As a matter of fact, the institutional framework on its own is not enough for the development of SMEs and should be supplemented with economic policies, laws, national strategies as well as adequate environment their functioning as a key requirement.

The significant institutions which are established in many countries for support of SMEs are:

- national agency for development of SMEs and entrepreneurship
- regional agencies for SMEs development
- business incubators
- research and development institutions
- educational institutions
- entrepreneurial associations
- chambers of Commerce
- other SME support institutions (NGOs, consulting networks, free zones, etc.).

The National agencies are usually established as state institutions for implementation of government policies in SME sector.

<sup>172</sup> D. LajoviãN. Nikoliã, R. Drobnjak ,“ Introduction to business“, Faculty of Economics, Podgorica.

These agencies initiate the need for the establishment of other institutions for financial and institutional support of SMEs. The main role of the national agencies is:

- implementing the government policies for SME sector;
- giving the specific proposals to government which are related to SMEs development;
- analysis of the situation in the SME sector and the relevant environment;
- coordination of national partners and programs for SMEs support and programs for support of small businesses financed by donors;
- preparation of annual reports on the situation in SME sector;
- providing local services for SME business counselling;
- improvement of the SMEs competitiveness and so on.

Regional agencies for the SMEs development and entrepreneurship are established for implementation of government programs in specific regions. These agencies have a regional character and offer a wide range of non-financial services in the following fields: education, consulting, informing and promotion. In developing countries, the EU insists of a regional partnership between the three sectors (public, civil and business) throughout establishment of these regional centers.

The business incubators have a significant meaning to SMEs support in their natal period.

The SMEs are passing several stages throughout their development, but the initial phase is the most vulnerable stage, then the risk of failure is biggest, they face with numerous challenges, lack of information, capital insufficiency, etc. and therefore the support is important to overcome this phase and assist them becoming independent.

The main aim of the business incubators is to maximize the SMEs establishment and survival. The business incubators usually offer favourable conditions, finances, premises, advisory and other services for their successful operation. Typically, the business incubators are financed by budget funds, private large enterprises, local community or international organizations. The support of business incubators can be systematized on this way: less expensive office space; using common equipment; using Internet connectivity and database; managerial, legal and economic consulting assistance; administrative and secretarial services; technological support; financial support etc.

Considering the fact that business incubators play a large role for support of SMEs, their number worldwide grows continuously (there are around 3500), but their performance and sustainability are put into question. The success and operation of business incubators depends on: the policy that stimulates the entrepreneurship, the policy which provides business infrastructure; the partnership with the private sector for mentoring and marketing, community involvement in promotion of entrepreneurship and cultural changes.

The R&D institutions cover a wide range of institutions (science parks, innovation centers, technology centers, research development centers, etc.) which perform research and development activities for the development of SMEs. These institutions provide research and technology transfer and they need to encourage the innovative activities important to increase the competitiveness of enterprises.

The educational institutions also have a major role for the SMEs development. The basic functions of these institutions are:

- promotion of entrepreneurship;
- support and development of the entrepreneurial culture;
- development of new technologies;
- they represent resource center for the SME sector in terms of creating new ideas and knowledge;
- provide professionals from different areas.

The economic chambers are established to address the interests of the business community and they are characteristic of all socio-economic and political systems. Like many other institutions and associations, the differences between chamber associations are result of social establishment. They were always an important economic factor and according to many analysts, their representation in society is perceived right after the political institutions - parliament and government.

Therefore, one of the prime ministers of UK said: "it is better having the Chamber as partner of the Government in drafting the laws, than as an opponent in the sphere of their implementation".<sup>173</sup>

Entrepreneurial associations existed long ago i.e. even in the middle age the individual craftsmen have perceived the need for a mutual association for realization of their interests. The main functions of entrepreneurial associations are: protection of specific rights within their sector; common actions for a free market and competition; cheaper and better quality supply; improvement of the social status of members, etc. The reasons for association of entrepreneurs have changed over the years, so the modern entrepreneurial associations are formed as independent institutions performing the following tasks: establishment of appropriate legal framework for operation of SMEs; providing affordable consulting services; organization of trainings and other educational programs for different activities; exchange of information home and abroad; providing of administrative and accounting services to members, etc.

The development of consultancy networks involves active participation of existing and new national consultants in programs for improvement of their skills in order to improve the quality and ability of local consultants, greater confidence and increased demand for the use of their services by the SME sector and so on.<sup>174</sup>

## 2. The analysis of institutional support to SME's development in countries of South Eastern Europe

The processes of transition from planned to market economy, ie from socialism to capitalism imposed multiple changes in the social and economic living in developing countries.

The processes of transition and privatization encouraged the private initiative and ownership, and thus the development of small and medium enterprises. Considering the meaning of SMEs for the economic development, many of the developing countries have taken the first steps in building of an entrepreneurial environment. In this regard, the attention is given to the design of policies and mechanisms for building of institutional infrastructure for support and development of small and medium enterprises.

	Central agency	Regional agency	Local agencies	Business incubators	Innovation centre	entrepreneurial areas	Information centre	Ministry for SME	One stop shop offices	Special banks	Chamber of Commerce
<b>Serbia</b>	X	X	X	X		X	X				X
<b>Croatia</b>	X	X	X	X	X	X	X	X	X	X	X
<b>Bosnia and Herzegovina</b>		X	X	X			X				Ö
<b>Macedonia</b>	X	X	X	X			X				Ö
<b>Bulgaria</b>	X	X	X	X			X				Ö
<b>Romania</b>	X	X	X	X	X		X		X	X	Ö
<b>Albania</b>	Ö	Ö	Ö	Ö	Ö		Ö				Ö

Source: data from different web sites in selected countries

The data presented in Table 1 shows the details of instruments and mechanisms of institutional infrastructure in countries from South Eastern Europe for support of small and medium enterprises.

<sup>173</sup> www.mchamber.org.mk

<sup>174</sup> *Äëäè ï î ø è ð ê î*, Ashtalkoski. S. Ashtalkoska I., Jovceska S., Podrška razvoju malih i srednjih preduzeća, Majska konferencija o stratejskom menadžmentu, Tehnički fakultet – Bor, Srbija, 2011

The data of the table 1 shows that large number of countries from South Eastern Europe have established the central, local and regional agencies to support SMEs, but the innovation centers and entrepreneurial zones are rarely represented, Ministry for SMEs was established only in Croatia and consultancy networks have been established in Croatia and Slovenia.

### **3. Measures and recommendations for strengthening of the institutional support to SMEs**

The development of institutional infrastructure and advisory, business services aim at: reduction of entrepreneurial risk, improvement of the market access and acceleration of the growth and development of SMEs. However, the support is not always coherent, integrated and financed from the budget. Reduced effects of support have resulted in insufficient level of development of the knowledge and skills of SMEs, inadequate application of the standards required for entering on new foreign markets, insufficient use of new technologies and innovation. All this reflects in low level of competitiveness of SMEs, insufficient valorisation of export opportunities and regional inequality in development.

The important measures that should be taken for improvement of the SMEs development are:

- improvement of the access to information on the conditions for starting a business and state incentives.
- establishment of a single on-line SME portal, as a specific form of institutional infrastructure for support of SMEs. (Namely, Austria and other developed countries have introduced one-stop portal for business services, as government web portal that provides information on starting and running a business in Austria).
- creation of local centers (regional office)- their role will be to provide information and advises to potential entrepreneurs in order to encourage the development of new ideas. As it is previously stated many young people have ideas but do not know how to implement them, because they are not adequately informed about the types of support offered by the state to open a new business. With the existence of these centers, the young people will know where to address for information related to new businesses support and professional assistance in the implementation of the business ideas. On this way they will encourage the innovation and creativity among young people. For example, in Poland, the Agency for Enterprise Development has established a network of 111 offices (consulting centers) that provide free information and services for entrepreneurs and people who plan to start a business. Through these centers, the entrepreneurs and businessmen will get all the necessary information in one place for obtaining licenses and permits, fulfilling legal obligations, as well as information about the required steps and documents for the law enforcement, etc. Thus administrative procedures will be easier and more transparent, and will reduce the possibility for corruption.
- in developed countries and even some developing countries, the practice is the presence of centers for entrepreneurship which will have direct contact with entrepreneurs. These centers usually operate at the local level for the implementation of development policies throughout the establishment of business incubators and free business zones for small and medium enterprises.
- for the creation of visible services for SME support, exchange of best practices, better communication between participants in the development of SMEs, improved access to integrated information and databases, it is necessary to create a network for business development, a kind of virtual business support network offering counselling services to business entrepreneurs via direct access to all information that they need for quality realization of their ideas on the market;
- creation of development agencies, centers, non-governmental organizations and foundations, all over the country in order to promote coordinated and balanced regional development, FDI promotion, export promotion of small and medium enterprises, support entrepreneurs and technological development in the scope of agency activities, environment protection and so on;

- establishment of successive stock exchange that in cooperation with the Chamber of Commerce will offer a wide range of support in the transfer of businesses; etc.;
- forming of the Council for the elimination of business barriers and creating a special program to eliminate barriers for SME Development - This program would implement analysis of the current business environment, SME barriers and will give suggestions to overcome them. Thus, on one location all the obstacles for SMEs will be displayed and is much easier to select the priority recommendations for creation of a favourable business environment;
  - Strengthening of the role of the National Agency for development of SMEs, which on one hand will provide support to SMEs on executive level, implementation of activities and projects in the field of development of the institutional support, improved access to information for SMEs, providing necessary advisory and business services, education, provision of grants to SMEs, encourage competitiveness and exports, internationalization of SMEs etc. and, on the other hand, will have a leading role for coordination and implementation of SME policies in other sectorial policies, in the areas where they tackle the development of entrepreneurship, as well as the support on activities of individuals participating in the development of small and medium enterprises;
  - development of innovation centers that will contribute for gathering the creative ideas from small and medium enterprises, universities and research institutes.
  - creation of institute for small businesses and corporations for provision of educational programs of future entrepreneurs, where the curricula for courses and technical training programs will be prepared;
  - establishment of entrepreneurial zones that will offer a range of benefits for starting and sustaining of the businesses, especially in their natal period which actually is a critical period for their durability. These zones are usually established in attractive regions, and the support for entrepreneurs consist of: tax and customs benefits, providing sophisticated infrastructure, logistics centers, specialized promotional services, constituted network for communication between the zones, etc.

### Conclusions.

SMEs are the key drivers of the economic development and because of that the national economies impellent strategies and measures for their support and development. The creation of institutional infrastructure is the key segment for support of SMEs, so the big number of instruments and measures undertaken are directed toward creation of institutions and services for SMEs.

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**EU FINANCIAL ASSISTANCE TO WESTERN BALKAN COUNTRIES WITH SPECIAL FOCUS ON ALBANIA**

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**Abstract:**

*The overall objective of EU financial assistance is to help prepare the Western Balkan countries to meet the challenges of future EU membership. From 2000 to 2007, SAPARD, ISPA, PHARE and CARDS were financial instruments which help candidate and potential candidate countries to carry out reforms, important for accession preparations, as per the membership criteria, but also for the economic and social modernization of the countries. In 2007, with a view to streamline all pre-accession in a single framework and under the same regulation, the new Instrument for Pre-accession Assistance (IPA) replaced the previous pre-accession programmes. The main objective of the IPA is to help the countries to face the challenge of European integration, to implement the reforms needed to meet EU requirements and progress in the Stabilization and Association Process and to lay the foundations for fulfilling Copenhagen criteria for the EU membership. The European Union, in the last few decades, has been particularly interested in providing support to countries which are potential candidates such as Albania. In the past, until 2007, the EU supported Albania through various instruments like: ECHO-Humanitarian Aid programme, PHARE and CARDS. The IPA 2007-2013 is aimed at supporting the accession process of Albania focusing on political, institutional and economic transition. EU assistance has been delivered within four priority areas: public administration; justice and home affairs; economic development; and environment and infrastructure.*

**Key words:** potential candidate, assistance, financial instrument, accession preparations, membership criteria, requirements.

**JEL Classification:** F36.

**Financial assistance to the Western Balkan countries**

The overall objective of EU financial assistance is to help prepare the Western Balkan countries to meet the challenges of future EU membership. In the period of 1991-1999, the total assistance to the Western Balkan countries amounted to €4.427 billion.

Table 1. EU assistance to the Western Balkans in the period 1991-1999, million euros

1991-1999	Albania	Bosnia and Herzegovina	Serbia and Montenegro	Kosovo	Croatia	Republic of Macedonia	Total
<b>TOTAL:</b>	925,5	2.093,2	425,6	272,8	347,7	363,8	<b>4.427,95</b>

Source: <http://web.ceu.hu/cens/assets/files/IPA.pdf>

From 2000 to 2007, SAPARD, ISPA, PHARE and CARDS were financial instruments which help candidate and potential candidate countries to carry out reforms, important for accession preparations, as per the membership criteria, but also for the economic and social modernization of the countries. The purpose of the SAPARD programme is to provide assistance in the agricultural sector and rural areas while the task of ISPA is to help the realization of priority infrastructure projects in the field of environmental protection and transportation. The objectives of the PHARE programme are to strengthen public administration and institutions for better and more effective functioning within the EU, to promote convergence with the European law in order to reduce the period of transition and to promote economic and social cohesion. The CARDS programme is focused on reconstruction and infrastructure, promotion of democracy, economic and social development and regional cooperation. For the period 2000-2006 the assistance to the Western Balkan countries amounted to more than €5 billion.

Table 2. EU aid for the Western Balkans through CARDS programme for the period 2000/2006, in million euros

2000-2006	Albania	Bosnia and Herzegovina	Serbia and Montenegro	Croatia	Republic of Macedonia	Other countries	Total
<b>TOTAL:</b>	315,5	502,8	2,547,8	523,8	298,2	1187,1	<b>5.375,2</b>

Source: <http://web.ceu.hu/cens/assets/files/IPA.pdf>

In 2007, with a view to streamline all pre-accession assistance in a single framework and under the same regulation, the new instrument for Pre-accession Assistance (IPA) replaced the previous pre-accession programmes. The main objective of the IPA is to help the countries to face the challenge of European integration, to implement the reforms needed to meet EU requirements and progress in the stabilization and Association Process and the lay the foundations for fulfilling Copenhagen criteria for the EU membership. The financial assistance to the Western Balkans from the IPA will be more than €4 billion.

Table3. The financial assistance to the Western Balkans in the period 2007-2013 (IPA)

2007-2013	Albania	Bosnia and Herzegovina	Serbia	Montenegro	Croatia	Republic of Macedonia	Total
<b>TOTAL:</b>	597.830.813	658.501.243	1.392.067.970	236.625.200	999.608.053	619.290.031	<b>4.503.923.310</b>

Source: [http://ec.europa.eu/enlargement/potential-candidates/index\\_en.htm](http://ec.europa.eu/enlargement/potential-candidates/index_en.htm)  
[http://ec.europa.eu/enlargement/candidate-countries/index\\_en.htm](http://ec.europa.eu/enlargement/candidate-countries/index_en.htm)

Since 1991 the European Union has been the largest donor to the Western Balkans countries, having provided more than €20 billion including humanitarian and bilateral assistance.

#### Financial assistance to Albania

The European Union, in the last few decades, has been particularly interested in providing support to countries which are potential candidates such as Albania.

In the past, until 2007, the European Union supported Albania through various instruments like ECHO – Humanitarian Aid Programme, PHARE and CARDS.

According to CARDS annual action programmes about €236 million was available to Albania.

Table 4. CARDS annual action programmes for Albania, million euros

Annual programme	Total
Annual programme 2005	44.2
Annual programme 2004	63.5
Annual programme 2003	46.5
Annual programme 2002	44.9
Program for support of the 2001 taxation	2.0
Support Program 2001	35.5
<b>Total</b>	<b>236.6</b>

Source:[http://ec.europa.eu/enlargement/press\\_corner/key-documents/cards\\_reports\\_and\\_publications\\_en.htm](http://ec.europa.eu/enlargement/press_corner/key-documents/cards_reports_and_publications_en.htm)

The IPA 2007-2013 is aimed at supporting the accession process of Albania focusing on political, institutional and economic transition.

Table5. Albania – Financial assistance 2007-2013, million euros

Component	2007	2008	2009	2010	2011	2012	2013
Transition Assistance and Institution Building	54,318,790	65,237,756	71,360,000	84,200,000	84,301,650	84,290,995	87,446,037
Cross-border Co-operation	6,681,210	8,582,244	9,822,921	9,973,173	10,126,636	10,283,169	10,666,232
<b>Total</b>	<b>61,000,000</b>	<b>73,820,000</b>	<b>81,182,921</b>	<b>94,173,173</b>	<b>94,428,286</b>	<b>94,574,164</b>	<b>98,112,269</b>

Source:[http://ec.europa.eu/enlargement/potential-candidates/albania/financial-assistance/index\\_en.htm](http://ec.europa.eu/enlargement/potential-candidates/albania/financial-assistance/index_en.htm)

European Union assistance has been delivered within four priority areas: public administration, justice and home affairs, economic development, environment and infrastructure. The assistance in public administration has resulted in supporting the institutions that are directly concerned by the reforms. Several projects aimed at capacity building of institutions are valued at more than €2.5 million. In the field of Justice and home affairs, EU assistance contributes to strengthening the judiciary capacities and structures and the police reform process. With €5.5 million of EU financial assistance aims to improve the functioning of the police, 4.4 million to support the management of Albanian maritime border, and €10 million have been invested on finalizing several detention prison facilities. The assistance in the area of economic development is focused on maintaining steady growth and increased competitiveness especially in the private sector. About €3.4 million have been spent to enable Albania's development policy for small and medium enterprises. EU support in the area of environment and infrastructure has resulted in improved water supply and sewage systems as well as upgraded road infrastructure and border crossing. The planned projects for the period from 2007-2013 are aimed to support the improvement of the infrastructure and environment, reforms in the police and judiciary, reforms in public administration, support of the development of human resources.

The most important projects are:



	Project	Date	Overall cost	EU contribution	Final date for contracting	Final date for execution of contracts	Final date for disbursements
1	Preparation of the Albanian Authorities for the Decentralization of Management of EU Assistance	2007	1.000.000	1.000.000	3 years following the date of conclusion of the Financing Agreement	2 years following the end date for contracting	Disbursements will continue for up to one year after the end date for the execution of contracts
2	Support for alignment of Albanian Statistics with EU standards	2007	2.850.000	2.850.000	3 years following the date of conclusion of the Financing Agreement	2 years following the end date for contracting	Disbursements will continue for up to one year after the end date for the execution of contracts
3	Improvement of Water Supply and Sewerage Systems in Albania	2007	25.500.000	24.000.000	3 years following the date of conclusion of the Financing Agreement	2 years following the end date for contracting	Disbursements will continue for up to one year after the end date for the execution of contracts
4	Technical Assistance to Ministry of Public Works, Transport and Telecommunications	2008	1.000.000	1.000.000	3 years following the date of conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution of contracts
5	Support to Civil Service Reform	2008	1.000.000	1.000.000	3 years following the date of conclusion of the Financing Agreement	2 years following the end date for contracting	Disbursements will continue for up to one year after the end date for the execution of contracts

6	Reconstruction of the secondary and local roads	2008	8.880.000	8.000.000	3 years following the date of conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution of contracts
7	Support to Blue Border Management	2009	5.120.000	4.000.000	Two years following the date of the conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution of contracts
8	Assistance to the Justice System	2009	3.300.000	3.300.000	Two years following the date of the conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution
9	Improvement of rural roads in Albania	2009	49.000.000	9.000.000	Two years following the date of the conclusion of the Financing Agreement	Four years following the end date for contracting	One year following the end date for the execution
10	Support to the EU integration process	2010	2.222.000	2.000.000	Two years following the date of the conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution
11	Strengthening the Assembly of Albania	2010	1.580.000	1.500.000	Two years following the date of the conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution

12	Human Resources Development in Albania	2010	3.330.000	3.000.000	Two years following the date of the conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution
13	Support to the Albanian Customs Administration	2011	3.300.000	3.000.000	Two years following the date of the conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution
14	Support to Agriculture and Rural Development	2011	20.750.000	10.000.000	Two years following the date of the conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution
15	Support for participation to Union Programmes	2011	3.256.000	2.435.000	Two years following the date of the conclusion of the Financing Agreement	2 years following the end date for contracting	One year following the end date for the execution

Source: [http://ec.europa.eu/enlargement/potential-candidates/albania/financial-assistance/index\\_en.htm](http://ec.europa.eu/enlargement/potential-candidates/albania/financial-assistance/index_en.htm)

### Conclusions

EU is actively assisting the countries of the Western Balkan in order to foster their democracy, economic and social development and regional cooperation. Albania, as one of them, is fully committed to the concept of lasting economic, social and political stability quarantined through closer ties to European Union.

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## THE RIGHTS OF ALBANIAN NATIONALS UNDER THE STABILISATION AND ASSOCIATION AGREEMENT BETWEEN ALBANIA AND THE EUROPEAN COMMUNITIES

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### **Abstract:**

*This paper investigates the legal effects of the EU Association Agreements in the EU legal order and in the legal order of Albania with a special focus on the rights established for Albanian nationals by the Stabilization and Association Agreement (SAA). It first considers the legal effects of the EU Association Agreements in the EU legal order during the pre-accession period. Such analysis shows that agreements between the Union and non-member states countries which follow the procedure provided by Article 218 of the TFEU form part of the EU legal order. According to the ECJ, provisions of association agreements can have direct effect provided that they contain a clear and precise obligation. Therefore, nationals of non-member state countries party to an agreement with the EU can rely on the provisions of those agreements before the courts of the Member States. On the other hand, the legal effects of the SAA in the Albanian legal order during the pre-accession period depend on the interpretation of the Constitution from national courts and on the interpretation of the objectives of the SSA itself by national judges. Therefore, the second part of the paper will analyse the relationship of international and national law according to the constitution and also the possibilities for supremacy and direct effect of the European law in the Albanian legal order. We will supplement such analysis with recent Constitutional Court decisions, which address the problem of legal effects of EU law in the Albanian legal order. The overall purpose of such analysis is to shed light on the citizen's rights in regard to the so-called pre-accession effect of EU law when the aspiring member state is on the way to full membership. This analytical perspective is important to both Albania and other South East European countries which are in the same legal position and are confused about the rights that their citizens gain from the SAA.*

**Keywords:** *the European Union, Europe Agreements, EU law, Albania, Stabilisation and Association Agreements, pre-accession effects.*

**JEL Classification:** *K33.*

### **Introduction.**

The European Integration of the Central and Eastern European Countries (CEECs) has been initiated with the so-called Europe Agreements (EA) and has been complemented by the pre-accession strategy.

In 1993, the Copenhagen European Council, agreed on some conditions regarding the accession in the EU of the associated East European countries. The so-called “Copenhagen criteria” required the candidate countries to satisfy the political and economic criteria<sup>175</sup>.

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<sup>175</sup> The European Council stated: “Membership requires that the candidate country has achieved the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for the protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces with the Union. Membership presupposes the candidates’ ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union.”

These criteria were followed by a pre-accession strategy developed by the European Council in Essen in December 1994 and reinforced by the Agenda 2000. The EAs, as one of the tools for structuring accession, aimed at establishing a political dialogue among the Association Council Bodies and gradually introduce a free trade area to liberalise trade and provide for co-operation in areas such as competition law, environment, education and training and contained provisions on free movement of persons, establishment and supply of services to Member States and candidate countries<sup>176</sup>.

Regarding the Western Balkan Countries the European Commission proposed the creation of the Stabilization and Association Process (SAP) as a new framework for the relationships between the EU and Western Balkan Countries. The purpose of this process was to assist these countries in fulfilling the EU criteria and being accepted as official candidate for membership. The Stabilization and Association Agreements were a very important element of the SAP process from the legal point of view. These agreements were concluded based on the same legal basis as EAs Article 218 TFEU (ex Article 310 ETC). From the point of view of their content the SAAs were also based on the existing EAs even if they included new elements related to the new specific situation of the Western Balkan countries<sup>177</sup>. The objective of these agreements was to support the consolidation of democracy, the rule of law, the economic development and the regional cooperation<sup>178</sup>. In the framework of the SAP process, the Stabilization and Association Agreements between Albania and the EU was signed on 12 June 2006 and has entered into force on 1 April 2009.

Both the EAs and SAAs are EU association agreements and have legal effects in the different legal orders. Provisions of these agreements can have direct effect and can establish rights for the citizens of the candidate countries once they come into power. Therefore, this paper will analyze the legal effects of the SAA between European Communities and the Member States on one hand and Albania on the other, for Albanian nationals. After explaining briefly the sources and the features of EU law, the paper will give an overview regarding the pre-accession effects of Europe Agreements in the EU legal order, as they make a good example for the SAAs. However as Albania is not yet a member of the EU the legal effects of the SAA in the Albanian legal order depend on the interpretation of the constitutional provisions regarding the relationship between international law and national law. Consequently, this paper will briefly analyse the relationship between international and national law, focusing on the so-called integrations Articles part of the Albanian Constitution. At the end, possible legal effects of the SAA in the Albanian legal order will be investigated in the light of the case law of the Albanian Constitutional Court regarding the SAA.

### ***1. Brief overview of European Union Law.***

The sources of EU law can be divided into primary and secondary EU law. The primary EU law consists of the EU constituent treaties which were adopted directly by the Member States. Primary law includes also annexes, appendices and protocols attached to the founding treaties, later additions and amendments, concluded international agreements like the Europe Agreements, Stabilization and Association Agreements and Accession Treaties<sup>179</sup>. Secondary EU law consists of acts of the European institutions. The norms issued by the institutions of the Union are regulations, directives, decisions, recommendations and opinions.

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<sup>176</sup> Ott. Andrea, "The rights of self-employed citizens in the Member States under the Europe Agreement" 2001 *The European legal forum*, at pg. 498

<sup>177</sup> Steven Blockmans, "Tough love: the European Union's relation with the Western Balkans" (T.M.C. Asser Instituut 2007) at pg 155.

<sup>178</sup> Hoffmann Judith, "Integrating Albania: The role of the European Union in the Democratization Process" I (1) *Albanian Journal of Politics* (2005) at pg. 58

<sup>179</sup> Alfred Kellerman, "The rights of Non-Member State nationals under the EU Association Agreements", 3 *European Journal of Law Reform*, (2008) at pg. 341

According to Article 288 TFEU (ex Article 249 of TEC) in order to exercise the Union's competences the institutions shall adopt regulations, directives, decisions, recommendations and opinions. The relationship between primary and secondary law is not expressly provided in the Treaties, but a hierarchy of norms can be implied by Article 263 TFEU (ex Article 230 TEC) according to which one of the reasons for the annulment of actions of EU Institutions can be infringement of the Treaties or of any rule of law related to their application<sup>180</sup>. Primary community law stands at the top of the hierarchy of the system of sources of EU law and all treaties concluded between the Union and third countries and acts of the institutions of the Union should conform to it. The Court of Justice of the European Union, according to Article 267 TFEU (ex Article 234 TEC), has jurisdiction to give preliminary rulings related to the interpretation of the Treaties and the validity of the acts of the institutions, bodies, offices or agencies of the Union. Thus the ECJ has no jurisdiction to rule on validity of provisions forming an integral part of accession, for example the Europe Agreements, the Stabilization and Association Agreements, Partnership and Cooperation Agreements<sup>181</sup>.

The two main principles related to the status of EU law, the principle of supremacy and direct effect, are developed by ECJ as they had no formal basis in the EC Treaty<sup>182</sup>. It was ECJ, which from the early existence of the Community, touched the issue of supremacy of EU law by stating in *Van Gend en Loos*<sup>183</sup> that the Community constituted a new legal order of international law for the advantage of which the States had limited their sovereign rights<sup>184</sup>. This principle was the main focus in the decision *Costa v. Enel*<sup>185</sup>, where ECJ held that EC Treaty had created its own legal order which became part of the legal systems of the Member States and the Member States had transferred to the Community institutions "real powers stemming from a limitation of sovereignty". The Court went on by giving other arguments such as the spirit and the aims of the treaty which made it "impossible" for the Member States to accord primacy to their national law<sup>186</sup>. Finally the Court argued that Article 249 TEC (now Article 288 TFEU) would be meaningless if Member States would not respect it by approving inconsistent national law. After having created a basis in *Costa v Enel* in the following cases such as: *Internationale Handelsgesellschaft*<sup>187</sup> and *Simmenthal*<sup>188</sup> ECJ held that not even a fundamental rule part of the national constitution could challenge the supremacy of directly applicable Community law<sup>189</sup>.

It is now established by the case law of the Court of Justice that Community law is supreme over the national law of the member states, including the fundamental norms of their national constitutions<sup>190</sup>.

Another important principle related to the EU law is the principle of direct effect. According to the broader definition of this principle, provisions of EU law which are clear and precise and unconditional enough to be considered justiciable can be invoked and relied by individuals before national courts<sup>191</sup>.

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<sup>180</sup> Article 263, TFEU para.2 provides that: "It shall for this purpose have jurisdiction in actions brought by a Member State, the European Parliament, the Council or the Commission on grounds of lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers.

<sup>181</sup> Supra note 5 at pg. 343

<sup>182</sup> Paul Craig Grainne De Burca, "EU law text, cases and materials" (Oxford University Press 2008) at pg. 344

<sup>183</sup> Case 26/62 *NV Algemene Transporten Expeditie Onderneming van Gend en Loos v. Nederlandse Administratie der Belastingen* [1963] ECR 1.

<sup>184</sup> Supra note 8 at pg. 345.

<sup>185</sup> Case 6/64 *Faminio Costa v. Enel* [1964] ECR 585, 593

<sup>186</sup> Supra note 8 at pg. 346.

<sup>187</sup> Case 11/70 *Internationale Handelsgesellschaft mbH v. Einfuhr und Vorratsstelle fur Getreide und Futtermittel* [1970] ECR 1125.

<sup>188</sup> Case 106/77 *Amministrazione delle Finanze dello Stato v. Simmenthal SpA* [1978] ECR 629.

<sup>189</sup> Supra note 8 at pg 347.

<sup>190</sup> Anneli Albi, "Supremacy of EC Law in the New Member States" 3 *European Constitutional Law Review*, (2007) at pg. 25.

<sup>191</sup> Supra note 8 at pg. 268

According to the “narrower” or classical concept of the direct effect it can be defined as the capacity of a provision of EU law to confer rights on individuals<sup>192</sup>. This principle was initially established by ECJ in its case *Van Gend en Loos* and after it was extended and now applies to EU primary law, secondary legislation and international agreements.

## 2. Legal effects of the Association Agreements in the EU legal order – Stabilization and Association Agreement between EU and Albania.

International agreements are binding upon the institutions of the Union and its Member States, according to Article 216 (2) TFEU. ECJ has consistently held since *Haegeman* ruling that once an agreement enters into force, its provisions form an “integral part” of Community law<sup>193</sup>. This reflects the monist approach regarding the relationship between international law and domestic law according to which agreements concluded by the Union form part of the Union legal order without the necessity of transposing those provisions in the Union legal order. According to the ECJ’s case law international agreements can have direct effect. In its reasoning in *Demirel*’s case ECJ reasoned that a provision of an international agreement concluded by the Community with non-member countries can be directly applicable when the provision contains a clear and precise obligation which is not subject, in its implementation or effect to the adoption of any subsequent measure<sup>194</sup>.

Article 217 TFEU (ex Article 310 TEC) provides the power of the Union to conclude Association Agreements. The Association Agreements concluded with the CEECs are the so-called “Europe Agreements”. Although there is no suggestion in the Treaty about the content of the Association Agreements, they establish the frameworks which would enable the applicant country to integrate gradually into the union<sup>195</sup>. Association Agreements include also the Stabilization and Association Agreements with the countries of the Western Balkans, whose objective is to support the consolidation of democracy, the rule of law, the economic development and the regional cooperation. The Association Agreements have been invoked before ECJ which continuously reasoned that they form an integral part of the EU legal order and that it had a broad jurisdiction on them<sup>196</sup>.

In order to understand the possibilities for direct effect of the SAAs, it is necessary to analyze the preliminary rulings of the ECJ on the direct effect of the Europe Agreements as they form a good example. There are several cases regarding the direct effect of the provisions on the right of establishment and free movement of workers provided in the Europe Agreements. In cases such as *Gloszczuk*, *Kondova*, *Barkoci* and *Malik, Jany*<sup>197</sup> nationals of Central and Eastern European Countries asked entry into and residence in the territory of the EU member states as they wanted to work there as self-employed persons.

Given that they did not have such rights of entry and residence under their national law they invoked provisions on the right of establishment provided in the respective Europe Agreements<sup>198</sup>. ECJ in answering the question of direct effect of the provisions on the right of establishment provided in the Europe Agreements considered their wording and the purpose and the nature of the Europe Agreements.

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<sup>192</sup> Ibid at pg. 268

<sup>193</sup> Supra note 8 at pg. 202

<sup>194</sup> Case C-12/86 ECR 1987, 3719

<sup>195</sup> Neill Nugent, “The Government and the politics of the European Union” (Duke University Press 2006) at pg. 71

<sup>196</sup> Supra note 8 at pg 186

<sup>197</sup> Case C-63/99 *Gloszczuk*; Case C-235/99 *Kondova*; Case C-257/99 *Barkoci* and *Malik* [2001] ECR I-6557; Case C-268/99 *Jany* [2001] ECR I-8615

<sup>198</sup> In the *Gloszczuk* case the Europe Agreement between EC and Poland was invoked (OJ 1993, L 348/1); the *Kondova* case concerned EC/Bulgaria Agreement (OJ 1994, L 358/1); in the *Barkoci & Malik* case the EC/Czech Republic Agreement was invoked (OJ 1994 L 360/1); in *Jany* case the Europe Agreements with Poland and the Czech Republic were relied upon.



The court concluded that the provisions on the right of establishment in the Association Agreements, is to be construed as establishing within the scope of application of those Agreements a precise and unconditional principle which is sufficiently operational to be applied by national court and which is therefore capable of governing the legal position of individuals<sup>199</sup>. Therefore, nationals of Europe Agreement countries have the right to invoke the provisions on equal treatment before the courts of the host Member State, even though the authorities of this state remain competent to apply to those nationals their own national laws and regulations regarding entry, stay and establishment. Regarding the right of the free movement of workers for nationals of the Europe Agreement countries, the Europe Agreements grant a right to equal treatment to those nationals who are legally residing and working in one of the Member States, however they do not establish a freedom of movement of workers for them. There is a line of cases of the ECJ concerning provisions on the free movement of workers contained in different Europe Agreements, which according to the Court can have direct effect, but those provisions grant to the nationals of EA countries only a right on equal treatment if they are legally employed in the territory of a Member State.

Albania signed a Stabilization and Association Agreement with the EU on 12 June 2006, which entered into force on 1 April 2009 after having been ratified by all EU Member States. Although, there hasn't been a court case in any of the EU Member States involving an Albanian national, which asked for a preliminary ruling of the ECJ on the interpretation of the SAA with Albania, it can have direct effect and Albanian nationals can enforce their rights in the EU legal order. Read in the light of the above mentioned case law of the ECJ regarding direct effect of certain provisions of the EAs, also provisions of the SAA with Albania can have direct effect. The SAA contains the provisions related to the movement of workers, Article 46 SAA<sup>200</sup>, in Title V, Chapter I on "Movement of workers" can have direct effect. According to this Article Albanian nationals, legally employed in one of the EU Member States, may enforce their rights and rights of their spouse and children on the equal treatment coming from Article 46, before one of the courts of the EU Member States.

The SAA accords rights to the self-employed Albanian citizens, thus according to Article 50<sup>201</sup> SAA Albanian nationals have the right to invoke the equal treatment provision before the courts of the host Member State, however the authorities of that Member State remain competent to apply their own national laws and regulations regarding entry, stay and establishment.

ECJ ruled in *Van Gend & Loos* that provisions containing negative obligations or the so-called standstill provisions can have direct effect. Identical standstill provisions are also set out in the SAA with Albania.

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<sup>199</sup> *Supra* note 23

<sup>200</sup> Article 46 SAA para. 1 provides that: "1. Subject to the conditions and modalities applicable in each Member State:– treatment accorded to workers who are Albanian nationals and who are legally employed in the territory of a Member State shall be free of any discrimination based on nationality, as regards working conditions, remuneration or dismissal, compared to its own nationals;– the legally resident spouse and children of a worker legally employed in the territory of a Member State, with the exception of seasonal workers and of workers coming under bilateral Agreements within the meaning of Article 47, unless otherwise provided by such Agreements, shall have access to the labour market of that Member State, during the period of that worker's authorized stay of employment."

<sup>201</sup> Article 50 SAA para.1 provides that:" Albania shall facilitate the setting-up of operations on its territory by Community companies and nationals. To that end, it shall grant, upon the date of entry into force of this Agreement:

(i) as regards the establishment of Community companies treatment no less favourable than that accorded to its own companies or to any third country company, whichever is the better, and;

(ii) as regards the operation of subsidiaries and branches of Community companies in Albania, once established, treatment no less favourable than that accorded to its own companies and branches or to any subsidiary and branch of any third country company, whichever is the better.

For example, Article 33 of the SAA, which provides that no new customs duties or new equivalent restrictions on imports or exports or charges or measures having equivalent effect shall be introduced, nor shall those already applied be increased in trade between the Community and Albania<sup>202</sup>, is similar to

Articles 30 and 34 of TFEU (ex Article 25 & 28 TEC), which prohibit customs duties and quantitative restrictions between Member States. According to the case law of the ECJ Articles 30 and 34 of the TFEU can have direct effect, thus also Article 33 of the SAA with Albania, as a standstill provision, can have direct effect. Every person and company established in the EU Member States could bring a case before a national court in one of the EU Member States based on Article 33 of the SAA<sup>203</sup>.

Another case might concern fiscal discrimination provided in Article 34 of the SAA. This Article prohibits fiscal discrimination by providing that the parties should refrain from and abolish any measure or practice of an internal fiscal nature establishing, whether directly or indirectly, discrimination between the products of one Party and like products originating in the territory of another party. This Article is similar to Article 110 of TFEU (ex Article 90 TEC). The first paragraph of Article 110, which can be compared to Article 34 (1) of the SAA, prohibits discriminatory taxation in respect of goods which are similar, such as one type of beer and another. There is a line of cases of the ECJ concerning the taxation of alcoholic drinks, where the court suspected that internal taxation schemes favored national products to the disadvantage of similar or potentially equivalent products produced elsewhere, and so applied Article 90 TEC (now Article 110 TFEU)<sup>204</sup>. The test used by the ECJ to determine whether the goods are similar, was laid down in *Commission v Denmark*<sup>205</sup>. The scope of Article 90 (1) is decided not only on the basis of strictly identical nature of the products but also on their similar and comparable use<sup>206</sup>. Thus, a producer of one of the Member States of the EU can sue the Albanian Tax Administration before its national court, in case of discriminatory taxation in respect of goods which are similar and that court would ask for a preliminary ruling from the ECJ.

### 3. International law in the Albanian legal order.

Article 5 of the Constitution, provides that Albania should apply international law binding upon it.<sup>207</sup> The way in which the Albanian Constitution has solved the issue of the relationship between international law and national law is closer to the monistic approach. As it will be explained, ratified international agreements are part of the Albanian legal order after being published in the Official Journal, they have supremacy over the national law in case of conflict and they can be directly applied. Article 116 of the Constitution creates a hierarchy between normative acts which are effective in the territory of the Republic of Albania, by placing the ratified international agreements before the national laws.

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<sup>202</sup> Article 33 para. 1&2 of the SAA provide that: “1. From the date of entry into force of this Agreement no new customs duties on imports or exports or charges having equivalent effect shall be introduced, nor shall those already applied be increased, in trade between the Community and Albania. 2. From the date of entry into force of this Agreement no new quantitative restriction on imports or exports or measure having equivalent effect shall be introduced, nor shall those existing be made more restrictive, in trade between the Community and Albania.”

<sup>203</sup> *Supra* note 5 at pg. 353

<sup>204</sup> Cathrine Barnard, “The substantive law of the EU the four freedoms” (Oxford University Press 2007) at pg. 48

<sup>205</sup> Case 106/84 *Commission v. Denmark* (1986) ECR 833 para.12

<sup>206</sup> *Supra* note 31 at pg. 50.

<sup>207</sup> Article 5 of the Albanian Constitution provides that: “The republic of Albania applies international law that is binding upon it”

According to Article 122/1<sup>208</sup> every ratified international agreement constitutes part of the Albanian legal order and can be directly applied except for the cases when it is not self-executing and its implementation needs issuance of a law.

Paragraph 2 of Article 122 recognizes the supremacy of the ratified international agreements over national laws and such agreements prevail over national laws which contradict them<sup>209</sup>. Thus, the Albanian Constitution provides for the supremacy of international law over the national laws and automatically solves problems of conflicts between them in favor of international law. This confirmed supremacy of international law towards national law separates Albania from the solution given by the dualistic countries regarding the relationship between international and national law<sup>210</sup>. Many Constitutions of other countries have only provided that their legislation is in conformity with rules and norms of international law, but they leave unsolved the problem of conflict between national norms and international norms. This is a partial solution given by the Constitutions of these countries<sup>211</sup>. The Albanian Constitution is similar to the Constitutions of Poland, Croatia, which provide for the supremacy of ratified international agreements over the laws of the land, in case of conflict between them<sup>212</sup>.

The Albanian Constitution creates two systems regarding the relationship between international law and national law<sup>213</sup>. The first system as it was explained above is based on two basic principles: first on the principle of direct applicability of the ratified international agreements (except for the cases when they are not self-executing and their implementation requires issuance of a law) second on the principle of the superiority of the ratified international agreements over the laws of the country, that are not compatible with them<sup>214</sup>.

The second system is related to the third paragraph of Article 122<sup>215</sup>, which introduces some special characteristics different from the general system of the relationship between ratified international treaties and national law.

This Article provides that norms issued by an international organization can have supremacy over the right of the country in case of conflict, but with one condition that the ratified agreement for the participation of the Republic of Albania in that organization should provide for the direct effect of the norms issued by that organization. The norms issued by this international organization will have supremacy not only over the national laws, as it was for the international norms of public international law, but they will have supremacy over the right of the country. From a literal interpretation of Article 122/3, the right of the country includes all internal norms including the constitution itself, so it is understandable supremacy over the Constitution itself and not only over the national laws<sup>216</sup>.

<sup>208</sup> Article 122/1 of the Albanian Constitution provides that: "Any international agreement that has been ratified constitutes part of the internal juridical system after it is published in the Official Journal of the Republic of Albania. It is implemented directly, except for cases when it is not self-executing and its implementation requires issuance of a law. The amendment, supplementing and repeal of laws approved by the majority of all members of the Assembly, for the effect of ratifying an international agreement, is done with the same majority.

<sup>209</sup> Article 122/2 of the Albanian Constitution provides that: "An international agreement that has been duly ratified by law has superiority over laws of the country that are not compatible with it"

<sup>210</sup> Sokol Sadushi, "Jurisprudenca e Gjykates Kushtetuese ne frymen e Koneventes Europiane per te Drejta e Njeriut", XI, E drejta Parlamentare dhe Politiokat Ligjore (2003).

<sup>211</sup> Ksenofon Kristafi, "Kushtetuta Shqiptare dhe e Drejta Nderkombetare", 47 (2) Tribuna Juridike (2004).

<sup>212</sup> Aurela Anastasi, "Internacionalizimi i se Drejtes Kushtetuese Klauzolat Kushtetuese te Integritimit te Shqiperise" 4 Polis, (2008) at pg. 19.

<sup>213</sup> Xhezair Zaganjori, Aurela Anastasi, Eralda Cani, "Shteti i se drejtes ne Kushtetuten e Republikes se Shqiperise" (Adelprint 2011) at pg. 60

<sup>214</sup> Ibid pg. 60

<sup>215</sup> Article 122/3 of the Albanian Constitution provides that: "The norms issued by an international organization have superiority, in case of conflict, over the right of the country if the agreement ratified by the Republic of Albania for its participation in the organization expressly contemplates their direct applicability".

<sup>216</sup> Luan Omari, Aurela Anastasi, "E drejta kushtetuese" (Shtepia Botuese Adelprint 2010) at pg 40

Article 122/3, is not clear as long as it is not implemented in practice and for as long as there is no interpretation by the Constitutional Court. It does not distinguish between international law and EU law. This separation should recognize the specific nature of the EU law. Under these conditions foreign experts, who consider the specific nature of EU law, supported also by Albanian experts, recommend that it would be better to add in the Albanian Constitution appropriate provisions giving EU law legal authority, supremacy and direct effect when possible<sup>217</sup>.

This Article would not change the position held by the Albanian Constitution towards international law in general as it would only provide for the special status of the Community law within the Albanian legal order<sup>218</sup>.

#### **4. Legal effects of the Stabilization and Association Agreement between Albania and EU – Constitutional case law**

According to Article 122 of the Albanian Constitution, international agreements ratified by law by the Republic of Albania, are part of the internal legal order, they can have direct effect and they can be applied by the national courts. The supremacy of international law over national laws sanctioned in the Constitution has also been applied in practice. The Albanian Constitutional Court abrogated provisions of the Criminal Code and provisions of the Criminal Military Code which predicted death penalty, in order to comply with Protocol No. 6 of the European Convention on Human Rights. Regarding the European Convention on Human Rights the Constitutional Court has developed a practice according to which it has invalidated Albanian laws contrary to the provisions of the Convention and it has also used decisions of the European Court on Human Rights as an interpretative tool. The Constitutional Court has developed a practice according to which non-conformity of Albanian laws with an international treaty construes a breach of the principle of the rule of law and is contrary to the Constitution.

The definition of the relationship between international law and national law in the framework of Albanian's Euro – Atlantic integration was one of the tasks of the drafters of the constitution. By carefully analyzing the constitutional status of international acts, besides the general standing explained above, there are also so-called specific articles which provide for the participation of Albania in supranational organizations<sup>219</sup>. One of this is Article 122/3, mentioned above, according to which norms issued by an international organization can have supremacy over the right of the country in case of conflict thus, over the Constitution itself and also direct effect. There are authors<sup>220</sup> which think, that regarding the SAA with Albania, Article 122/3 might serve as a constitutional base for the Albanian courts, when giving their decisions about cases for non-compliance by the Government of the standstill provisions provided in the SAA. For example, the Albanian courts can refer directly to the SAA, when Albanian and European companies established in Albania, dispute the correctness of implementation of obligations under SAA regarding custom duties, quantitative restrictions etc. However, during the pre-accession period the Constitutional Court has to interpret the national constitutional provisions regarding the priority of the provisions of the SAA in the Albanian legal order.

After the entrance into force of the SAA, the Albanian Constitutional Court has referred to the provisions of the SAA directly and it has recognized supremacy of its provisions over the national legislation. Case No. 24/2009<sup>221</sup> the Hydrocarbon Companies Association challenged the constitutionality of a Council Ministers Decision concerning the quality standards of gasoil, as a byproduct of crude oil, drilled in the territory of the Republic of Albania and traded for vehicles and generators. The association claimed among others that the above-mentioned decision could not be reconciled with the SAA because it allowed dominant position of a private company in the market regarding products that independently of their origin have the same usage and create the same effects related to the air pollution.

<sup>217</sup> Alfred Kellermann, "Impakti i Anetaresimit ne BE ne Rendin e Brendshem Ligjor te Republikes se Shqiperise", XXXV E Drejta Parlamentare dhe Politikat Ligjore, (2007). at pg. 372

<sup>218</sup> Ibid at 372

<sup>219</sup> Supra note 43 at pg. 42.

<sup>220</sup> Supra note 5 at pg. 353

<sup>221</sup> Decisions of the Constitutional Court of the Republic of Albania 2009 published 2010.

The Constitutional Court referred to Article 33 point 2<sup>222</sup> of the SAA which, according to it, limited the right of the Albanian State to regulate the execution of the freedom of economic activity.

The Court furthermore stated that the above-mentioned decision through the exclusion it provided changed the Albanian legislation, by creating a situation which banned imports for a certain product and favored the internal products compared to other products. The Court decided that the decision of Council of the Ministers was not in compliance with the SAA and it was abolished.

An important obligation for Albania during the pre-accession period is to adjust to the *acquis communautaire*. This adjustment is achieved not only by adaptation of compatible legal norms but also by assuring the same application of legal norms in practice. Thus, interpretation of Albanian laws and other acts in the light of EU law can be interpreted as one of the obligations according to the SAA. The Albanian Constitutional Court seems to be willing to interpret national law as far as possible in compliance with EU law. Case No. 3/2010<sup>223</sup>, concerned the constitutionality of the law “On statutory audit, the organization of the profession of the statutory auditors and chartered accountants” Among others the Professional Organization of the Economist claimed that the abovementioned law created a monopoly position of the statutory audit in the market because there was only one professional association, which grouped the statutory auditors and membership in that professional association was a condition in order to become a statutory auditor. The Constitutional Court ruled based on the Directive 2006/43/EC of the European Parliament and of the Council, of 17 May 2006, “On statutory audits of annual accounts and consolidated accounts”, which obliged the Member States to harmonize their legislation on auditing and auditors with this directive. The Court did a comparative interpretation, pointing out that almost in all Member States of the European Union, and also candidate countries there was one professional association for auditors, which was based on national laws or other national regulatory acts, independently of the fact that, these associations in some countries, based on their tradition, included also chartered accountants. Under this point of view the Court pointed out that there was no monopoly situation, as the law didn’t prevent anybody to take the expert license, it only provided the way this license was approved and its continuous control.

### **Conclusions.**

The EU Association Agreements form an integral part of the EU legal order and their provisions can have direct effect when they contain a clear and precise obligation which is not subject in its implementation or in its effects, to the adaptation of any subsequent measure. Thus nationals of countries which have signed an Association Agreement with the EU and that agreement has come into power can enforce their rights derived by those agreements before the courts of the EU Member States. The ECJ in many cases related to the EU Association Agreements has had the opportunity to interpret the legal effects of EU Association Agreements. It ruled that provisions on freedom of establishment and free movement of workers create rights for the nationals of the EU Association Agreements countries.

Thus, based on the case law regarding the Europe Agreements it can be inferred that also Albanian nationals can enforce their rights derived by the SAA with the EU. Legally employed Albanian workers in one of the EU Member-States shall be free from any form of discrimination based on nationality, regarding working conditions, remuneration, and dismissal compared to the nationals of that Member States. Also self-employed Albanian nationals who legally reside in the territory of the Member States must be treated equally and they cannot be discriminated against because of their nationality.

During the pre-accession period, the effects of the SAA in the Albanian legal order will depend on the interpretation by the Constitutional Court of the constitution regarding the priority of the provisions of the SAA within the Albanian legal order and on the interpretation given to the objectives of the SAA.

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<sup>222</sup> From the date of entry into force of this Agreement no new quantitative restriction on imports or exports or measure having equivalent effect shall be introduced, nor shall those existing be made more restrictive, in trade between the Community and Albania

<sup>223</sup> Decisions of the Albanian Constitutional Court 2010 at pg. 34

It can be inferred from the above-mentioned case law of the Albanian Constitutional Court that it is very willing to refer to the provisions of the SAA directly, after it's entering into force, and to acknowledge its supremacy over national laws. The Albanian Constitutional Court is also willing to interpret Albanian laws in the light of the relevant EU law provisions. Thus, it takes into account one of the obligations under the SAA regarding the approximation of laws.

Article 70 of the SAA provides that Albania is under obligation to ensure that existing laws and future legislation should be gradually made compatible with Community *acquis*. In principle, the Albanian Constitutional Court has used in its reasoning Articles of the SAA and its objectives in order to interpret Albanian law in the light of EU law.

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**INDICATORS FOR MEASURING ICT INNOVATIONS – THE CASE OF THE REPUBLIC OF MACEDONIA**

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***Abstract:***

*The business has been always dependent upon the technologies. Nowadays, ICT and especially the Internet, has become an integral part and a key logistic system to support the business processes. The imperative is not only being a part of the so called e-globalization, but the responsiveness to changes and the possibilities to be proactive while using innovative business technologies is to be attached an extreme importance. Given the above considerations, this paper aims at identifying the indicators measuring ICT innovations. They are considered extremely important so as to properly measure the ICT innovations of the companies in the Republic of Macedonia. In accordance with the framework to define innovation we have classified four types of indicators intended for quantifying the ICT innovations (ICT product innovation, ICT process innovation, ICT marketing innovation and ICT organizational innovation). Each of them is to be composed of five sub-indicators.*

**Keywords:** *ICT innovation, indicators.*

**JEL Classification:** *O30, O31.*

**Introduction**

Nowadays, the firm's innovation processes are being usually associated with the use of information and communication technologies (ICTs). Given the permanent evolution of such technologies, it is of particular importance for the businesses to keep up with certain innovative ICTs if they want to achieve a competitive advantage and sustain the market, as well. Thus, ICT is to be considered critical either in boosting the business innovations and improving the quality of products or in the possibility to increase the production process efficiency and create the new organizational structures.

Those technologies and particularly the Internet have made fundamental changes in methods to complete the business activities, but also modified the entire economic reality. "...Consequently, the Internet is not only the consequence of innovation in ICT, but also enabler for various types of innovation not only in the private, but also in the public sector, and for more broader and complex innovation processes..." The advent of Internet has imposed some new forms of business cooperation since "ICTs have the potential to increase innovation by speeding up the diffusion of information, favouring networking among firms, enabling closer links between businesses and customers, reducing geographic limitations, and increasing efficiency in communication." On the other hand "...ICT makes it possible to reduce transaction costs, improve business processes, facilitate coordination with suppliers, fragment processes along the value chain (both horizontally and vertically) and across different geographical locations, and increase diversification..." In the environment that is growing even stronger, this would certainly mean that the company's survival is being largely dependent upon the possibility of rapid change, but also the adjustments of the business initiative in getting ahead the competitive threats. Yet, the plans for organizational change are usually contingent on the limited financial, human and technological resources which certainly bound the further possibility to influence a new situation. Due to ever increasing importance of the information technology and especially the Internet, as well as the growing opportunities they offer to improve the business performance, the modern companies dealing with innovations in this sector are to increasingly emphasize the competitive struggle in placing the technologies that would allow for a certain improvement of the business processes.

#### **Forms of innovation.**

Today's company subsistence is being largely dependent upon its readiness to implement the ICT innovations which, in some cases, have completely changed the frame of work and the operation of business processes. Nevertheless, they might cover a great risk and threats if not implemented in a proper manner and the right time. In accordance with Oslo Manual, developed jointly by Eurostat and the OECD, the innovation is being defined as "the implementation of a new or significantly improved product (good or service), or process, a new marketing method, or a new organisational method in business practices, workplace organisation or external relations." Yet, the innovation must not always refer to "doing something new", but also "doing something old in a different way". Oslo Manual has clearly underlined the four key innovations, such as "Product Innovation", "Process Innovation", "Marketing Innovation" and "Organisational Innovation". In the view of the OECD glossary of statistical terms, Product Innovation is to be considered an "introduction of a good or service that is new or significantly improved with respect to its characteristics or intended uses. This includes significant improvements in technical specifications, components and materials, incorporated software, user friendliness or other functional characteristics." This means that product innovation is being essential for large number business strategies and usually refers to technological innovations. Process Innovation is to be defined as "implementation of a new or significantly improved production or delivery method (including significant changes in techniques, equipment and/or software)" According to the same source the organisational innovation means the implementation of a new organisational method in the undertaking's business practices, workplace organisation or external relations. Marketing innovation is the "implementation of a new marketing method involving significant changes in product design or packaging, product placement, product promotion or pricing."

Given the above clarifications for different types of innovation, ICT may have a certain direct or indirect influence on each of them. This paper will therefore explain the four different forms of innovations supported by the use of ICT:

- ICT enabled product innovation – using this type of innovation leads to a certain decrease of the production costs, increase of the productivity and the conception of a new product and service or the improvement of the existing ones;
- ICT enabled process innovation – ICT significantly contributes to the possible improvements of the business processes or the establishment of the new working methods.



However, the implementation of ICT innovations in improving or changing the business processes have to begin with a complete and full understanding of the strategy, processes and the structure of the business entity since such implementation would otherwise lead to a certain failure ;

- ICT enabled marketing innovation– ICT has a great potential to promote the marketing activities, especially with the advent of the internet-based techniques and technologies. This assumption is being confirmed by testing the hypothesis that“ICT use increases the probability to innovate in marketing”
- ICT enabled organizational innovation– this type of innovative technologies permits the transformation of the firm’s organizational structure by establishing innovative ICT tools to be essentially considered the internet-based ones.

#### **Indicators to measure the ICT innovation.**

The empirical research usually refers to limited reports for the company’s possibility to implement the innovative ICT-supported concepts. That is to say, a very few studies make an attempt to identify the indicators for the firms’ readiness to implement the ICT innovative solutions. Given the prominent importance of the readiness to use the ICT enabled innovations as an indicator for the efficiency of the firms to cope with the competitiveness of the global market and the movements in line with the modern economies, the possibility to define and assess the ICT enabled innovation readiness is to be considered a real challenge. With these indicators in particular, the companies will provide an appropriate mechanism to recognize their strengths and weaknesses in the process of digital restructuring and approaching towards the world innovation ICT trends.

Bearing in mind the distinct forms of ICT enabled innovations this paper aims at identifying indicators to measure the firms’ readiness to use the ICT innovations. That is to say, a new approach is here developed to summarize the indicators for measuring the ICT-supported innovation readiness. Each group of indicators is being carefully selected to correspond with the key technologies that reflect the form of innovation which they apply for. Given the large number of alternative indicators, special emphasis has been placed to selecting those that reveal a high degree of representation and a substantial review of the issue that has been theoretically described by the definition referring to a certain form of ICT enabled innovation.

The four groups comprise the following indicators:

- **ICT enabled product innovation**

- (a1) % of the companies that use a data collection and integration
- (a2) % of the companies that use software solutions for the product design CAD/CAM systems
- (a3) % of the companies that have established a production process automation
- (a4) % of the companies that use technologies for the production process simulation
- (a5) % of the companies that use technologies for the production process planning

- **ICT enabled process innovation**

- (b1) % of the companies that have implemented an ICT workflow management
- (b2) % of the companies that have implemented an ICT document management
- (b3) % of the companies that use technologies for the process automation
- (b4) % of the companies that perform a business process simulation
- (b5) % of the companies that exercise a business process reengineering

- **ICT enabled marketing innovation**

- (c1) % of the companies that perform a data mining

(c2) % of the companies with the software implemented for the customer Relationship Management – CRM

(c3) % of the companies making an ICT data collection (web bugs, cookies, ...)

(c4) % of the companies using the e-marketing tools

(c5) % of the companies that have implemented themarketing expert systems, simulation and forecasting

• **ICT enabled organizational innovation**

(d1) % of the companies that use the groupware tools

(d2) % of the companies that have published an Intranet web

(d3) % of the companies that exercise a cloud computing

(d4) % of the companies holding a software for an Enterprise Resource Planning - ERP

(d5) % of the companies that perform an online resource tracking

**Survey results – Case of Republic of Macedonia**

In December 2011, the pilot research has been conducted for assessing the readiness of the Macedonian companies to implement ICT enabled innovation. The survey has been accomplished by the questionnaire of the 20 well-structured closed questions divided by the group of five for each of the sub-indicators previously defined. The data from the State Statistical Office have been also used for some of the indicators. The survey has included a total number of the 50 Macedonian companies, out of which 16 or 32% apply to manufacturing, while 34 or 68% appertain to the service sector. Most of the companies are placed in Skopje and Pelagonija region. Compliant with the data obtained, the partial sub-indices have been determined along with the composite index for the firms' readiness to implement the ICT innovations.

Table 1 reveals the data obtained

ICT enabled product innovation					ICT enabled process innovation					ICT enabled marketing innovation					ICT enabled organizational innovation				
(1)	(2)	(3)	(4)	(5)	(1)	(2)	(3)	(4)	(5)	(1)	(2)	(3)	(4)	(5)	(d1)	(d2)	(d3)	(d4)	(d5)
%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
of	of	of	of	of	of	of	of	of	of	of	of	of	of	of	of	of	of	of	of
the	the	the	the	the	the	the	the	the	the	the	the	the	the	the	the	the	the	the	the
company	company	company	company	company	company	company	company	company	company	company	company	company	company	company	company	company	company	company	company
has	has	has	has	has	has	has	has	has	has	has	has	has	has	has	has	has	has	has	has
published	published	published	published	published	published	published	published	published	published	published	published	published	published	published	published	published	published	published	published
an	an	an	an	an	an	an	an	an	an	an	an	an	an	an	an	an	an	an	an
intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet	intranet
websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites	websites



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**TRADE INTEGRATION BETWEEN ALBANIA AND EUROPEAN UNION  
A GRAVITY MODEL BASED ANALYSIS**

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*International trade integration of an economy is a stone for a successful economic development of a country. In the context of European Union enlargement there is a specific interest in exploring the regional trade integration of the countries inspiring the involvement in the EU. As a rather successful econometric approach the gravity model has been widely used to infer and predict substantial foreign trade flows between countries more empirically than theoretically.*

*The aim of this study is to examine the potential trade volume between European Union and Albania which is trying to join it in the near future. The focus of Albania is how Albania can integrate to the EU market and gather benefits from this international trade possibility to foster its economic development. Considering the previous agreements bilateral or involving reciprocity between Albania and EU, as well as the recent status of Albania as the country favored in the international reciprocal economic exchanges, where it is verified a not very happy situation for Albania, the analyze of the situation through the gravity model, gives us some conclusions on how Albania should move in the future in this international trade process to increase its benefits. The new situation coming in the near future, in case Albania gets the status of the candidate country (acceding country), this model can help us find the most weighting variables in the increase of the benefits from the Albania-EU international trade in our favor, in favor of Albania*

**Keywords:** *International trade, Common currency, Gravity model, Trade integration*

**JEL Classification:** *FO2.*

**Introduction**

According to Akyuz et, al (2010), the European union (EU) is the world's second largest economy; only slightly smaller than the US in purchasing power parity terms but slightly larger at the official exchange rates. Moreover, EU is the world's largest merchandise exporter accounting for about one – fifth of the world trade as well as the largest services exporter that accounts for over a quarter of the world trade. The EU's economic importance has increased substantially since the early 1980s by increasing its number of members. Albania wanting to be economically and politically strong in the region has always aspired to enter the EU for a long time. By acting like this Albania knows that its benefits will be huge as EU is the most important trading partner and source for direct foreign investments. Aspiring to liberalize toward EU mean also trade liberalization with EU member states which will yield greater benefits and open the possibility of internationalization of the domestic economy and business.

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To this goal Albania have to get use of all its means and channels in order to enter EU market, and in the same time to get use of its neighborhood, countries already members of EU, as well as the countries in the way to EU being steps forward compared to Albania.

- **Albania and EU economic framework**

Having a look at the history of Albania with EU we notice a very tough relationship between us and EU making the membership very challenging to us because of many reasons.

June 2006, was very significant for Albania when we signed the Stabilization and Association Agreement with the EU, an initiative taken since long time ago from EU, May 1999 for five Balkan countries – Albania, the former Yugoslav Republic of Macedonia, Croatia, Bosnia – Herzegovina and the Federal Republic of Yugoslavia. The SAA was ratified on January 2009 by the 25 EU member states of the time and entered in force on April 1, 2009. (F)

On April 28, 2009 Albania has applied to become EU candidate country which has resulted in a very tough duty for all of us. On November 8, 2010 the Ministers of Interior of the Member States of the European Union approved the lifting of the visa regime with Albania while on November 9, 2010 in the Annual Report the Commission stated that Albania was not ready to become an EU candidate country. (F)

### 2.1. Common currency

Literature has discussed a lot the relationship between monetary unions and bilateral trade. This is conditioned by the situation of common currencies which other European countries have experienced well in advance compared to Albania. Studies show that monetary unions have lower inflation; promote trade and double bilateral trade.

According to Rose and Stanley the conventional gravity model can be used to account for factors that drive trade and assess trade effects as below;

$$T_{ijt} = \beta_1 D_{ij} + \beta_2 (Y_i Y_j) t + u_{ijt}$$

Where:

$T_{ijt}$  denotes the natural logarithm of trade between countries  $i$  and  $j$  at time  $t$ ,

$\{\beta\}$  is a set of nuisance coefficients,

$D_{ij}$  denotes the log of distance between  $i$  and  $j$

$Y$  is the log of real GDP,

$Z$  represents other controls for bilateral trade,

$CU_{ijt}$  is a dummy variable that is one if countries  $i$  and  $j$  are in a currency union at  $t$ , zero otherwise,

$u$  is a well behaved disturbance term

union on trade, ceteris

paribus.

One of the most known and accepted effects of substituting a single currency for several national currencies is trade stemming. This results from the reduction of transaction costs because it is clearly cheaper to trade between countries that use the same currency. According to Rose (1999), currency unions do have effects on trade and this effect is big or bigger than the effect of joining a free trade area. In his study about 9 European countries having the same currency he tried to give an answer to the following question; Do countries inside currency unions tend to trade more holding other factors constant?

The estimate Rose found out is that countries with the same currency trade over three times as much with each other as countries with different currencies. So as we can conclude, engaging in a common currency stimulates the trade relationship between countries holding other things equal. Taking this statement in mind we can suggest that Albania has one other reason of interest to join the common currency union as this will contribute to the increase of trade. This is very substantial for our economy taking into consideration the fact that we are a small economy and in need of international foreign markets.

There is also a clear and logical background of explanation about why the engagement in a common currency encourages trade. According to Rose (1999), a common currency represents a serious government commitment to long term integration which in turn can induce the private sector to engage in much more international trade. Moreover, this facilitates financial integration and foregoing the cost of hedging exchange rate risk.

- **An econometric approach – Gravity Model**

The gravity model has its origin on the Newton's Law of gravity. The bilateral trade flow between two countries and is proportional to the mass of labour or goods, produced by the country, attracted by a mass of demand by country, but it is inversely proportional to the distance between the two countries;

Where is the movement of goods and is the distance between country and and is a constant. If we make an econometric estimation of the equation it comes:

Where represents the volume of trade between two countries  $i$  and  $j$ , and are the gross domestic products (GDPs) of and, is the distance between country and, and  $\zeta$  represents an error term with expectation equal to 1.

According to Anderson (2011), to estimate the equation we take the logarithms of both parts:

Here the constant becomes part of.

The logic brings us to the fact that to sell a good there are many other possible markets, and to buy a good there are many other possible origins. So, the trade between two countries is influenced also by other alternatives they have to collaborate. Another variable is important to the equation. According to McCallum (1995), it is named Remoteness Variable (REM). The variable expresses the average distance of region from all other partners not including. So

where is the distance between region and region, is the gross domestic production of region.

The first applications of the gravity model to explain trade flows are made by Tinbergen (1962) and Pöyhönen (1963), where the volume of trade between two countries is equal to the ratio of national incomes to the distance between the two countries. Howard J. Wall Federal Reserve Bank of St. Louis July 2000

Anderson's first researches for the gravity model (1979) tell that a country is more likely to trade with a bilateral partner, than with the ones who are more resistant to trade. He bases his theory on the term CES (Constant Elasticity of Substitution) and that the demand for the goods depend on their place of origin. Among others, a big development to the models gave Bergstrand (1985) and Deardorff (1998), who added a Hecker- Ohlin structure. McCallum (1988) treated the gravity model empirically. He proposed the following equation:



Here  $X_{ij}$  is the exports from region  $i$  to region  $j$ , and  $Y_i$  and  $Y_j$  are the gross domestic production in regions  $i$  and  $j$ ,  $D_{ij}$  is the distance between regions  $i$  and  $j$ , and the dummy variable

Considering the remoteness variables the regression comes to:

Another gravity model is used by Rose (2000), which expresses the empirical form of the model. Further versions are the ones from Anderson and Wincoop (2003), who include multilateral trade resistance (MTR). Nowadays, the gravity model trade flows between two countries is not only based on the distance and economic mass, but to estimate gravity model we should analyze bilateral trade resistance (BTR), which is the size of the barriers between two countries and also multilateral trade resistance (MTR), which are the barriers that both of the countries face in the trade with all the trading partners. Rose (1999) used an augmented gravity model instead of the standard one in order to count for as many other factors as possible. The equation he used in his methodology is as follows;

where  $i$  and  $j$  denotes countries,  $t$  denotes time, and the variables are defined as:

$B_{ij}$  is a binary variable which is unity if  $i$  and  $j$  share a land border,

$N_{ij}$  is a binary variable which is unity if  $i$  and  $j$  are part of the same nation (e.g., France and its overseas departments),

$C_{ij}$  is a binary variable which is unity if  $i$  is a former

colonizer, and  $C_{ji}$  is a binary variable which is unity if  $i$  colonized  $j$  or *vice versa*,

and  $T_{ij}$  is a binary variable which is unity if  $i$  and  $j$  are both

- **Transnational bridging through ethnic entrepreneurship**

At this point we can easily see that the last version of the model fits considerably enough with the case of Albania and its possibilities to internationalize towards EU countries using all the channels and counting for the factors closely linking it with EU countries to which we share borders, or other factors, here in the model considered as dummy variables. We can still rewrite the model as follow:

Where:

$A$  denotes Albania and  $E$  denotes EU countries,  $t$  denotes time, and the variables are defined as:

$\beta$  is a very dynamic variable, and tends to be reduced in effect considering the progress of Albania toward EU

land border, we share borders with Italy and Greece

is already active between EU and Albania (Euro One and CEFTA)

the bilateral (between  $i$  and  $j$ ) nominal exchange rate in the period before  $t$ ,

$\delta_{ij}$  is a binary variable which is unity if  $i$  and  $j$  have ethnic minorities

$\gamma$  a vector of nuisance coefficients, and

While, the other variables used in the model of Rose, are useful to calculate our possible results from the regional internationalization with the Balkan countries and Turkey, no considering the same binary variables ore calculating other ones in the case of China or other countries members of TO, which are listed below

$i$  and  $j$  have a common official language,

and its overseas departments),

the same

colonizer, (Albania and Turkey, or Albania and Italy on the Second World War)

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**SECTION VI: GENERAL MANAGEMENT****CONSUMER ATTITUDE TOWARDS GLOBAL BRANDS: EMPIRICAL ANALYSIS FROM THE CONSUMERS' PERSPECTIVE**

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***Abstract:***

*The aim of this paper is to investigate consumer attitude regarding global brands in the Macedonian market. Foreign brands are very important value for the citizens in the Macedonia and other countries in the world. However, little scholarly research has been conducted regarding this issue. This study proposes a model that integrates key variables measuring consumer attitudes and consumer characteristics. Every day, some brands seem to disappear from store shelves while others reappear sometimes later in the same shelves or in different shelves. Methodology that we are going to use is quantitative research, particularly regression analysis which belongs to hypothesis testing who will be very important issue that can lead us to the final conclusion and discussion. As well, qualitative method that is most important method is designing questionnaire and collecting information from consumers will be used.*

**Keywords:** Brands, consumer attitudes, global brands, local brands.

**JEL Classification:** M19.

**• Introduction**

Today we all live in the world that we have possibility to consume many products and services that are consumed globally. This process is related with the concept of globalization. Companies in the twenty first century seems that are much more interested to go internationally than locally. When the companies go internationally they go together with the product brand name. One important question related with global brand is what are global brands and where is the difference with the local brands.

A lot of global researchers give important and scientifically answer. According to Dimfote et.al (2008) global brands are widely available across international market and enjoy high level of recognition across the world.

In today's global markets it's very important to understand why consumers prefer to buy much more global brands than the local brands. This question is related why companies moves toward global brands.

According to Steenkamp et.al (2002) there are several reason that occurs this case. First, globalization can yield economies of scale and scope in R&D, manufacturing and marketing. Second, its strategic appeals increases as meaningful segments of consumers around the world develop similar needs and tastes. Third, globalization speeds up a brand's time to market by reducing time-consuming local modification. These reasons that are presented above they are not main reason for moves towards global brands. Some countries are able to create build global brands, and these are a very advantage in the context of country of origin of product, but are some countries that aren't able to build global brands. Typical case in this sense is Chine. Numerous economist argue that China can't build global brands particularly Smith and Sorrel (2010) stated that one reason China lacks brand power is its B2B focus and Chinese brands are unlikely to be dominant anytime soon-even if China's economy becomes the world's biggest .

Consumers are seen global brands as novel, they may have high prestige, but when novelty goes away, the prestige goes down (Larry Yu, 2003). As well in his research Larry stated "If a brand is perceived to be global, that creates value in the mind of consumers. Most of the value creation is through the fact that consumers ascribe products that are global to be of good quality". The consumer choice is very complex issue because this is influenced by many factors, especially in the developing countries. According to Batran et.al (2000) consumer in developing markets are increasingly faced with the choice between older local brands and newer nonlocal or foreign brands. As we understand this statement given above consumers decision regarding brand choice is obviously very important for marketing managers and researchers.

This topic is very interesting for reason that in many literatures i.e., books and journals a lot of authors have used the concept of country of origin (CO) as synonym related to quality for product or services, performances or products who are not "risky" for consumers. Sometimes consumers perceived are able to make interesting comparison when the question is directed to the developing or less developed and developed countries. Country of origin should not operate same in countries that are in the process of development in the context of innovation, standardization, product attributes and building strong brands that will be present all around the world.

Sometimes as we have mentioned before that country of origin is complex issue because according to Sameei et al. (2005) many manufacturers and retailers often "use brand names that suggest language origins different from the brands' true [COOs]"

Balabanis and Diamantopoulos (2008) give some examples like, Alba, a British manufacturer of electronic equipment, has introduced the Hinari brand, a name that does not convey the real origins of the product; other well-known examples of potentially misleading brand names are Matsui (United Kingdom) and Sharp (Japan). Similarly, Jeep vehicles sold in Austria carry a visible "Made in Austria" sign, signifying the local manufacture of these vehicles in Graz (thereby dissociating the Jeep brand Name from its U.S. origin)

## 2. Literature review

Academics and researchers concerning this topic are very knowingly over two or three decade due to the importance and value for consumers and companies. In different countries this topic is analyzed in the different perspectives despite consumer characteristics, consumer needs, preferences, consumer income and many others features. Some researchers argued that managers should not be too enthusiastic about global brands because consumers do not really have any intrinsic motives for preferring global brands (De Mooij, 1998). Consumers in many cases are interested to know about the COO of brands.

In this context according to Balabanis and Diamantopoulos (2008) a brand's COO can be learned explicitly (through memorization of information regarding the brand's COO from various sources; e.g., advertisement, product labeling, word of mouth, personal product experience) or implicitly (by classifying brand into a COO from the brand's attributes). In one research that have been conducted by Strizhakova et al.(2008) 85.8 % of young college-educated sample in developed and developing countries expressed strong preferences for global brands and 6 % of participants expressed strong preferences for local brands. Another issue that is object of investigation from different research and who is with relevant significance.

Many of prior research in this topic have defined consumers perceive products made in developed countries to be of higher quality compared with products made in emerging markets( Josiassen and Harzing 2008). As well as, from the point of view Hu et al.2008 consumers in emerging market perceive imported products from developed markets to be of superior quality, and products from other emerging markets to be of similar or inferior quality to their domestic products. Compare to developed market consumers perceive products from less developed markets to be of inferior quality, and those from other developed markets to be of similar or superior quality to their domestic products (Gurhan-Canli and Maheswaren, 2000)

As well, these differences are not the main characteristics of consumers' attitudes regarding foreign brands. However, Sharma et al. (2006) also indicated that there are many factors such, demographic, psychographic and socio-economic factors who lead to differences in attitudes towards foreign products for consumers in emerging and developed markets. In one research made by Holt et al .2004 they identify four main features of the global brands such as: quality signal, global myth, social responsibility and American value. As well, from the 16 global brands they found that (44 %) of respondent stated that quality is the main reason for preferring global brand, global myth is represented by 12 % and social responsibility followed by 8 %.

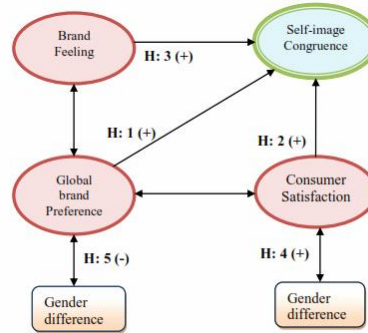


Figure 1. Conceptual model of brand dimensions and hypothesis testing

In order to clarify better the significance of this research we have build on theoretical model which is illustrated above with the four components, of them three later will be treated as dependent variables ( Brand feeling, global brand preference and consumer satisfaction) and independent variable self image congruence. The symbols with H (+) means that there is significant relationship or difference between variables and H (-) means that there is not significant relationship between variables.

## 2.1. Characteristics of global brands

Samuel and Douglas (2000) argued that global brands are that have the following characteristics:

- Extensive geographic reach: available in all major markets and most minor ones.
- Perceived by consumers as global: awareness among consumers that the brand is sold throughout the world.
- Uniform positioning and image worldwide: brands such as, Coca-Cola, Rolex, Nike, Gucci, McDonalds, Mercedes-Benz, Marlboro, and Sony.

Kotabe and Helsen (1988) determined a global brand that is available in many nations and, though it may differ from one country to another, the localized versions have a common goal and a similar identity. In another words, global brands carry one brand name and /or logo. The term global brand has been used to refer to brands where at least 20 percent of the product is sold outside their home country or region (Johansson, 2005).

A number of authors have shown that consumers prefer brands that they perceive as originating from a nonlocal country, especially from Western countries, more than they do local brands and that preference is linked not only to perceived quality but also to social status (Alden, Steenkamp, and Batra 1999). According to Samule and Douglas (2000) there are ranges of forces that are fostering and facilitating global brands. These forces consist of:

*Increased standard of living:* consumers in both the developing world and the developed world can afford to purchase an expanded range of products. This opens up markets and makes it feasible to develop global brands.

*Consumer mobility:* increasingly consumers are world travelers and are being exposed to products in different countries. They expect to be able to obtain the same products wherever they travel. Mobility also takes the form of immigration, where new residents look for familiar brands in their new surroundings.

*Globalization of media:* in addition to consumer mobility, consumers who stay in their own country are increasingly exposed to advertising messages. Teenagers in over 80 countries are exposed to MTV and its commercial messages. Even where ads are not a factor, movies and TV programs show life-styles and products that extend beyond a single culture. These establish aspirations, expectations, and markets for new products and ideas.

*Rising media costs:* at the same time media costs are increasing worldwide and firms are eager to economize on these costs as well as leverage established images worldwide.

*Shifts in power relationships:* increasingly manufacturers are finding themselves at the mercy of retailers. As retailers have grown in size and power, they are dictating the terms and conditions of sale. In many cases retailers are creating their own brands. To provide shelf space for these 'store brands' they are dropping weak manufacturer brands. To retain distribution, manufacturers need to have strong brands with identities that span multiple countries.

## 2.2. Consumer Attitude.

The consumers' attitude has changed in tremendous way since the global brands have been offered to emerging markets before two decade ago, particularly in the Republic of Macedonia. We conclude about this issue due to the many global brands who directly or in the indirect way are in our home shelves. Everybody have different attitude regarding brands, services, education, food, beverage books. So, the term of attitudes seems that is very famous and is used in the different field of study. Each of us, might be asked what attitude? According to Banyte et al. (2007) forming consumer attitude toward brands is based in the theory of consumer behavior and is result of positive and negative emotions and consumer moods influenced by such emotions, meanwhile is an assumption that emotions are one of the sources for the formation of consumer attitude.

## 2.3. The function of attitude.

As may consumer concepts that relay in the field of consumer behavior, as well as attitudes are part of this consumer behavior unit that play important function in the consumer perspective. Katz (1960) proposed the following function of attitude:

*Utilitarian function-*which is related to the basic principles of reward and punishment (if consumers like the taste of cheeseburger, that person will develop a positive attitude toward cheeseburger)

*The value-expressive function-* in this case attitude perform a value-expressive function express the consumer's central values or self-concept.

*Ego-defensive function-*attitudes that are formed to protect the person, either from external threats or internal feelings, perform an ego-defensive function.

*Knowledge function-*attitudes are formed as the result of a need for order, structure, or meaning.

## 3. Methodology.

In this study, we have investigated different brands from different country of origin (USA, France, Italy, Japan, Germany, China, Sweden,).

The study was conducted in Macedonia, mainly in the biggest cities, such Skopje, Tetova, Gostivar, Struga, Kumanova. The questionnaire was written in Albanian language and then translated into English and consist of four part. The research process is based in the models which consist on several dimension but we have used one of them in this case data collection methods (Saunders *et al.*, 2009, p.108). A total of 467 questionnaires (**N=467**) were distributed among the customers by the researchers themselves, during one month period time. They were targeted at different bank branches, shopping malls, parks, a sporting event and universities. The instrument adopted was a self administered questionnaire, comprising Mainly of Liker-type five item scales with end-anchors (**1 = strongly disagree, 5 = strongly agree**). The questionnaire consists of four main variables or as we have presented in the theoretical model like brand dimensions with the subgroup variables i.e. **Consumer Satisfaction with global brands** (After consuming everything I am very satisfied with global brand, The overall quality of global brands are excellent ,If anyone asked me I would strongly recommend him /her the global brand), **Global brand preference** (I like global brand better than any other local brand, I would use global brand more than I would use another local brand , Global brands are my preferred brand over any other local brand brands, I would be inclined to buy global brands over any other local brands), **Brand feeling** (Global brands give you a feeling of warmth, fun, excitement, security, approval, self-respect) and **Self Image-congruence**(Wearing/buying global brands consist with how I see myself, People similar to me wear /buy global brands and reflect who I am).

The questionnaire is compounded with 27 variables of them four are the main variables that are the framework of research and the rest variables are divided by demographic variables and the subgroup variables who are part of the four dimensions that we have argued above.

In order to test our hypothesis, we have conducted an empirical study and we have covered several cities in the Macedonia, as we have mentioned above. The four hypotheses have been tested using t-test or independent –sample t-test and ANOVA.

#### 4. Empirical findings and analysis.

The majority of the participants in the study were between 24-35 year or 39.4 percent and 35-45 year or 28.4 percent, the age of 111 participants were between 18-23 year and the rest of respondents had above 46 years (7

Tab 1. Age of respondent

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 18-23	111	23.7	23.8	23.8
24-35	185	39.4	39.6	63.4
36-45	133	28.4	28.5	91.9
above 46	36	7.7	7.7	99.6
5	2	.4	.4	100.0
Total	467	99.6	100.0	
Missing System	2	.4		
Total	469	100.0		

Tab2.Gender of respondent

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Male	218	46.5	46.7	46.7
Female	249	53.1	53.3	100.0
Total	467	99.6	100.0	
Missing System	2	.4		
Total	469	100.0		

Analysis from table above reveal that 218 participant or 46.5 percent were male and 249 or 53.1 of participant were female. The majority of participant were single 278 (59.3 %) and married 189(40.3) of participants.

**Tab.4 Please indicate you educational level**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid University degree	293	62.5	62.7	62.7
Master level	41	8.7	8.8	71.5
High school	110	23.5	23.6	95.1
Elementary school	23	4.9	4.9	100.0
Total	467	99.6	100.0	
Missing System	2	.4		
Total	469	100.0		

**Tab.3 Marital Status**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Married	189	40.3	40.5	40.5
Singel	278	59.3	59.5	100.0
Total	467	99.6	100.0	
Missing System	2	.4		
Total	469	100.0		

**Tab.5 Please indicate you income level**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 150-250 euro	27	5.8	5.8	5.8
250-350 euro	146	31.1	31.3	37.0
350-450 euro	237	50.5	50.7	87.8
450-550 euro	34	7.2	7.3	95.1
above 550 euro	23	4.9	4.9	100.0
Total	467	99.6	100.0	
Missing System	2	.4		
Total	469	100.0		

Table four indicate that the majority of respondents in this research were with university degree 62.5 % with master level 8.7 % and the rest of respondent had high school and elementary school. The monthly average income is different of them 50.5 percent have income between 350- 450 Euros and 31.1 percent had income between 250-350 Euros.

**H1:** There is positive relationship between self –image congruency with brand preference



<b>Tab. 6 ANOVA table of Self Image Congruence and brand preference</b>					
	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	20.874	11	1.898	4.570	<b>.000</b>
Within Groups	188.948	455	.415		
Total	209.822	466			

These findings based in the ANOVAs table provide support for the first hypothesis, we can conclude that null hypothesis is rejected because p value is less than alpha 0.05, respectively the level of significance is  $0.000 < 0.05$  and there is significant positive relationship between self-image congruency and brands preference

**H2:** There is positive relationship between self –image congruency with consumer satisfaction for global brands.

<b>Tab.7 ANOVA table of Self Image Congruence and consumer satisfaction</b>					
	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	24.209	9	2.690	6.623	<b>.000</b>
Within Groups	185.613	457	.406		
Total	209.822	466			

Results in the ANOVAs table above provide evidence for the second hypothesis. Based in this evidence null hypothesis is rejected because p value is less than alpha 0.05, respectively  $0.000 < 0.05$  and we can conclude that there is significant positive relationship between self-image congruency and consumers satisfaction for global brands.

**H3:** There is positive relationship between self –image congruency with brand judgment

<b>Tab.8 ANOVA-table of Self Image Congruence and brand judgment</b>					
	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	27.690	12	2.308	5.752	<b>.000</b>
Within Groups	182.132	454	.401		
Total	209.822	466			

Based in the ANOVAs table, respectively in the table number eight we can conclude that null hypothesis is rejected because p value is less than 0.05, ( $0.000 < 0.05$ ) there is significant positive relationship between self-image congruency and brand judgment.

**H4:** Do male and female as a consumer differ in the context of satisfaction with global brands

Tab. 9 Independent Samples Test										
		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	df	Sig. (2tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
									Lower	Upper
C S	Equal variances assumed	.008	.929	2.041	465	.042	.124	.061	.005	.244
	Equal variances not assumed			2.039	460.361	.042	.124	.061	.005	.244

Table number 1 reports the final results of testing the hypothesis regarding consumer satisfaction with global brands, Levene's Test for Equality of Variance, t-test, degree of freedoms, 2 tail test, mean difference, standard error difference and 95 % confidence interval of the difference. Hypotheses above respectively, hypotheses number four is accepted because the p-value 0.042 is less than alpha 0.05, we can conclude that there is significant difference between male and female in the context of consumer satisfaction with global brands.

**H5:** Do male and female as a consumer differ in the context of brand preference

Tab.10 Independent Samples Test										
		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	Df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
									Lower	Upper
GB P	Equal variances assumed	.068	.794	1.867	465	.062	.148	.079	-.008	.304
	Equal variances not assumed			1.873	386.915	.062	.148	.079	-.007	.304

Hypothesis number five as result that we got from the independent sample test explain us that that p –value is greater than alpha 0.05 ( $0.062 > 0.05$ ) we do not reject null hypotheses and we can conclude that there is no difference between male and female in the context of brand preference.

### Conclusions and Recommendations

From this research Based in the empirical results we can conclude that there is positive relationship between brand dimensions, brand feeling, brand attitude, consumer satisfaction for global brands and self image congruence as independent variable in our statistical analysis. As well, there is positive relationship between male and female toward satisfaction with global brands, expect in the context of brand preferences. So, consumers prefer and are satisfied with global brands, they feel and have positive attitude with them, as well as that express self image in from of consumers who buy local brands.

Due to the limitation of the paper we would like to give several recommendations in order this research to be important and clear for readers, students and managers. First of all, this study or result of this study might not be the same in the different countries; this study mainly is dedicated to the citizens in the Macedonia. Second, the four brand dimension that we have proposed like theoretical model in our case seem to be significant, on the other side this model is different in different scientific environment and quantitative analysis.

Third, this research could be good point for further research with more brand dimension in our country or to combine these dimensions in different environment. As well, this study provides an initial insight for brand managers to correctly identify which brand dimensions are appropriate for the consumer attitude.

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## MODELS OF HUMAN RESOURCES MANAGEMENT: CASE OF PUBLIC AND PRIVATE COMPANIES IN ELBASAN

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### **Abstract:**

*Current trends in practices and perceptions of human resource functions have changed, especially the dynamic and growing role that is expected to be performed by human resources managers. The High level position that HR Manager occupies in the organization and human resource department has a special importance in the organization's success. Human resource management is a basic organizational function, which gives an important contribution in achieving the objectives not only in business companies but also in other spheres of human activity. "The quality of human and intellectual capital owned by an organization is viewed as a key factor to differentiate them from rivals and achieving high qualitative results." (Armstrong and Brown 2001). It is important to everyone, especially for managers, to better understand these challenges, in order to increase chances of success through more effective responses. The current competitive business environment, has great expectations of the manager of strategic partner and model of the human resource manager is becoming more popular in American and European organizations. The purpose of this paper is to highlight the different patterns of the human resources management in general and in particular in public and private firms in the city of Elbasan. For realization of this study is using a methodology that consists of a combination of primary data with secondary ones. Results of this study are interesting and important for all human resource managers of firms operating in the city of Elbasan. The results of this study will help the work of human resource managers in albanian companies and other people interested in the field of human resource management. At the conclusion of this study verified that the model used for human resource management firms Elbasan is the traditional model.*

**Kew words:** management, human resources, public and private firms.

**JEL Classification:** M10.

Historically, the term "human resources" is defined into the workforce and is listed between the four main factors of production: land, labor, capital and labor costs. This treatment of employees like a source, like the financial or physical resources has its roots in the policies of employees during industrial revolution Human resource management came to as a result to the fact the organizations of employee required to work and produce more than rewarded (Appelbaum. E, Bailey. T, 2000).

The meaning of human resources changed over the years because it was expanded the concept of the organizations and employees began to be treated more like human beings and not as living material or organizational systems (Fisher, D. 1989). Human resources started be viewed as flexible and dynamic resources, so the organizations started looking different ways in order to motivate them to increase performance and this gave rise to growing research in the field of human resources and recently taken information sciences and psychology, economics and political economy. (Fisher, D. 1989). The concept of human resources is expanding from the term human resource management human resource development, which has to do with the support and skills that employee are given not only to realize their work, but also to prepare for growth their careers. Human resource management has passed through a long process to development until there reached the status that has won today, one of the most important functions of management in an organization (Koli.Z, Llaci.Sh, 2005). Human resource management is that part of the process management focused on human relationships and securing of their welfare in order they give the maximum contribution at work.

The Industrial Revolution led a growing business and increased their need for resources. The concept of the people like a valuable resource for the business evolved and won advantage. Using of the term "source" for the people was based on the fact that they assist in producing goods and services were available. In the nineteenth century, factories began to recruit large numbers of employees and hence it was necessary for a managerial function that deal with personnel management.

In this era of business development were noted improvements to efficiency and productivity production units. During this period with the increase of factories and the organizations start to develop theories money management. Because management was a a new area, the first that had contributed to entrepreneurs and company managers. Department of Human Resources was not considered like a special and not required anyspecial skill or knowledge. (Guest.D, 1987).

The organizations began to take special managers to preserve their industrial relations. Industrial relations have three aspects: building science, problem solving, and ethics (Kaufman, 2004). In the aspect of building the science, industrial relations is part of the social sciences and it seeks to understand the employment relationship and its principles through rigorous research and high quality. In this way, knowledge of industrial relations crossed with the knowledge in the field of labor economics, industrial sociology, history and social work, human resource management, political science, law, and other areas.

The purpose and value of the function of workers was debated and commented by many professors. It has always been open a debate about the necessity and the usefulness of traditional human resources department and the discussions have been on the question whether organizations should continue to have such departments within of their organization.

Many of these comments have been made by considering the human resource management like an art which does not require special knowledge or skill. This point of view of human resource office made the role of temporary staff manager into the organization concerning their contribution to company performance. Their work did not direct connection with the implementation of future profits and revenues can not be determined according to the welfare of employees.

Anyway the changes in the workplace became more dynamic and alive. The external business environment became more competitive and organizations began to consider the workforce like a competitive advantage. The management of people became more difficult because the people coming from the different cultures and have different mentalities.

In some industries this change was most apparent and in others not so much. Also, the change in the purpose and role of Personnel Manager has resulted from the vision of the organization as a whole and in accordance with the thinking of the process of owners and the main managers. Different researchers have proved to find models about what we should do the personnel manager in the organization, who is his objective and where he stands in linear connection with managers and other departments like the marketing, research, etc..

Relying on the research literature on different models of human resource management, the following pages we will show us some of these models and show us how much has been integrity our day. Below are the first models of various different authors who will subsequently help us to prove the model that use the firms in the city of Elbasan.

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Here are some important model of HRM:

Professional model of the personnel manager (Watson 1977), Conduct descriptive model of Legge (1978), Mahoney & Deckop Model (1986), Tyson and Fell Model, etc.

- **Monks Model (1992) this model is quite similar to Tyson and Fell's model.**
- Monks shares 4 models in the practices of HRM.

1. Traditional / Administrative (check daily results, resolve conflicts based on the procedures and policies)
2. Traditional / industrial relations ( traditional model but resolves conflicts and act as an intermediary)
3. Innovative / professional (HRM professional and expert), adviser in company's affairs)
4. Innovative / sophisticated (HRM visionary the highest level, member of the managing staf)

The main purpose of this paper is to identify the model used in realising HRM function and the importance that managers give to this function degrading simultaneously which is model more commonly used.

Another important purpose will be the disclosure of managers' attitudes towards the necessity of a model that relates to the strategic aspect of human resource management.

We want to conclude that the most common model used in Albanian organizations and in Elbasan companies is expected to be the traditional /administrative model (concerning Monks model).

And the conclusion of this paper we can conclude that :

- Human resource management is a basic organizational function, which gives an important contribution in achieving the objectives not only in business companies but also in other spheres of human activity. "The quality of human and intellectual capital owned by an organization is viewed as a key factor to differentiate them from rivals and achieving high qualitative results. "(Armstrong and Brown 2001)
- Most of the interviewed companies private and public in Elbasan region prefer the traditional model (46.4% in the private and public sector 40%) according to Monks (1992).
- There are cases of using other models in human resource management as the model which focuses more on handling or mediating conflicts and solve problems, etc..
- Current trends in practices and perceptions of human resource functions have changed, especially the dynamic and growing role that is expected to be performed by human resources managers . The High level position that HR Manager occupies in the organization and human resource department has a special importance in the organization's success.
- Companies in which is evident the implementation of a different model of human resource management are: ECF and Kurum. They show the use of a high quality and a positive attitude to the need of a strategic aspect in HRM.
- Another very important conclusion remains the fact that general managers of these organizations and of human resources capacity building and development of employees as challenges for the future.
- Training human resource managers and general managers of the organization is a very important challenge and a key factor for further development of these organizations and also for better functioning of the human resources department.

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## KNOWLEDGE MANAGEMENT AND COST BENEFIT ANALYSIS OF CREATING HUMAN CAPITAL

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### **Abstract:**

*The most traditional economic literature on growth and growth factors, relied on production functions, is based on using capital and labor as inputs. Human capital has always been considered as external factor and its impact on production has always been questioned. Recent approaches in economic literature are introducing human capital and knowledge as a specific input to growth and there is much talk of knowledge economy, based on human capital and key role of human capital in generating economic growth. Investment in human capital led to increased productive capacity of other factors of production and can also change these factors into new products and operations. Traditional economic aspects, such as labour and materials, are still important, but now it is crucial to be able to add value to products and services through knowledge. This points that knowledge and investing in human capital is one of the main factors for increasing returns and long term economic growth. The basic goal of processes for creating national human capital is the improvement of the quality of population, which leads to the improvement of the productive capacity of the society and national economy. Human capital creation represents a certain form of investment in which every investor expects a certain degree of return of the investment (ROI). When investing into human capital, two basic aspects arise: income and cost. In this paper we will try to apply the methodology of cost-benefit analysis. Based on this analysis we will discuss the necessity of financing, investing, improving and optimizing human capital as a key element to successful organizational growth.*

**Key words:** Human capital, knowledge, knowledge economy, economic growth, national human capital, income, cost, cost-benefit analysis, organizational growth.

**JEL Classification:** M10.

### **1. COST- BENEFIT ANALYSIS OF CREATING HUMAN CAPITAL**

#### **1.1. Benefit analysis of creating human capital**

The basic goal of processes when forming human capital in terms of national economy is the improvement of the quality of the population. This leads to improvement of the social productive capabilities and the economy. The forming of the human capital is a form of investment realized through educational system. This is why every investor, who invests in forming of human capital, expects certain return from the investment. The return on investment can occur in non-cash or cash form. On the other hand, in order for this investment to be realized, certain expenditures need to be made. From the point of view of these two basic aspects for forming of human capital, the analysis of this topic will focus on classic and known methodology, that is, cost-benefit analysis.

By using this analysis, we will be able to explain the necessity from financing the processes through which a human capital and the development of human resources are created, but also to look ways on how to improve these same processes. The best way to determine the return of the investments, from forming of human capital, is detecting the benefits of that same way. The benefit represents all of that which leads to increasing the function of the benefit of the society. Here we can include:

- All of that which increases the manufacturing capabilities
- All of that which reduces the need of covering the expenditures and releases resources for alternative use
- All of that which leads to general satisfaction, development of social spirit, and etc.

There are different forms in which benefits are shown from forming of the human capital through education. Although there is large number of researches in the area of benefits and usage of education, many scientists and specialists are encouraging the usage of Weisbrod classification of systematization of the gains and benefits that are generated from forming the human capital through education and educational process. From here, the gains and benefits from forming the human capital through education can occur in these forms:

- Individual and financial gains – that are connected with the training of one given person and can express the opportunity for bigger profit, that is, bigger personal income.
- Option for financial return of the investment – occurs as a gain from the opportunity of the individual to acquire bigger educational classification. The value of the option is determined from the probability of the usage of the same and the expected return of the investment, if the option is used.
- Non – cash alternative benefits – include open capabilities for choosing the working place, career, interests that are appropriated for the level of education
- Opportunity of hedge – that is, the protection from the changes that happen from aspect of technological development. Because of this, education can be considered as form of individual protection against the changes in the search of skills that are gained from technological development. This is because new technologies demand new knowledge and this makes the adaptability of the human capital one of the most important factors for the development of economic growth.
- Non – market benefits – are the result of the development of capabilities, knowledge and skills of the individual and which enable the realization of activities.
- Benefits that are connected with the executive profession and job – these benefits can be noticed from the influence of the educated and qualified individuals who have in overall performance of their colleagues in cases when the manufacturing process requires team work. This reflects on the effectiveness and efficacy of the company and from this we can determine that education is the reason for these benefits.
- Benefits that are connected with the place of residence – these benefits are connected with the family, environment where we live, neighbors and etc.
- General gains of the society – literacy and education of the citizens and resources for the realization of economic growth.

From the forms mentioned above, it is evidently that gains are generated not only from individuals, that is, not only from those who own the human capital but also by the social benefits and benefits of the companies. According to this, benefits can be categorized as following:

- Individual gains from forming the human capital through education
- General gains from forming the human capital
- Gains of the companies encashed directly from companies (employers)

Despite the merits of the classification of Waybord, still not all forms for gains from education are presented. But, this classification represents excellent basic for analytical research of nature, genesis and distribution of positive externals generated from forming of human capital.

As a result of this, researches arise under which human capital is formed through education:

- It increases the satisfaction of the free time
- It allows the cover up of the original expenditures of education

With regards to the first mentioned, it can be concluded that the rational individual will always work towards maximizing of the function of the gain and this includes the gain of the free time.

$$U_{(t)} = U[x_{(t)}, HK_{(t)}, F_{(t)}; R_{(t)}, \mu_{(t)}]$$

Where at:

X – Represents the sum of the collective goods

F –represents the free time

HK – represents the human capital

R – Individual characteristics

U – Unrealized factors which affect the behavior of labor supply

Opportunities for maximization of benefits is not unlimited because the income that can be earned by a higher level of education is not only limited to the amount, but also by time. Also, the human capital is subjected to amortization which reduces the same. The cause for amortization can be the following:

- New knowledge and the continuous development of that same knowledge
- The degree of the forgetting the previously learned knowledge in the process of forming the human capital.

In regards of the second, the human capital, whose individual own and have acquired through education, appears as a generator of income which allow the coverage of prep resources that are spent, that is, expenditures. This is so because the individual's labor market is expressed as:

$$W_{(t)} = RHK_{(t)} HK_{(t)}$$

Where at:

W – Represents the personal income i.e. paycheck

RHK – represents the money value to the unit of human capital

In other words, within the labor market, wages can be expressed as a proportional dependence between the individual's owned amount of human capital and the market value of unit of human capital.

This proportional dependence can still say that there is much criticism in the scientific community. Alternatively to this, J. Mintzer develops and suggests the following thesis of function of income:

$$Y = \acute{a}_0 + \acute{a}_1s + \acute{a}_2e^2 + u$$

$$(\acute{a}_1 > 0, \acute{a}_2 > 0, \acute{a}_3 < 0)$$

Where:

Y – represents income

s – represents years spent in education

e – represents work experience in years

u – correction factor

The elaboration of the function of income of J.Mintzer is based on the empirical determined direct link between the level of education and income. In other words, the individuals with bigger education in practice are carriers to a bigger human capital and thus they have more income. The first attempts at development and elaboration of the modern aspects of the concept of human capital, realized by U.S. scientists G.Beker, T.Shulc, by using empirical data that is derived from income of individuals working in American companies, have established a direct relationship between the size of individual income and a level of education that an individual possesses. Through these elaborations they succeed in measuring and comparing the direct financial gains from investments when forming human capital and the expenditure for financing in education.

Also, some international comparative research, in terms of the percentage of return on investment in human capital formation, show that in most cases the percentage of individual return on investment is higher than the percentage of social return on them. It should be emphasized that these studies consider only the benefits of this process that can be financially measured. But, according to the logic of public finance, individual incomes have gross and net value, so the value of the difference is caused by items progressive income tax.

Based on this, it can be said that the resulting higher income from education will lead to greater fiscal benefits from taxation of income and also from consumption. Fiscal gains from taxation of consumption are also an important source of income, because most income is associated with a higher living standard which logically leads to consumption of more and more expensive goods and services.

According to this, it can be said that there is a ground basis and cause to the already existing classification of forms in which the gains of forming human capitals appear. Here we can also include the category – public financial gains, gained from financial path like the progressive taxation as well as the proportional consumer taxation.

In order to determine the money value to the general financial gains, we can assume that the income ( $I_{(D)}$ ), which is generated by performing activities that require higher education is greater than the income ( $I_{(A)}$ ) by performing the appropriate activities that require only secondary c(è) where è is with value bigger than zero

$$I_{(D)} = \text{è} I_{(A)}$$

Also, if we mark the index of progressivity of the tax of income with p, and the income tax on labor position that requires high school is marked by  $TI_{(A)}$ . In such circumstances, the fiscal return on investment from individual taxation  $RFI_{(D)}$  of the increased income from higher education will be expressed as:

$$RFI_{(D)} = \text{ñè} TI_{(A)} - TI_{(A)}$$

Or:

$$RFI_{(D)} = (\text{ñè} - 1) TI_{(A)}$$

From here, it follows that the percent of the fiscal returns of the investments  $RFI_{(D)}$  when forming human capital from the tax of income, can be expressed as:

$$RRFI_{(D)} =$$

or:

$$RRFI_{(D)} = (\text{ñè} - 1)$$

As a result of increased income, due to a higher level of education, which is then followed by raising the standard of living, logically follows a fiscal return of the investment from consumption of expensive goods and services. Hence, if  $\text{TC}_{(A)}$  is the index of increased consumption by increased income from education, then  $TC_{(A)}$  would be a tax paid by individuals without educational level, ie individuals with lower incomes. Under these conditions, the absolute value of the annual fiscal return of investment from taxation increased spending on a given worker ie individual with higher education, will be presented as the following way:

$$RFC_{(D)} = TC_{(A)} - TC_{(A)}$$

or:

$$RFC_{(D)} = (-1)TC_{(A)}$$

From  $RFC_{(D)}$  analogous to  $(RRFI_{(D)})$ , the index of fiscal return of investment  $RRFC_{(D)}$  of investment to create human capital by the tax on consumption, can be expressed as following way:

$$RRFC_{(D)} =$$

or:

$$RRFC_{(D)} = (-1)$$

Based on percentage of fiscal return of investment in the taxation of personal incomes  $RRFI_{(D)}$  and consumption  $RRFC_{(D)}$ , we come to the following general formula for determining the percentage  $SRRFI\&C_{(D)}$  of the social return of investment in creating human capital:

$$SRRFI \& C_{(D)} = (\tilde{n} \tilde{\epsilon} - 1) + (\tilde{\epsilon} - 1)$$

where:

SRRFI &  $C_{(D)}$  - the percentage of social return on investment by creating human capital, granted through fiscal methods and instruments;

$\tilde{n}$  – the index of progressivity of the income tax;

$\tilde{\epsilon}$  – the index increased income resulting from higher education;

– the Index of increased value consumption caused by the rising level of education.

In addition to this, if we compare individual monetary return of investment with social monetary return of investment by creating human capital, we can conclude that the end point to which it is possible fiscal return of investment in terms of consumption, is the length of life of the individual. On the other hand, the ultimate moment for the fiscal return of investment in terms of personal income taxes, is an active duty period of the individual.

To some extent, companies (employers) occur as lessee i.e. tenants of human capital so, without educated and skilled workforce they will not be able to create and organize a rational cost-effective business process. Thus, many studies suggest that companies (employers) pay their employees the equivalent of marginal product produced by themselves.

There are also studies that emphasize non-monetary social benefits from the formation of human capital include:

- establish an effective mechanism to detect and develop potential talents;
- creating a professional and flexible workforce;
- creating conditions at the institutions that stimulate scientific and technological research;
- tends to increase political stability by developing an informed electorate;
- expansion of intellectual views of citizens, etc..

All these forms of indirect positive social externalities of education is difficult even impossible to be determined and measured.

### **Analysis of expenditure in creating human capital**

A number of benefits ie positive externalities generated in creating human capital, resulting from the previously realized investments. In other words, the process of creating human capital is the process of spending resources that require significantly large social, individual and financial resources of firms.

Because of this, the research expenditure to finance processes for creating human capital, requires the application of two different approaches:

- individual;
- institutional.

From an individual perspective, the creation of human capital, achieved through the mechanisms of the educational system bears certain expenditure for the successful completion of higher education. The total cost of education  $C_{BSc, i, j}$  of individual  $i$  at age  $j$  can be presented as a set of:

- Cash costs  $C_{BSc(m), i}$  including: university fees, cost of books, housing expenditure ie wages, transport costs etc..
- Alternative cost  $C_{BSc(o), i}$ , or the cost of opportunities in ie missed benefits. Usually, the income is measured and represents which individual would have received, if instead of education, that same time can be used for work that would receive adequate income ie salary.

If we assume that the time for completion of high school is exactly 4 years, it will form the individual capitalized cost  $C_{BSc, 4}$  at the time of graduation equal to:

$$C_{BSc,4} = (C_{BSc(M),i,j} + C_{BSc(O),i,j}) (1+i)^{5-j}$$

where  $i$  is the market interest rate.

The concept of the alternative cost of the basis and logic, form a significant part of the total cost of education for a particular individual, i.e. the cost of creating human capital unit with a high level of education, is quite simple: the value of the overall resources is measured by the next best alternative for their use. For individuals, the alternative of higher education and continuing education is entering in the labor market. Because of this, the alternative cost is represent via function of increasing the income, obtained by the inclusion in the labor market i.e. starting with work after turning age 18 i.e. when the individual became a holder of a temporary human capital. As an alternative to society in general, the missed income from students represent lost production of society. It should be noted that the accuracy of this relationship is valid only in conditions of full employment and the absence of a duty to perform military service.

In terms of institutions, the cost of creating human capital affects the costs for support and development of educational system. These expenditures figured as appropriate elements of the state budget and have a character of social investment in the creation of national human capital. At the same time, as a source of income for the collection of resources for such investment occurs corporate taxation. Thus, we can say that through the mechanisms of the financial system of a country it is possible to include the companies in the process of creating a national human capital. How important expenditure from institutional aspect can be specified the following:

- The Direct Budgetary expenditures include:
  - Fixed University charges relating to: capital budget expenditures for construction, reconstruction, libraries etc..
  - Variables university expenditures relating to: salaries of university staff, funding of research, office supplies etc..
- The Alternative indirect expenditures include:
  - The possibility of alternative use of limited public funds which otherwise be spent on direct expenditure in education;
  - The ability for maximizing the quality of the educational product i.e. graduates.

While exploring the expenditures needed to create human capital, it should be noted the possibility to cover part of the expenditure by the higher education institution. Covering a part of the expenditure will be financed by the school fees that students pay.

At the same time, we should have in mind that with the start-up in the companies, those who have higher education, and not only those, they did not use the full potential that they have. Due to this fact, it takes time, adaptation and integration in the new environment and organizational working processes.

### **Knowledge management and Knowledge management system**

In recent years we are witnessing how countries of the developed world are shifting from stage of industrial era to stage of what is referred to as post-industrial era or knowledge based economy. In knowledge based economy productivity and economic growth are generally determined by the rate of technological development and accumulation of knowledge. Nowadays, recent approaches in economic literature are introducing knowledge as a specific input to growth and there is a much talk of knowledge economy and key role of knowledge in generating economic growth.

Investment in knowledge can lead to increased productive capacity of the other factors of production and can also change these factors into new products and operations. Human capital, intellectual capital, knowledge and skills are increasingly recognized as vital constituents of future economy and the key elements to successful organizational growth. Executives in large organizations know that they must develop better techniques to manage knowledge. They examine how they can better manage their human capital.

Knowledge management is a continuous management process. That helps organizations to identify and quantify the value of human capital which is available, to plan, organize, manage and control the relevant information and experiences complemented by education, representing memory code of any organization.

Generally, knowledge management is:

- Using the available knowledge from the external environment
- Installation and storage of knowledge in business processes, products and services
- Storing knowledge in databases and documents
- Promotion of increased knowledge through organizational culture and employee motivation
- Transfer and use of knowledge across the organization.
- Assessment of the benefits received from the application of knowledge and its incorporation into the base of the organization.

For an organization to be successful, it needs to use knowledge as the most important resource that can not be easily replicated by rivals that represent source of uniqueness and competitive advantage. One of the key goals of knowledge management is to keep the experience, knowledge and information, which can quickly and easily leave the organization.

The question is, why it is needed a knowledge management system?

“A Knowledge Management system is one that connects to all sources of knowledge.”



Knowledge Management Systems (KMS) are technologies that support Knowledge Management (KM) in organizations, specifically - knowledge generation, codification and transfer. These activities can be explained in a comprehensive theory about organizational knowledge creation based on interactions between tacit (highly personal) and explicit (formalized) knowledge. The process begins with the enhancement of an individual's tacit knowledge through hands-on experience, supporting the generation of knowledge. Socialization then follows, involving the transfer and sharing of tacit knowledge between individuals. Dialogues allow the conceptualization of the tacit knowledge and trigger externalization, the transformation of knowledge from tacit to explicit. Finally, the knowledge is combined with existing knowledge and internalized (codified).

The basic idea of creating a knowledge management system is the system users to have a ready access to the necessary information which is documented in the database, to its source, and possible solutions - if there is a problem. Making all this information available, the organization significantly would save time, money, duplication of work and making it difficult to use this information in the future. A knowledge management system is an information management system with all the tools required to help to turn information into knowledge.

The establishment of knowledge management system is simple, but it's a long-term project. When establishing the system, first you need to do is to identify what knowledge is, where it is located and to which should be distributed. Next you need to do is embed a feedback mechanism. It will show how to use the system and the problems that can arise when using it. Then comes the architecture of the system. In a sustainable knowledge management system, there should be a place where you store the knowledge, knowledge inputs, system evaluation and use, as well as a book with knowledge and content management. This step also includes the integration of existing information systems in the organization.

Lastly, comes the development of knowledge management system. Knowledge management systems are developed through the use of several types of technologies: Intranets, information retrieval engines, Groupware and workflow system, help-desk applications, brainstorming applications, data warehouse and data mining tools...

Creating a knowledge management system is not a simple task. However, the benefits of a well-designed system are immense:

**Awareness** —Everyone knows where to go to find the organizations knowledge, saving people time and effort.

**Accessibility** - All individuals can use the organizations' combined knowledge and experience in the context of their own roles

**Availability** - Knowledge is usable whenever it is needed whether from the home office, on the road or at the customer side.

This results in increased responsiveness to customers, partners and coworkers.

**Timeliness**—Knowledge is available whenever it is needed, eliminating time-wasting for distribution of information, just in case people are interested.

To see what is the situation in public institutions in our country, in terms of awareness of knowledge management and the introduction of a knowledge management system, we created a questionnaire and it was conducted among 30 respondents in a public health institution.

## **Research**

### **Subject and goal of the research**

The subject of research is the state of knowledge management in public health and the need to introduce an appropriate information system for knowledge management.

The goal of the research is to determine if there is knowledge management in state, ie public health institutions, how it applies, if there are information systems for the collection and sharing of specific knowledge and skills. Thus, a higher organizational efficiency, reduction of costs and improvement of decision making, will be achieved

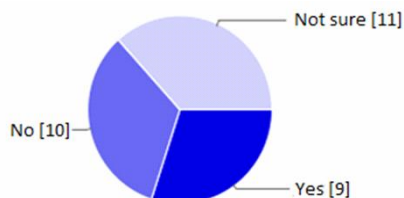
### Research Method

The research was done on a total of 30 respondents using a questionnaire. The respondents are part of the health administration and public health doctors. The questionnaire is anonymous and it consists of 10 questions which corresponds to only one of the three answers (Yes, No, and I'm not sure).

### 3. Results from the research

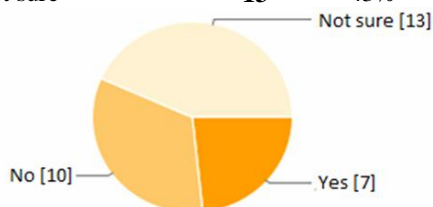
- Are you familiar with the concept of "knowledge management"?

Yes	<b>9</b>	30%
No	<b>10</b>	33%
I'm not sure	<b>11</b>	37%



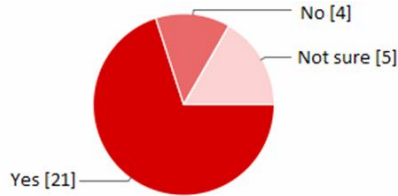
- Does your organization documents information of excellent executed procedure / practice?

Yes	<b>7</b>	23%
No	<b>10</b>	33%
I'm not sure	<b>13</b>	43%



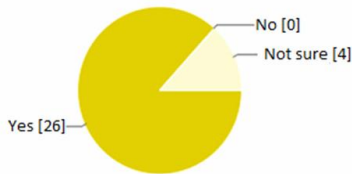
- Does your organization use operating systems or models which enable the transfer of information between employees who work with patients and managers ?

Yes	<b>21</b>	70%
No	<b>4</b>	13%
I'm not sure	<b>5</b>	17%



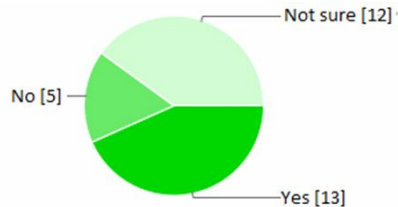
- Does your organization use operating systems or models which enable the transfer of information between the organization and relevant institutions which create health policy?

Yes	<b>26</b>	87%
No	<b>0</b>	0%
I'm not sure	<b>4</b>	13%

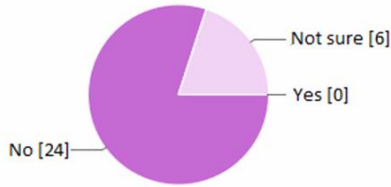


- Are there any formal procedures that ensure the dissemination of knowledge and learning by staff who attended seminars, congresses, working on projects, etc..?

Yes	<b>13</b>	43%
No	<b>5</b>	17%
I'm not sure	<b>12</b>	40%



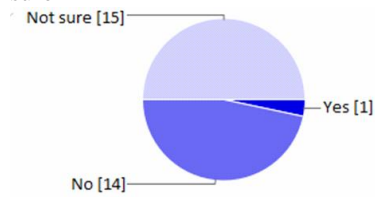
- Does your organization develop an expert systems for the collection and dissemination of specific knowledge and skills that contributed to better decision making?



Yes	<b>0</b>	0%
No	<b>24</b>	80%
I'm not sure	<b>6</b>	20%

- Do you know the meaning of "implicit" and "explicit" knowledge?

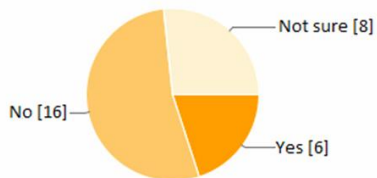
Yes	<b>1</b>	3%
No	<b>14</b>	47%
I'm not sure	<b>15</b>	50%



- In your organization do most of the information / documents that circulate in the same, are in an electronic form?

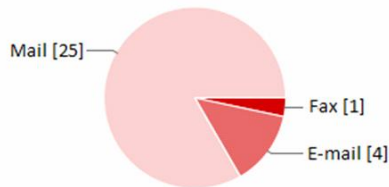
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Yes	<b>6</b>	20%
No	<b>16</b>	53%
I'm not sure	<b>8</b>	27%

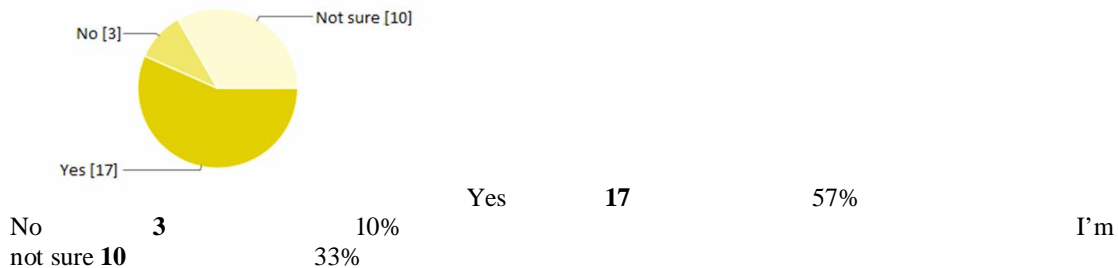


- Which of the following ways are the most used to send information / documents to other organizations / institutions?

Fax	<b>1</b>	3%
E-mail	<b>4</b>	13%
Mail	<b>25</b>	83%



- Do you think that the introduction of knowledge management systems or models would contribute to higher organizational effectiveness?



If we analyze carefully the calculated values of all the questions, you will see that most of them have been answered with **No**, and **I'm not sure**, but a small percentage of them have been answered with **Yes**. From this, we can conclude that employees in our public health institutions are not familiar and do not apply the knowledge management. The research results indicate that in our public health institutions have not developed information systems for the collection and dissemination of specific knowledge and skills that would contribute to better decision making. Very important thing is the information that most of the employees in public health are still using outdated methods ie mail for sending information and documents to the other institutions, thus wasting time, money, duplicate work and make it difficult their use in the future. The opinion of the majority of employees in the public health institutions for the introduction of information systems knowledge management is positive. They believe that the introduction of these systems would contribute to higher organizational effectiveness.

As a response to the situation that exists in our organizations, we need to introduce more lectures, trainings and seminars that would contribute to public health employees to gain certain knowledge to be trained for implementation of knowledge management. It is necessary to create a knowledge management system which will realize the following benefits:

- reduce the loss of human capital,
- reduce the cost caused by duplication of work when the institution needs to solve the same problem,
- Achieving economies of scale in obtaining information from external suppliers.

- Reducing unnecessary activities on the basis of knowledge,
- increased productivity so that the knowledge will be faster and more easily available,
- increase employee satisfaction with the opportunity for personal development and advancement.

### **Conclusions.**

The forming of the human capital is a form of investment realized through educational system. This is why every investor, who invests in forming of human capital, expects certain return from the investment. In order for this investment to be realized, certain expenditures need to be made. By using cost-benefit analysis, we explain the necessity from financing the processes through which a human capital and the development of human resources are created, but also to look ways on how to improve these same processes.

Human capital, intellectual capital, knowledge and skills are increasingly recognized as vital constituents of future economy and the key elements to successful organizational growth. Executives in large organizations know that they must develop a system in order to manage knowledge. Knowledge Management Systems (KMS) are technologies that support knowledge management in organizations, specifically - knowledge generation, codification and transfer . The basic idea of creating a knowledge management system is the system users to have a ready access to the necessary information which is documented in the database, to its source, and possible solutions - if there is a problem. Making all this information available, the organization significantly would save time, money, duplication of work and making it difficult to use this information in the future.

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## CHALLENGES OF PPP PROGRAMMES

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### *Abstract*

*Over the last decade or so, private sector financing through public – private partnerships ( PPP) has become increasingly popular as a way of procuring and maintaining public-sector infrastructure, in such sectors as transportations ( road, bridges, tunnels, railways, ports, airports), social infrastructure (hospitals, schools, prisons, social housing), public utilities ( water supply, waste water treatment, waste disposal), government office and other accommodation, and other specialized services ( such as communications networks or defence equipment ). Many countries are developing PPP programmes. In this paper we will try to consider some of the general requirements for developing a PPP programme, and its legal framework. Method used for the considering the general requirements in developing PPP programme and its legal framework, is the reviewing of PPP activity in a representative selections of countries:*

- *United Kingdom*
- *United States*
- *Australia*
- *France*
- *Korea*
- *Spain*
- *South Africa*
- *Portugal*
- *Italy*
- *Hungary*

*In Albania are given concessions ( a form of PPP ) only in the field of water power, electricity centrals in a value of 5 milliard Euro, but there are not yet developed such PPP programmes for the other fields of infrastructure. But Albania is in the right way of taking the candidacy of the European Community member. In this point of view, having those experiences, standards and limitations of such EU institutions as the International financial reporting standards (IFRS), EU legal framework for PPP, will be very helpful for the Albanian Public Authorities to understand the problems and challenges that are to be faced in developing PPP programmes.*

**Key words :** *Public – Private Partnership, PFI Model, Value for Money, Affordability, balance sheet treatment, Economic Justification.*

**JEL Classification:** *M11.*

### **Introduction**

Over the last decade or so, private-sector financing through public-private partnerships (PPP) has become increasingly popular as a way of procuring an maintaining public-sector infrastructure in sector as transportation ( roads, bridges, tunnels, railways, ports, airports), social infrastructure (hospitals, schools, prisons, social housing ), public utilities ( water supply, waste water treatment, waste disposal ), government office and other accommodation, and other special services ( such as communications network or defence equipment ).

Structuring PPP is complex because of the need to reconcile the aims of the large number of parties involved – on the private sector there are investors, lenders and companies providing construction and operational services; on the public sector side there are public authorities creating and implementing PPP policies as well as those procuring the PPP, nor forgetting the general public who use the facilities that a PPP provides. Most of these parts need to have a basic understanding of policies and finance issues, and how their part of the project is linked to and affected by them.

But in this paper reviews only one side, public sector in the way how the Public Authority decides to invest in the new public infrastructure, and whether doing so via a PPP is the right approach. There are various measures which a Public Authority may use to determine if an investment in new public infrastructure is economically justifiable. These measures do not themselves point in the directions of either public sector procurement or a PPP. Additional factors need to be taken into account to make this decision:

- Value for money ( VFM )
- Affordability
- Balance – sheet treatment

Of course since the demand for funding for public-sector projects is almost infinite, and resources are limited ( even with the help of a PPP programme ), the decision to proceed with a project is based on other factors beside the financial measures set out here.

## 1. ECONOMIC JUSTIFICATION

When deciding if an investment is economically justifiable, a Public Authority:

- identifies the benefits and costs of the project, including its indirect affects;
- prepares a cost – benefits analysis, a key element of which is the discount rate to be applied to future benefits and costs;
- or calculates the economics return of the project

### 1.1 Externalities

Apart from the single long-term financial benefits from a new facility compared to continuing the existing one ( e.g. on maintaining costs, or because the new facility replaces several older ones ), or other benefits which can be priced ( e.g. the saving on driving time from a new road ), an initial evaluation of a public sector project also has to take account of ( and place evaluation on ) its wider economic or social benefits or costs ( ‘externalities’, also known as ‘external economies or diseconomies’ ). Externalities, which will be positive where they provide a benefit and negative where there is a cost, may include :

- economic development – e.g. increases in land values and general economic activity;
- effects on safety or public health – e.g. reductions in accidents deaths once a new road has been built;
- environmental impact – e.g. increases or decreases in noise or air pollution

It is worth noting that externalities cannot easily be included in the cost paid by Concession users, which is why there is a case for public sector subsidy in such cases. Within the European Union, any such support is only allowed if it does not constitute ‘State Aid’ ( other than certain specific exceptions, such as support for underdeveloped regions, or to promote a major project of common European interest ). If it is found to constitute State Aid any subsidies must be refunded, and the enforceability of guarantees may be uncertain. The European Commission reviewed State Aid for PPP in the context of the London Underground PPP in 2002. The general conclusion, which illustrates the principles that the public sector should pay for externalities, was that “ ... when these types of infrastructure arrangements are concluded after the observance of an open, transparent and non-discriminatory ( procurement ) procedure, it is, in principle, presumed that the level of any public sector support can be regarded as representing the market price for the execution of a project. This conclusion should lead to the assumption that, in principle, no State Aid is involved.



## 1.2 Cost – Benefit Analysis

The benefits and the net externalities should be compared with the facility's costs; funding of these costs – whether from taxation, public sector borrowing or a PPP – is irrelevant in this context, since economic benefits should be independent of this. The Public Authority has to use either a DCF or an IRR calculation for this purpose, to allow for the different timing of these costs and benefits. Using a DCF calculation, the benefits of a public sector project can be assessed as:

- the NPV of project benefits, plus
- the NPV of positive externalities

and the costs can be assessed as :

- the NPV of project costs, plus
- the NPV of negative externalities

The NPV of these figures is calculated using the public sector discount rate ( PSDR ), discussed below. As with any investment, if the total NPV is positive the investment can be justified. However, the difficulty with a simple DCF approach is that if a choice of projects is being evaluated, the more expensive projects may be favoured by the DCF approach, and therefore a cost – benefit analysis is needed. If benefits cannot easily be measured, which may be the case with social infrastructure, then costs alone of different solutions would have to be compared – this is known as a 'costs – effectiveness analysis'.

There is a further issue with using DCF calculations to make public sector investment decisions – the effect of discounting costs a long way in the future ( e.g. the costs of repurchasing land ). If say, a project involves a cost for the public sector of 1.000.000 USD in 30 years time, discounting this at 6% gives a cost in today's terms of 174.110 USD, which may be considered small in relation to the NPV of the project as a whole. But in the 30 years' time the 1.000.000 USD will still to be found, unless 174.000 USD is set aside today and saved up with interest for 30 years, which does not happen. Thus the generation of today places an undervalued burden on the future by using a DCF calculation to make investment decisions where there are large-scale costs towards the end of the project. Moreover the higher the discount rate the more the effect of such costs is disregarded.

## 1.3 Public Sector Discount Rate

The question of what rate should be taken as the PSDR is difficult to resolve, and the approach varies widely from country to country. It is important not to make the discount rate too high, as the effect of this may be to undervalue benefits which may only be available some considerable time in the future and hence to discourage long term thinking in public sector investments. A public sector investment typically involves an initial negative investment cost followed by years of benefits – hence the lower the PSDR the more attractive the investment will seem. There is surprisingly little international consensus on how to determine the PSDR.

One approach is to use a public sector 'risk free' rate, and then add an adjustment to this rate to reflect project risk, which can be done through:

- a generic risk adjustment to the rate for all public sector projects ( typically used where no comparison has to be made with private sector projects ); or
- a standard risk adjustments to the rate for all projects in a particular sector ( as in Norway ) – thus for a road project which high risk of construction-cost overruns and uncertainty of long – term usage requirements, a high PSDR would be used; or
- a rate adjustment for a project which reflect its particular risk ( e.g. as in Ireland and the Netherland ).

The argument for a generic PSDR is that the public sector is spreading risk over many projects, so it is the average risk rather than worst-case or project-risk which has to be taken into account.

However this means that high risk projects, which should be less favoured than low risk projects, will in fact be treated the same way. There is a strong case for accepting that there is no 'right' answer to the level of the PSDR, and therefore the best thing to do is to use a range of different discount rates, and see whether an overall pattern emerges from doing so.

But there is also a problem with any discount rate, as construction costs occur early on, so even using a high discount rate will not adjust these by very much to reflect the risk of cost overruns. Therefore an alternative approach is to use the risk-free rate for all public sector investments, but adjust the projected outcomes which are being discounted to reflect risk – thus in the road case, the project cost, operating expenses and usage projections would be adjusted to reflect the risk that the outcome would not be as projected. As projections of cost and benefits are uncertain, it again makes sense to use a range of different risk scenarios when discounting at the risk-free rate, and make a judgment from this spectrum of results. There may be some merit in using a risk-adjusted rate and a risk-free rate with separate risk adjustments to see if they come up with different answers, and if so why, but this is not generally done.

Studies were carried out in Britain in 2002 and 2004 to try to establish a reasonable range of 'optimism bias' as a basis for adjusting projected public sector project outcomes for risk – the risk that the public sector is usually over-optimistic about outcomes, and thus there are substantial cost overruns compared to the original projections. ( One reason for this 'optimism', other than poor project management skills, is that when public sector investment is constrained, public officials – whose careers benefit from completing projects, and are not necessarily penalized if project costs overrun – have an incentive to understand likely costs to get their projects approved. ) The wide range of results – reflected in the British Treasury's current allowable ranges for optimism bias on capex for new ( standard construction ) buildings of between 2% and 24%, and for roads of between 15% and 32% - illustrates how much uncertainty there is in this area. ( Such figures do not of course take into account the possibility of the Public Authority eliminating cost overruns via a turnkey D&B Contract instead of the conventional design-bid-build approach to public sector procurement ).

A further issue needs considerations here – what is the 'risk-free' rate which should be used as a base for any of these calculations? There are several answers to this, each of which is used in various countries:

- the current market rate for government bonds ( as in Albania, Ireland, the Netherlands and the United States ); or
- a fixed rate based on the historical average for government bonds; or
- the 'social time preference rate' ( STPR ), the rate which private investors expect to receive for foregoing present consumption in favour of future consumption ( assuming this is a risk-free transaction ).

The STPR and the long – term historical average government bond rate should be similar, but the problem with using either a fixed historical rate or a fixed STPR is that these may get seriously out of line with current market rates, which distorts the results, especially where market-base financing comes into the picture as it does with PPP-s. Again there is little international consensus on the correct approach here. Thus in the United Kingdom the risk-free PSDR was reduced from 6% real (without including the effect of inflation) to 3.5% in 2003, which was the government's calculation of the STPR. Since that time interest rates have dropped considerably and even the 3.5% real rate is currently well over the returns investors expect for a risk-free investment, and the government's own cost of borrowing.

The arbitrary nature of a fixed PSDR is illustrated by changes made by Norwegian government in 2005. Until then, the PSDR was 3.5% plus a sector based risk mark-up in the range 0.5% - 4.5%. The level 4.5% was applied to road projects, considered to represent a high risk, making a total discount rate of 8%. Sweden, on the other hand, used a total rate of 3%. This meant that a particular bridge between Sweden and Norway was economically justified for Sweden but not for Norway, even though most of its users were Norwegian. In 2005 Norway changed the PSDR to 2% plus a general risk-mark-up of 2%. An Article on this change in Nord Road and Transport Research was entitled ( presumably with tongue in cheek ) ' Norwegian Road Projects are now Profitable – the Government Reduces the Discount Rate'.

#### 1.4 Economic Rate of Return

The alternative to a DCF-based calculation is to use the “economic rate of return”(ERR), an IRR calculation which uses the same economic data. This may be contrasted with the ‘financial rate of return’ (FIRR), the direct cash flow return from the project. In the ERR calculation, the investment has to pass an IRR hurdle rate similar to the PSDR to be justifiable. But again as has been above, an IRR calculation has its defects in this respect-in particular the undervaluation of benefits receive in the long term. This measure too must therefore be treated with care, and ideally adjusted by changing the reinvestment rate to the PSDR via a MIRR calculation to better reflect reality. Moreover choosing the hurdle rate and dealing with risk adjustment is as difficult as doing so with a DCF calculation.

## 2. VALUE FOR MONEY AND THE PUBLIC –SECTOR COMPARATOR

Having decided that a new Facility is economically justified , how can a Public Authority decide whether the PPP route is the right one? This question has two aspects :

- Does a PPP offer good VfM compared to public sector procurement?
- Is this project being procured as a PPP in a way which offers good VfM?

A Public-Sector Comparator (PSC-also known as a public –Sector Benchmark (PSB) is an attempt to answer the first of these questions. (‘Lease – purchase analysis’, as required by the office of Management and Budget, is the nearest U.S equivalent to a PSC)

A PSC is an assumption of what the NPV cost (sometimes known as the net present cost (NPC)) of the project would have been had it been acquired through a conventional public sector procurement, which is then compared with the NPV cost of PPP. The latter may also be estimated, or it may be known if bids have been receive for it. If the PPP’s NPV cost is lower than PSC, the PPP can be justified. (This is not the same as the economic cost benefit analysis discussed above - here only the two sets of project costs are being compared.) Even if payments are not made by the public authority, as in the case of a Concession, the user charges represent revenue foregone by the public sector and hence the analysis is the same as for a PFI-Model Facility.

But a PSC raises a number of difficult issues – in particular :

- How comparable costs are to be produced
- What discount rate is to be used to make these costs comparable in NPV terms
- How adjustments are to be made for risk transfer and other differences between the two types of procurement, including tax.

The final analysis it is not easy to produce a PSC which will stand up to detailed scrutiny and it is better to concentrate on other ways of ensuring VfM.

### 2.1 Cost Comparison

It is difficult to compare a PSC-s costs with those for PPP, whether based on initial estimates or actual bids. It obviously cannot be assumed that these costs would be the same for each. Because risks are being transferred to the private sector under the PPP, the PPPs cost will increase to compensate for this. For examples, if a Construction Subcontractor for a PPP project has to take on extra, the construction price itself will be increased to allow for risk, so the same so the same construction cost cannot therefore be used in the PSC, where this extra risk will not apply. Similarly, if there is a scope for the private –sector innovation which should be a benefit of a PPP, by definition this cannot be predicted in advance and included in the Public Authority’s initial evaluation comparing the PPP to the PSC

As to opex, FM Subcontractor will also charge more where risks are transferred to them under the PPP. Also in a PPP a Public Authority will incur additional costs in procurement, negotiation and later supervision of the Project Company which would not be required if its own officers were running the Facility.

- **Discount Rate**

Obviously the discount rate which is used for this calculation also greatly affects the result, should this be same for the PSC and the PPP ( including bid evaluation )? Suppose the PSDR is 6% ( including an allowance for inflation ), compared to cost of capital for a typical PPP projects of, say 8%. If the difference between the two represents a valuation of the risk transfer to the private sector, it would be logical to use the 6% PSDR for the PSC and 8% for the PPP to compare the two –assuming a perfect risk transfer the result should be exactly the same, but this is of course a big assumption. (Tax payment by the PPP also distort the position). Different public –and private sector discount rates also raise issues when valuing a franchise sale. And there are other problems with this approach :

- It seems inherently odd to use a higher discount rate when discounting a PPP's costs, as the higher the discount rate the more a risky project will be favoured. Clearly the Public Authority is taking a greater risk with public – sector procurement than with a PPP, which is an argument for discounting the costs of the latter at a higher rather than a lower rate.
- The nature of cash flow being discounted is quite different: the PSC costs consist of a high level of initial capex and a lower level of long term opex , whereas the costs of a PPP consist of a higher long - term Service Fees only, with no initial cost. The NPV cost of a PSC is much more dependent on the discount rate than the NPV cost of a PPP. As discussed above, where a project is capital –intensive, as with a PPP, discount rates alone cannot properly allow for the initial capex – related risks.

Alternative approaches therefore reflect those used for the economic justification discussed above (again there is little international consensus), namely.

- to use single generic, sector or project - specific discount rate which is applied to both PPP and the PSC, without adjusting the latter for risk transfer (this may or may not be the same as the PSDR, a different rate may be used than that for the original economic justification, which does not consider how the facility is to be procured or funded ); or
- to use the same risk –free discount rate for both PPP and PSC, and adjust the latter's cash flows for risk as discussed below; or
- use a discount rate reflecting the private –sector cost of capital for both PPP and PSC, and again adjust the latter for risk (as in Australia)

Whatever the discount rate, so long as it is below the Project Company 's own cost of capital a PPP will be inherently more expensive in financing terms and hence risk-transfer adjustment are likely to be required in the PSC to demonstrate VfM – the lower the PPP discount rate, the greater the adjustments required. Therefore the Australian approach above is more favorable to PPP's than the British one.

### 2.3 Risk – Transfer Adjustments

If, therefore, the PSC is to be adjusted for risk transfer the PSC calculation will the consist of :

- the unadjusted NPV of the PSC that based on cash flow projections without taking account of risks retained by The Public Authority; plus
- the NPV risk transferred to the project Company under the PPP , which would otherwise be retained by the public authority and so should be included in the PSC cost; plus
- the NPV of risks retained by the Public Authority; plus
- an adjustment to take account of the different tax positions of the PSC and PPP

There is an obvious relationship with the decision on the balance – sheet treatment for a PPP, which is as discussed below may also be decided by the level of the risk transfer. The approach to calculating the risk – transfer adjustments (which are the same as ‘optimism bias’ mentioned above is the mirror image of that for deciding balance-sheet treatment, it looks mainly at the risks transferred to the private sector rather than those retained by the sector, by :

- identifying all relevant risks transferred to the private sector (in summary the relate to capex , usage , opex and macroeconomics risks );
- assigning a range of likely costs for each risk, had it been retained by the Authority (taking account of the optimism bias discussed above );
- assigning percentage probabilities of occurrence for each risks;
- multiplying the cost impact by the probability to arrive a value for the risk;
- identifying the probable timing of each risk event;
- Calculating the NPV of the risk value based on the timing; and
- adding the result to the PSC, as these risks are retained by the Public Authority public sector procurement

The process can be out in reserve to assess the value of risks retained by the Authority, but this is generally less important as the same risk would probably be by the Public Authority under a PPP, and so the result will be same for either rout.

Another area of risk transfer in the reverse direction, namely that of the inherent flexibility in a PPP leading to increased costs for the Public Authority is seldom taken into account in a PSC. It is true that this effect is difficult to quantify perhaps not much more so than the other risk –transfer calculations), but it is a major issue and should not be ignored.

The PSC should be based on a range of outcomes varying with the probabilities of the risks, rather than one simple NPV amount for the risk transfer –there will be no ‘right’ answer, and there is inevitably a high degree of judgment or subjectivity in this process, as seen from the large range of possible adjustment for optimism bias discussed above, which could be applied here. Furthermore it is arguable whether weighting of risk in this way properly reflects the real world.

Moreover, if the real choice is between a PPP and no project, not a PPP and public sector procurement, the public authority and its advisers will be under strong pressure to manipulate the results “to prove “ that the PSC cost is higher than the PPP cost by making large risk adjustment. This pressure, combined with the subjectivity of the process, fundamentally undermines the credible PCS which use this risk –adjustment approach, despite the logic of the theory behind them.

## 2.4 Tax Revenues

Calculation of the adjustment for the different tax position of PPP should theoretically be a more straightforward process, as this results primarily from the marginal tax project’s net revenues. If the public authority is not a tax-raising body it may not receive any direct benefit from this extra tax flow into central or local government, but nonetheless from the point of view of the economy as a whole it is reasonable to take this benefit into account. However, the theory and the reality of tax payment have a tendency to deviate from each other, being very dependent on the structure of the project company’s ownership and how it and its investors deal with their tax affairs. For example, use of share holder subordinated debt instead of equity can almost eliminate tax payments by the Project Company. It is therefore very difficult to generalize about the extra tax benefit to be received from PPPs, or even to compare one bidder accurately with another in this respect.

## 2.5 Credibility of a PSC

When a risk –adjusted PSC is published, either by the Public Authority or by Government audit office, the result may look something like Table below. The NPV of the Service Fees will usually be higher than the NPV of the cost of public - sector procurement because of the higher cost of finance.

Detailed justifications for the PSC adjustments which counterbalance this are seldom published, so the calculation has to be taken on trust. Hence published risk-adjusted PSCs are seldom very convincing, but, as discussed above, PSCs which are not risk-adjusted do not work well either, and in either case the choice of discount rate(s) for the PSC and PPP evaluation makes a big difference to the answer.

Should the PSC be disclosed to bidders? Practice on this is varied : some countries take the view that it should not be disclosed because it may lead bidders to treat the PSC as a target price instead of submitting their best bids : on the other hand others take the view that disclosing the PSC will ensure that bidders understand the requirements of the bid correctly.

Logically, the NPV cost of the PPP should be recalculated regularly throughout the procurement process and compared with the PSC, to ensure that the PPP maintains its advantage over PSC. The PSC itself should only be changed if there are significant changes in the scope of nature of the project, or if it is apparent that cost or risk elements have to be re-priced (although the latter is obviously open to manipulation to produce the “right” result once more). This was the approach in the United Kingdom until 2004, and remains the case in some other countries which use PSCs, such as Australia and the Netherlands. In Albanian there is not such a practice; it has some benefit, as late-stage use of the PSC can be an instrument for negotiating with bidders to push their price down.

<b>PSC CALCULATION</b>		
	<b>PSC</b>	<b>PPP</b>
NPV of cost of public – sector procurement (including capex and opex)	990	
NPV of Service Fees		1000
NPV of risk adjustments	90	
NPV of additional tax	45	
Risk- adjusted NPV cost	1035	1000

But reality dictates that it is not possible to reverse course towards the end of a lengthy period procurement based on a calculation which is merely theoretical in nature, and so if PSC is to be used at all, it is best used at the initial stages of procurement when it could possibly affect the decision. This approach is now taken in the United Kingdom.

However this means that the PSC and PPP figures are both based on initial cost estimates, not bids, which makes them even more difficult to prove; in particular optimism-bias adjustments only against the PSC become very questionable because there is also often substantial optimism bias in the early stages of procuring a PPP, so that the final Service Fees may be much higher ( or the scope of the Facility lower ) than expected at the initial planning stage.

If there is no PSC (because the Public Authority has recognized that a PPP is the only way that the facility can be procured) or if the PSC is a “one-time” calculation at an early stage of procurement, how can the Public Authority ensure that a PPP procurement is giving the best available VfM? The simple answer to this is that VfM is best produced through competitive tension between bidders, and therefore the procurement process must be such as to maintain this tension for a long as possible.

### 3. AFFORDABILITY

While VfM is important for the Public Authority, an equally relevant question is that of “Affordability”, whether it can actually afford pay the Service Fees ( in the PFI Model ), as the Public Authority will probably have a set budget for the project, within which it has to work. Equally, in the Concession Model, the Facility has to be affordable for users. It may be simplest just to set an Affordability limit for the first year of the operation assuming that Service Fees are level thereafter, and measure bids against this, but some care needs to be taken where Service Fees are indexed against inflation to ensure there is no mismatch with the Public Authority’s own resources in later years.

The first step to ensure that this Affordability limit is not breached is for the Public Authority to take advice on costs, financing, and usage where this is relevant, to form the basis for a realistic 'shadow' financial model which demonstrates that the Service Fees should be affordable before the procurement process begins.

If, despite this, bids come in over expectation and the budget cannot be increased, the Public Authority will have to redesign the project in some way, by reducing its scope, to reduce its PPP payments to an affordable level. There are two things to bear in mind in this situation:

- if the bids are found not to be affordable, a Preferred Bidder should not be appointed until there has been a further round of bidding on a reduced project scope. Entering into negotiations with a Preferred Bidder without a defined project scope is certain to lose VfM
- The Service Fees should not be manipulated so that they are abnormally low at the beginning of the PPP Contract, as a way of making the PPP 'affordable' to begin with, and then rise steeply later on. This is particular temptation when Affordability is primarily measured by taking the Service Fee during the first full year of operation as a baseline.

As with the PSC a Public Authority has to consider whether it is better to let bidders know what the Affordability limit is from the start, so that unrealistic bids are not submitted, but with the danger that the bidders treat this as a target price instead of offering the best bid. Alternatively, late –stage disclosure of Affordability can be used as a way of negotiating with bidders to bring their final price down.

#### 4. BALANCE – SHEET TREATMENT

If it is clear that the choice is between a project which is outside the public – sector budget (at least in relationship to its initial capex ) and no project at all, which as discussed above is the usual motive for going down the PPP path, then there needs to be a method for deciding whether or not a project is 'on balance sheet' for the Public Authority and hence the public sector as a whole .

It is clearly not an ideal approach for Governments to set their own public –accounting rules for PPPs, and there are international efforts to create consistency in this respect based on the United Nations System of National Accounts last updated in 1993. The international Monetary Fund (IMF) has a Task Force on the Harmonization of the Public Sector accounting which covers, the topic of the Government /Public Sector/Private Sector Delineation. Within the European Union, Eurostat, the Statistical Office of the European Communities, provides the European Union with statistics from EU member countries on a harmonized basis, and as a part of this process has to decide what should and should not be included within the figures for public –sector budgets. Eurostat's rules on government accounting which are based on SNA, are therefore a useful starting point in considering balance- sheet treatment for PPPs.

Does the user pay ?

No  
Yes

PFI model  
Concession model

Does the private sector bear construction risk?  
Are less than 50% of revenues derived from the public sector ?

Yes  
No

No  
Yes

Does the private sector bear the usage (demand) risk?

Does the private sector bear the availability (service delivery) risk?

Not  
Yes

Yes

Not

Private sector project  
Public sector project

### Decision Tree for Eurostat balance-sheet treatment

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**KNOWLEDGE MANAGEMENT (KM)-CRUCIAL IN A WORLD OF INFORMATION**

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**Abstract:**

*Knowledge, if managed properly, turns into value and adds higher yields in life and work. It comes as a result of time to certain degrees and starts with general empirical data, where facts and observations are “raw material”. Content of such data comprise what we call information. Knowledge is next to the last of “Information pyramid” at the top of which is wisdom. Albania’s integration process is accompanied with a “boom” of information flowing. Such information is a great endowment in acquisition of knowledge, experiences and best practices. We think that is required maximum exploitation of existing structures. Knowledge is acquired in allocated conditions and for this its treatment is a job for appropriate structures of human resources management.*

**Key words:** *knowledge, manage, human resource management (HRM), codification, knowledge dissemination.*

**JEL Classification:** *M10.*

**1. Knowledge Management.****1.1. Definition of KM.**

Different authors have defined KM in different prospective. This perhaps as a consequence of perceptions, understandings and experiences they have. Harrison<sup>224</sup> argues that, KM is a complex concept paper that has been defined as any process or practice of creating, acquiring, capturing, sharing and using knowledge, wherever it resides, to enhance learning and performance in organization. Goal: augmentation of learning and organizational performance. Willard<sup>225</sup> on the other hand argues that KM as the development and facilitation of collaborative working, recognizing the interconnected nature of people, processes and information, in organizations that have become regional or global. In support of this definition, KM is a solicitation and is used in and outside the organization. This means the simple and meaningful fact that KM is an inexhaustible resource that influences in the rise of organizational performance. Davenport and Prusak<sup>226</sup> argue that in organization, knowledge is not embedded only in documents or repositories but also in organizational routines, processes, practice and norms implemented day by day.

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<sup>224</sup> Harrison, R. (2000). Employee Development, 2<sup>nd</sup> ed. Wiltshire : The Cromwell Press, pg.80-85

<sup>225</sup> Willard, N. (1999), « Knowledge Management : Foundation for a Secure Structure, Journal of Managing Information, Vol.16 No.5, pg.115-120

<sup>226</sup> Davenport, and Laurence Prusak (1998). Working Knowledge : How Organisation Manage, What they know. Boston : Harvard Business School Press., pg.280-285

**1.2. Explicit and Tacit Knowledge.** Knowledge is divided into two approaches, explicit and tacit<sup>227</sup>. Explicit knowledge is that aspect of knowledge that can be easily expressed or articulated in language. For instance, manuals, project reports, a map of a city center, etc. on the other hand, tacit knowledge is that part of a knowledge that is embedded in people's experience through human experience. And it cannot be articulated and is live knowledge that would not survive outside the human system through which its dynamics is sustained. For instance, an older and experienced manager is able to immediately understand employees condition or an experienced doctor intuitively understands the patient's condition whether it can be recovered or not.

### 1.3. Dimensions of KM.

KM covers four main dimensions. These are knowledge creation, knowledge embodiment, knowledge dissemination and knowledge use<sup>228</sup>. Knowledge creation falls under two areas; social and scientific construction. Scientific knowledge construction is whereby knowledge is a justified true belief or law. We can mention here the law of gravity. Social construction of knowledge is that knowledge which is constructed by a community of practice like scientists, engineers, consultants and scholars<sup>229</sup>. For instance, management knowledge constructivists like Taylor's Scientific Management, Elton Mayo of Human Relation Theory etc. Knowledge embodiment is the social interchange of knowledge within an organization<sup>230</sup> (). This is exercised through KM activities like sharing, informal meetings, dialogues, discussions, exchange of views, observations, brainstorming, conferences and the use of information technology like e-mail and intranet. For instance, academics and students at universities may now exchange ideas for different issues aiming mainly at their performance. Their goal is to pass their exams achieving higher results. Knowledge dissemination is the transfer of knowledge from one person to another, depending on the nature and purpose of an organization. For instance, organization issues rules and manuals and organizes workshops for the students to be known with the latest experiences. Among the experiences we can mention "Lessons Learned", where employees who have a better experience transmit the gained experience to newcomers in different forms and methods, like formal and informal meetings. Baumard<sup>231</sup> argues that education faculties are themselves knowledge organizations.

The use of knowledge is meant for economic benefits. However, this varies depending on the purpose and mission of an organization. Knowledge can be used for product development, service delivery, improving organization's efficiency, cost and time saving and community development.

**1.4. Goal of KM.** The goal of KM is to identify and capture the knowledge of the organizations so that they can be exploited as a resource, knowledge as assets, knowledge as something to be leveraged and the value of intellectual capital<sup>232</sup>. Walton<sup>233</sup> argues that KM is the argument that much of learning about key activities is held in the experience of individuals and that this is lost when too many key leave.

**1.5. Focus of KM.** KM focuses on knowledge sharing in a team to ensure that knowledge is transferred from individuals to collective or social knowledge in order to secure continuous innovation and problem solving and in organization. For instance, launch of a new product in market as a way to show constant success.

<sup>227</sup> McShane & Von Glinow, "Organizational Behaviour" 2012, McGraw-Hill Company, New York, p. 123-124

<sup>228</sup> McAdam and Reid (2000). « A Comparison of Public and Private Sector Perception and use of Knowledge Management. Journal of European Industrial Training, Vol.24, pg 185-187.

<sup>229</sup> Baumard, P. (1999). Tacit Knowledge in Organisation. London : Sage Publication, pg. 80-85.

<sup>230</sup> McAdam and Reid, 2000, *Ibid*.

<sup>231</sup> Baumard, P. (1999) *Ibid*.

<sup>232</sup> Buchanan and Huczynski (1977). Organisational Behaviour : An Introductory Text, 3rd edn. Gosport : Ashford Colour Press Limited.

<sup>233</sup> Walton, J. (1999), Strategic Human Resource Development. Trowbridge : Redwood Books Limited. pg. 76-84

## 2.0. Practice of KM.

There are two aspects of KM, personalization and codification<sup>234</sup>. Personalization rests on person-to-person contacts of sharing knowledge through dialogue and brainstorming. And information technology (email and intranet) and telephone is used for networking among community of practice. This strategy is widely used among scientists at different research they conduct.

Meanwhile, codification is the process of KM that relies on a people-to-document. That is, vital knowledge from knowledge workers is removed and kept in a computer or electronic repository. For instance, CD-ROM and Internet have a lot of knowledge on various subjects for people's consumption.

Finally, according to McShane and Von Glinow<sup>235</sup>, some codified explicit knowledge is of such value that organization has to manage it as a legal entity with property rights, like the right of producing weapons. Such conclusion is reached having seen that KM focuses on knowledge sharing in a team for organizational development and sustainability.

### 2.1. KM as a managerial fad.

The advent of KM has encountered mixed reactions. According to Scarborough and Swan<sup>236</sup>: "There is little doubt that we have entered the knowledge economy where what organizations know is becoming more important than the traditional sources of economic power-capital, land, plant and labor". However, Ruggles<sup>237</sup> argues that to a growing number of companies, KM is more than just a buzzword or a sales pitch, which adds values through active leverage like: know-how, experience and judgment resident outside and inside organization. Davenport and Prusak<sup>238</sup> argued that the creation of the position of Chief Knowledge Officer as a response to KM was felt as a passing fad.

McAdam and Reid<sup>239</sup> carried out a comparative research on the perception of the public and private sector on KM comprising of ninety-seven informants and eight workshops. The findings show that, KM has been recognized in the public sector as opposed to the private sector. However, KM is an emergent rather than an established system in most organizations. Their findings confirmed that KM is an emergency for organizations. Team leaders and employees are seen as having a much lesser role. The appropriate state offices also confirm McAdam and Reid findings. This shows that KM is a new and necessary concept in managerial aspect.

Strategic level manager create the vision of knowledge necessary to organization and this helps including middle and lower level managers up to the last employee. In these companies, KM is understood as a managerial fad fully integrated.

### 2.2. Managerial predications

Rise and fall of managerial fad-Organizational learning, scientific management and human relation management show that fads often change and their value is determined by time. Scarborough and Swan argue that popularity of such a "style" in managerial literature is almost the same in many countries. Meanwhile, the interest in KM is actually on higher rates. Buchanan and Huczynski<sup>240</sup> argue that KM is a manifesto of organizational fad, which goes along from old fashions to new ones with particular interest on humans, as a potential force of economic productivity or service. This implies that changes in socio-economic environment makes the scientists to continue cultivate new fads as a necessary mechanism.

### 2.3. KM as a point of reference for effective operations inside organization.

<sup>234</sup> Hansen, Nohria, and Tierney (1999), « What is your strategy for Managing, Knowledge. « Harvard Business Review, March-April. pg, 45-50

<sup>235</sup> McShane & Von Glinow *Ibid*, p. 63.

<sup>236</sup> Scarborough and Jasky Swan (1999), Issues in People Management : Case Studies in Knowledge, Wiltshire : The Cromwell Press. pg, 135-137

<sup>237</sup> Ruddy Ruggles "The State of the Notion" 1998, Knowledge Management in Practice, pg. 205-210.

<sup>238</sup> Davenport, and Laurence Prusak (1998) *Ibid*.

<sup>239</sup> McAdam and Reid (2000) *Ibid*.

<sup>240</sup> Buchanan and Huczynski (1977) *Ibid*.

KM and its dissemination are evident. It assures strong points by helping people to operate effectively inside the organization. A labor force includes people with different views and experiences.

This produces the possibility for ideas to be discussed and easily shared. In this way it facilitates problem solving. This can be related to the proverb “One mind is nothing, two are one”.

Referring to education theory there are two lines: formal and non-formal education. Formal education is taught at schools, colleges and universities and different training institutions. Main method of education is teaching and lecturing. On the other hand, non-formal education is possible through the establishment of a social climate within the group.

HRD is divided in two: individual and group. For the individual is seen as development of abilities, a step forward in career, while for the group as a good opportunity to improve capacity and assert the necessary leadership and improve efficiency for decision-making process.

This means helping the group to accomplish plans, programs and amount number of activities with the goal to develop people. The success of organizing teaching in-group depends planning the right strategy, creating harmony and reciprocal relations inside the group, improving knowledge, ability and experience of group members. KM requires a clear vision for organizational leadership. Web<sup>241</sup> argues that KM practice in organization requires clear statement from higher instances to the lowest one, the necessary communication mechanisms for information distribution, understanding and including the appointed goal, necessary planning and training program, adaptable systems and procedures as well constant monitoring to make sure that everything is in the right place. This means that in case of lacking a clear organizational vision KM will be impossible. For instance, Lester<sup>242</sup> argues that lacking a clear policy, individual knowledge and evaluation system negatively influence in its distribution inside the organization.

### **3.0. Implication of KM on respective structures for HRD.**

The emergence of KM in organization has set forth the role of responsible structures starting from the main problem that HRD will depend from learning process and necessary abilities. Some of the main duties are:

#### **3.1. Protagonist of KM**

KM has placed these structures as key ones in this process. Walton<sup>243</sup> (1999, p.76-84) argues that it is a duty and responsibility of appropriate structures because they are responsible to facilitate this process by even including themselves in peoples training and process development.

#### **3.2. Facilitate knowledge creation process**

Respective structures have the responsibility to facilitate knowledge creation inside organization. This requires concentration on that knowledge that is necessary to accomplish the mission in the future. Nonaka and Takeuchi<sup>244</sup> argue that middle level manager play a key role in facilitating knowledge creation process in organizations. They serve as a strategic node, which joints upper level managers with them of the ground level or a bridge between idealistic visionaries of higher levels with realities of daily life displayed in human activities.

#### **3.3. Consulting role for HR Managers**

HRD consultants are to consult on personnel issues in order to avoid unnecessary job displacements. Lester<sup>245</sup> argues that a consultant of HRD has to be included in selection process, motivation and displacement of people and to consult the organization on knowledge they need for the future. This has certainly to be reflected in the strategic plans for recruitment, training and progress in career.

<sup>241</sup> Webb, S. (1998), Knowledge Management : Linchpin of Change, London : Aslib Staple Hall. pg. 70-85

<sup>242</sup> Lester, T. (1998) Knowledge Management. pg. 157-160.

<sup>243</sup> Walton, J. (1999) *Ibid.* pg. 76-84

<sup>244</sup> Nonaka and Takeuchi (1995). The Knowledge Creating Company : How Japanese Companies Create the Dynamics of Innovation. New York : Oxford University Press, p. 355-360.

<sup>245</sup> P Lester, T. (1998) Knowledge Management. pg. 157-160.

On the other hand, it shows the necessity of including the appropriate consultants in human resource planning and administration.

For instance in cases when the number is reduced thanks to reforms it is necessary for HR Consultants to be very good ones. Their main role is to determine the potential individuals for the future. This is very important during transformation process and implementing the new structure.

### 3.4. Builders of infrastructure

Moreover, the role of HRD Consultants is to assure and build the necessary infrastructure for KM inside the organization. According to Cannell<sup>246</sup> HR Consultants do not have any other choice beside to integrate on line learning on employees' curricula. It is necessary to understand weakest and strongest point of the new technology and be able to identify where and when they can offer a low cost solution. According to Lank<sup>247</sup> there are four main areas:

1. Definition of tacit knowledge and explicit knowledge actual and necessary for the organization
2. Development of necessary mechanism for knowledge accumulation, dissemination and basic knowledge process
3. Definition of knowledge gap and necessary mechanism for their completeness through training
4. Management of investment process, information technology and the role for more knowledge and expertise inside the organization and taking the appropriate measures for these investments to be productive

### 3.5. Initiator of knowledge dissemination

Finally, HRD Consultants are initiator of knowledge inside organization. It is hoped from them to initiate knowledge dissemination and profits of organization and employees. They argue that HR Directors, under the influence of appropriate consultants, have three main roles to play and these are: improvement of knowledge inside organization, management of relations with information holders outside organization like academics, companies who have their databank etc and secure that this investment will increase the figures of economic and service indicators. For instance, HRM Directorate through its consultants made possible the connection with their counterparts in order to offer higher-level different courses for the increase of criteria's on personnel side for EU integration.

Even the success of education managers, which lay on whole of the pyramidal system, is of the principal in KM; their success will depend on many factors. Davenport<sup>248</sup> (1998,ibid) argues that KM requires inclusion of policies from the highest levels. It requires the support of top managers and the will of others to tell what they know. More concretely, higher-level managers create the vision, managers of middle level develop concrete concepts for their employees to understand and implement. As mentioned above, it is comprehensible that if there is a lack of will from higher-level managers' point of view and determination of other levels to disseminate their knowledge and that knowledge adopted from appropriate structures, HRD Consultants cannot realize their duties and play their role in organizations.

### 4.0. Conclusions

KM is a development process, requirement, inclusion and use of knowledge of employees for the development and stability inside the organization. It includes four dimensions: knowledge creation as part of the individual, its dissemination and use. The goal of KM is its dissemination through personalization and codification. Personalization is the process of knowledge dissemination that supports human factors of a team. Meanwhile, codification remains in the extracts and placements of explicit knowledge in documents as CD-ROM, computers, manuals and other means of preservation. In this way, the organization has the practical possibilities to use them, through different means. KM is still a new concept and research shows that still it is not expanded in private and public sector.

<sup>246</sup> Cannell 1999: Incentive Pay: Impact and Evolution, Institute of Personnel Management, London, pg.110-115.

<sup>247</sup> Lank 1997: Leveraging invisible assets: The Human Factor, pg. 76-84.

<sup>248</sup> Davenport, and Laurence Prusak (1998) *Ibid*.

For the appropriate structures of HRM, KM makes possible the role of knowledge dissemination protagonist as well as creation, consultation of managers for the management of their employees. They will be builders of the necessary learning infrastructure for their employees to learn and gain the appropriate abilities.

However, the effectiveness of such structures will depend on the support of higher-level managers. Such a conclusion is drawn because KM requires political support that on its own requires a clear vision in the organization.

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**MANAGING INVESTMENT CONDITIONS: THE CASE OF MACEDONIA**

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**Abstract:**

*Foreign Direct Investments (FDI) are one of the fundamentals that enables and accelerates economic development of a national economy. Therefore, each national economy must layout preconditions that will enable attracting of foreign capital. Among other things, an adequate legislation considering the FDI's is a prerequisite. Hence, the governmental role and policies towards FDI issues may have significant influence on improving the investment climate. The purpose of this paper is to present the manner and scope to which the governmental policies approach this crucial issue. For this purpose, the first goal is to look upon legislative aspects for attracting FDI in Macedonia. The second one is to explore the institutional mechanisms that present coordinates and determinants of the framework for doing business. Simultaneously, the research subject is legislative that regulate this area, as well as some other legal aspects, as: the laws related to the foreign trade, fiscal sector, institutional frame, foreign exchange operations, the area of labor relations, etc. The research results lead to conclusion that the legislation framework, as significant factor of national business environment, provides opportunities for FDI enhancement in Macedonia. Although significant results have been achieved so far, particularly in the last decade, still, there is a need for further improvement of current legislation.*

**Keywords:** Foreign direct investments; Foreign capital; Legislation; Business; Macedonia.

**JEL Classification:** M15.

**1. Introduction**

According to the International Monetary Fund definition, the foreign direct investments (FDI's) are investments which aim is to gain permanent interest in the enterprises, which operate out of the investor's country and by that the essential intention of the investor is to enable and achieve effective management with the enterprise where he invests in [1: 9]. This is connected to certain minimal share in the ownership capital (equity) in the company (most frequently 10%) so as this investment to be able to be treated as foreign direct investment and which enables effective participation in the management. It is similar definition of OECD according to which a company with foreign direct investment is such company where one investor owns 10% or more of the regular shares or votes of an enterprise, or a company where the foreign investor owns less than 10% of common shares or votes but still there is possibility effectively to influence on the company management [1: 9].

The basic motive for attraction of foreign direct investments for each country is securing means which are missing for work and development that enables realization of projects and programs in conditions when own means are not sufficient (domestic savings/accumulation) or when the conditions for its engagement are inconvenient.

It is obvious that on the macro level, with the help of FDI one country could stabilize and make sustainable the balance of payments, but also it could improve the conditions on the domestic market, it could decrease the level of unemployment, and the last but not least, to transfer a technology and know-how. All of the previous has its positive impact on the economic growth.

The economy of Macedonia which at the beginning of the 1990s to the beginning of the new millennium passed through the process of transition, has been transferred into market oriented economy and the investor's interest is increased for it from all over the world. Namely, the national treatment of the foreign investors, the protection of the ownership, the stable legal and business surrounding influence the economic and before all the political stabilization of Macedonia, which represents a basic precondition for the increase of investors' interest. The improvement of the investment climate, the capable and qualified labor, the fertile tax policy transformed into lowest tax rates in Europe, influences the investors to take into consideration Macedonia as a potential country for investments of their capital.

The legal system in Macedonia has been constantly improved in the direction of continuous encouragement and support of the economic progress of the country, the globalization flows and the political development. It is significant to mention the adjustment of the domestic legislature towards the legislature of EU, which goes according to the confirmed dynamics of Macedonia with the Agreement for stabilization and association. That means that many legal decisions are closer or identical to the corresponding in the developed European countries. In the passed period there has been implemented regulatory guillotine, which enabled confirmation of the boundaries and the drawbacks which influenced the management procedures connected to the realization of the necessary steps for investments and the development of entrepreneurship in Macedonia. After statements, the observations and findings from the made guillotines the government of Macedonia took steps for the removal of the boundaries and drawbacks which resulted with the increase of the efficiency and the effectiveness of the management procedures. In that direction many of the Government measurements are in the direction of faster realization of the business plans and project of the investors. The tax policy, the human potential, the enforcement of the service, obtaining process as well the simplification of the management procedures, but also the development in the field of the protection of intellectual and industrial property, they all are considered as advantages in the direction of attraction of investments and also taking into consideration that such parameters and fields are most frequently the crucial preconditions for entrance of foreign investors in one country.

Aware of the importance of the multilateral and bilateral agreements signed by the Republic of Macedonia and other countries, this paper presents some of them. It is certainly important because in that way the investor can clearly notice whether the country he comes from has signed an agreement for avoidance of double taxation, agreement for free trading or an agreement for support and mutual investments protection in Macedonia.

## **2. Constitutional basis for FDI**

With the independence and the adoption of the Constitution in November 1991 R. of Macedonia found the constitutional legal frames for the new social order and establishment of new economic system. One of the key value in Macedonia's Constitution is market freedom and entrepreneurship freedom towards establishing market based economy principles. Furthermore, the Constitution additionally confirmed the market principles on which new economic regulations are based, planning guarantees and limitations of the same. Namely, according to the Constitution the freedom of market and the entrepreneurship is guaranteed. The Government supplies equal legal status of all subjects on the market.

The Government takes measures against the monopolistic status and the monopolistic behavior on the market. Freedom of the market and the entrepreneurship can be limited with law solely for defense of the country, environmental and nature protection, or people's health.



Having in mind the capacities of the national economy and the economic subjects in Macedonia the Constitution additionally gives support for entrance of foreign investors through the guarantee of the safety for taking (export) of the invested equity and the equity that they invested in Macedonia. That is in Article 59 and it has been planned to foreign investors the right of free exports and the invested equity and gain are guaranteed. The right gained on bases of the invested capital cannot be reduced by law or other provision.

### **3. The main legislative determinants for investments.**

The most significant fields for the foreign direct investments are represented in one common cycle starting from: registration of the business, employing adequate labor, starting with the business, tax burdening, agreement, obligations for trading, reinvestment, protection of the investors, and closing of the business.

Initiation of business - This part covers the possibilities for registration of a commercial company and the most important fields that could be the subject of interest for the investors such as the concessions and public-private partnership, mineral raw materials, energetic, commerce with securities, funds, stock markets etc. So, this part covers all that is important before the beginning of the business. When initiating a business in Macedonia, there are several key institutions. Namely, the authorized institution for initial registration of the business is the Central register where for only four hours and without the necessity for initial capital, one could open the several types of commercial companies: trader-individual, public commercial company, company with limited liability - DOO, company with limited liability of one person - DOOEL, joint stock company, limited company and limited company with stocks. In the frames of the Central register, technical offices are formed as well which prepare the overall documentation for initiation of a company, which additionally reduces the expenses and the time necessary for registration of a company. To the investors it is on their disposal the Agency of foreign investments of Macedonia in any phase of the investment process. For the necessities of the entrepreneurs and the support of their business, the Agency for the support of the entrepreneurship of Macedonia has been formed. The commission for securities is liable for efficient and legal functioning of the market of long term securities and protection of investors' rights. This institution is liable for implementation of The Law on securities, The Law on investment funds and the Law for taking over of the joint stock companies.

The key laws for initiation of business in Macedonia are: the Law on commercial companies (28/2004, 84/05, 25/2007; 87/2008), the Law on single desk system, and leading of commercial register and the register of legal entities (84/2005, 150/2007; 140/2008), the Law on Central register (50/2001, 49/03, 109/05, 88/2008), the Law on concession and other types of public-private partnership (7/2008; 139/2008), the Law on mineral raw materials (24/2007, 88/2008, 52/2009), the Law on energetic (63/2006, 36/2007, 106/2008), the Law on securities (95/2005, 25/2007, 7/2008), Law on the investment funds (9/2000, 29/2007, 12/2009), the Law on foreign exchange operations (34/2001, 81/2008), the Law for establishment of Foreign Investments Agency of Macedonia (37/2004, 81/2008), the Law on establishment of Entrepreneurship Agency of Macedonia (60/2003), etc.

Labor/employment - Qualification of the labor, the legal provisions of this sphere are certainly in the focus of investors' attention because without workers it is impossible to enter in serious investments. In this area the most important laws and provisions have been covered that are interesting for the investors. In the employment part the provisions are covered that regulate the labor market. The most important state institution of this sphere is the Employment agency which frameworks cover the procedure for registration of employed people which is simplified with shortening of terms, reduction of benefits and the documentation that is asked from the companies. Still, the biggest news represents the introduction of system for contracting the calculation and payment of gross salary of workers since January 2009 [2, 3].

Simultaneously as a compositional part of this system is the integrated payment of all social transfers and the personal income tax by the Department of Public Incomes. With the adoption of the Law for peaceful solution of the labor lawsuits (87/2007) out of court procedure through mediation by which the terms of the procedures themselves are shortened, the expenses have been reduced and the workers are returned on the labor market faster. Regarding the employment procedures the most important laws are as follow: the Law on labor relations (62/2005, 106/2008, 161/2008), the Law on compulsory contributions from the social insurance (142/2008), the Law for peaceful mediation of labor lawsuits (87/2007), the Law on employment and work of foreigners (70/2007, 5/2009), the Law on pension and disable insurance (80/1993, 153/2007, 152/2008, 161/2009), the Law on initiation of employment (62/2006), the Law on disable persons (87/2005, 88/2008, 161/2009), the Law on employment and insurance in case of unemployment (37/1997, 102/2008, 161/2009), the Law on agencies for temporary employments (49/2006), etc.

Initiation of business/work. At the start of its business, each investor is interested for the possibilities of crediting and financing of business plans, obtaining of different permits and licenses, the obligations that result from taking account for the environment, different advantages that technological industrial zones offer and certainly the ownership relations as fundament of the civilization. The releasing of the procedures for business initiation is just the first pillar of the regulation reforms that are implemented in Macedonia. In that direction with the project regulation guillotine, hundreds of laws have been simplified and their sub legal acts and the obtaining of licenses and permits for business running is released and cheaper. Also, the introduction of the rule “the silence is an approval” represents a powerful instrument for pressure towards the administration to reply on the citizens’ requests and businessmen in the prescribed term, because on the contrary it will be considered that the answer is positive [4].

The documentation and the terms for obtaining licenses and permits is considerably reduced with new changes of the Law on construction land and the Law for construction. The procedures for construction permits are simplified but also the foreign legal and physical entities will be able to gain the ownership on construction land. The fees and compensations at the land registry office, the Customs and the Bureau of meteorology are reduced. With the new Law on Banks which enabled departments of well known foreign banks in Macedonia to be opened and by that the approach to capital necessary for financing of new investments projects is released. The credit registers in the frameworks of the Central (National) bank is additionally upgraded and there is a procedure at the moment for foundation of new investment projects.

In order to achieve larger efficiency in the registration of the ownership rights and its overall functionality and digitalization to the end of 2008, large reforms are taken over the Land registry department. With the strengthening of human resources and introduction of ITC technology, the process and the work procedures of the land registry have been improved.

For business initiation it is essential to emphasize the laws that refer to the possibilities for crediting, ownership, the environmental protection and certainly the free economic zones. Also, connected to credits there should be mentioned: the Law on banks (67/2007), the Leasing law (4/2002, 49/2003, 88/2008) and the Law on contractual pledge (5/2003). For the ownership regulation the most important are the following: the Law on ownership and other property rights (18/2001, 92/2008), the Law on land registry of real estates (40/2008), the Construction law (51/2005, 82/2008), the Law on construction land (82/2008, 143/2008) and the Law on privatization and rent of construction land in state ownership (4/2005, 13/2007, 165/2008).

During the last 10-15 years, the environmental protection has been gaining more and more importance for the business running. From the point of view of the investor the most important are the following laws: the Law for the environment (53/2005, 24/2007), the Law on nature protection (67/2004, 84/2007), and the Law for waste management (68/2004, 107/2007, 102/2008, 143/2009). The free economic zones are regulated by the Law for technological industrial zones (14/2007, 103/2008, 130/2008).

The tax burden is maybe the most essential part in the investment decision, but also during the period of business running. That is why the most important legal decisions in the area of taxes have been covered as well as the contracts for avoidance of double taxation in Macedonia that it ratified with other countries. The laws in this area confirm the most important tax burden which would be interesting for the investors. In that direction the implementation of policy for larger economic freedom of business flat rate income tax has been introduced and flat rate personal income tax which rates are only 10% and by that Macedonia has the lowest package of taxes in Europe. It is essential to emphasize that the reinvested income is completely exempted from taxation. In that area there should be taken into consideration: the Law on income tax (74/2006, 160/2007), the Law on personal income tax (74/2006, 160/2007), the Law on value added tax (44/1999, 114/2007, 103/2008), the Law on property taxes (61/2004, 102/2008), the Law on the amount of default interest rate (65/1992), the Law on communal fees (61/2004; 92/2007), etc.

When taxes are in question it is important to mention that in the frames of the Department of Public Incomes separate offices have been established for small and medium sized companies and by that an attempt has been made for adjustment and releasing of the administration procedures for tax payments of this type as tax payers. Large tax payers can send by Internet tax forms and opinions to the office for large tax payers and by that the processing has been considerably fastened and also the time for tax payment.

The contract for avoidance of double taxation promotes the economic cooperation between Macedonia and other countries especially in the domain of stock exchange, services and common investments and by that stimulation and intensifying of the economic financial relations between the countries is enabled. Macedonia has ratified 30 contracts for avoidance of double taxation, generally with these contracts the avoidance of double taxation of the resident of one or the other country has been regulated referring to income taxes (personal income tax and income tax) and property tax. In that way the residents of one state gains the same tax treatment in the other state. Correspondingly, the rights of the state are regulated where there are cases which will make the taxation and which will not, as well as which state is entitled to make payment of certain tax obligation. Also, with the contracts the dividends, interests and the incomes of copyrights are also treated and etc. Macedonia has concluded contracts for avoidance of double taxation with the followings states: Croatia 17/953, Turkey 45/95, Poland 17/97, Italy 34/97, China 49/97, Russia 7/98, Albania 16/98, Sweden 21/98, Ukraine 21/98, Slovenia 31/98, Netherlands 13/99, Bulgaria 23/99, France 23/99, Taiwan 44/99, Egypt 7/2000, Denmark 48/2000, Switzerland 55/2000, Romania 7/2002, Czech Republic 7/2002, Iran 7/2002, Finland 7/2002, Hungary 12/2002, Belorussia 96/2005, Spain 96/2005, Moldavia 130/2006, United Kingdom and Northern Ireland 47/2007, Latvia 47/2007, Germany 86/2007 and Austria 152/2007.

Contractual obligations/commercial conditions. When the investor runs its business in Macedonia it is of exceptional importance the fields such as commerce, export/import, customs, contractual relations, the freedom on market and the completion as well the contract of free commerce with EU and other states that is, all areas that influence the running of business commerce and obligation relations. These fields are regulated by the Law on commerce (15/2004, 129/2006 è 63/2007, 88/2008), the Law on e-trade/e-commerce (133/2007), the Law on competition protection (4/2005, 70/2006, 22/2007), the Law on taking over of joint stocks companies (4/2002, 36/2007), the Law on customers protection (38/2004, 77/2007, 103/2008), the Law on customs (39/2005), etc.

Sufficient improvement has been reached in the releasing of the export and import. Namely at the Customs procedures for goods transit more efficiently and faster are implemented. With the introduction of single desk system the procedures have been considerably shortened as well as the documents which are necessary at export import. R. of Macedonia has concluded three multilateral contracts for free market: 1. The Stabilization and Association Agreement, 2. EFTA and 3. CEFTA.

With the Stabilization and association agreement, Macedonia took over the obligations for liberalization of the market with the European union, signing of contracts for free trading with states from the region and etc.

With joining to EFTA asymmetrical approach in the commercial running has been secured with the industrial and the agricultural nutrition products on behalf of Macedonia. By that the Macedonian industrial products are exported freely without customs on EFTA states markets for the necessities of 12 million people.

The Central European contract for free trading (CEFTA 2006) represents important step in the efforts for economic integration of the countries from the South East Europe (region) From the economic aspect the increase that is the possibility for creation of a single zone for free trading will be especially acceptable for the countries with small sized market such as Macedonia. This contract beside the liberalization of the stock commerce for the first time opens space for increased cooperation between its members and in the following areas: services, trading, public supplies, investments, and protection of the intellectual property. Macedonia has concluded bilateral contracts for free trading with Turkey and Ukraine.

Reinvestment is the area of exceptional importance for Macedonia because the gained capital of the investor is essential to be invested here and that purpose large tax relives and advantages are on his disposal. In the part of investment and reinvestment the Government offers special advantages, planned as tax relives that are through supportive tax policy in the part of reinvestment. By exempt that is the reduction of tax rates the investors and the businessmen can reinvest their income that they earned in Macedonia. The provisions that support the reinvestment are mainly included in the Law on value added tax (44/1999, 114/2007, 103/2008), the Law on income tax (27/2006, 159/2008), the Law on personal income tax (74/2006, 160/2007, 159/2009) etc.

Protection of investors. Wide spectrum of legal regulations manages this material which includes the contracts for investments protection as well. For the protection of the investors' rights and improvement of cooperative operating, the Law on commercial companies is fully applied. At the same time, the Commission of securities adopted new sub legal acts by which the provisions for information announcement of joint stock companies have been strengthen and measures have been introduced by which it is sanctioned the use of inside information. Special attention has been dedicated to the protection of the minority share holders, who in the past used to be blackmailed and interrupted freely to operate with their capital. Regarding the foreign investors the legislature in Macedonia guarantees free transfer and repatriation of capital and income.

In 2006 Law on International commercial arbitration has been adopted securing that all foreign arbitrage decisions are under direct authority of the Arbitrage court. Also the Republic of Macedonia has signed and ratified the New York convention for recognition and execution of foreign arbitrage decisions(1958) and Washington convention for solution of investment lawsuits between the states and the citizens of others state (ICSID, 1965). In this field key are: the Law on International Commercial Arbitrage (39/2006), the Law on Industrial Ownership (47/2002, 42/2003, 9/2004, 39/2006 è 79/2007), the Law on Commercial companies (28/2004, 84/05, 25/2007, 87/20085), the Criminal law (19/2004, 7/2008) and the Law on Corruption Prevention (28/2002, 126/2006).

In this part laws are also included which cover the inspection, surveillance, the Law on Labor Inspection (35/97), the Law on Department of Public Incomes (81/2005), the Law on Living Environment (53/2005, 24/2007), the Law on Food Safety, Products and Materials that are in contact with the food (54/2002, 84/2007), the Law on Market Inspectorate (24/2007), the Law on Sanitary and Health Inspection (71/2006), the Law on Construction (51/2005, 82/2008).

In order to avoid double taxation and large mutual protection of investments bilateral agreements have been concluded to guarantee the same. Namely, the agreements for support and mutual protection of investments are concluded in order to attract foreign investments and in the frames of efforts and activities of the Government for promotion of the cooperation with other countries. Usually these types of agreements are signed in terms of legal protection of investments made by investors of one country to another. Republic of Macedonia and the states that signed and ratified these agreements are obliged to deliver treatment to other country's investors which are no less of the treatment they deliver to their own investors. These agreements usually regulate the manner of resolving eventual disputes between the investor and Contracting Party, as well as eventual disputes between two Contracting Parties.

Macedonia has concluded such types of agreements with Croatia (17/95), Turkey 5/97, Slovenia 55/96, the former United Republic of Yugoslavia 69/96, Germany 8/97, Switzerland 8/97, Poland 17/97, Italy 34/97, Russia 7/98, Malaysia 7/99, Albania 15/98, Korea 15/98, France 16/98, Ukraine 21/98, Sweden 31/98, Netherland 13/99, Belgium 23/99, Bulgaria 23/99, China 44/99, Romania 7/02, Finland 7/02, Bosnia and Herzegovina 7/02, Austria 7/02, Hungary 12/02, Czech Republic 7/02 and Spain 110/05.

Closing of a business. The bankruptcy and the liquidation, the duration and the way of leading of these procedures are of essential importance for the investors and they circle this process. The financial means and the time that is necessary for liquidation or closing of a commercial company mainly represent the essential elements referring to this field. Namely, with regards to Macedonia and the procedures for closing of a business, the Law on bankruptcy (34/2006, 126/2006 and 84/2007) allows cheaper and faster implementation of the bankruptcy procedures in average of nine months.

#### 4. Tax reforms.

Generally, economic performances of Macedonia are manifested through the stable growth of GDP which is about 4-5%, the low inflation rate the average of which is 2-3%, the fiscal discipline confirmed by the international financial institutions as well as the coordination between the fiscal and the monetary policy.

With the appropriate legislation, Macedonia undertook economic reforms, and by doing so it offered the most attractive tax package in Europe. Namely, the income (profit) tax rates and the personal income tax are 10% (the profit tax was decreased for 15% and the personal income tax was decreased for 15%, 18% and 24%). Regarding the value added tax, the general tax rate is 18% whereas the preferential/privileged tax rate is 5% (including computer software and hardware, food etc.) [5].

The property tax rate amounts 0.1-0.2% and the inheritance tax is in the range between 2-3% for the tax payers that are second in the row of inheritance and 4-5% for the tax payer who is third in the row of inheritance or the one who is not in any relation with the person leaving the inheritance. For the purpose of stimulating additional foreign and domestic investments, the corporate tax on undistributed profit is 0%.

The introduction of the flat rate tax was made for the purpose of simplifying the tax system which is expected to further stimulate the successful companies to improve their operation and to increase their profitability. The intention is to also make the companies use the money they "saved" from taxes for the purpose of increasing their competitiveness. The flat rate system enables having transparent and efficient administrative procedures, simple calculation and fast filling in of the tax forms.

Special tax relief is offered to companies that operate in technological industrial development zones. This covers relief from both profit tax and personal income tax payment during the first 10 years. Each company is relieved from paying the undistributed profit tax. Companies can pay tax via Internet, and this saves their time and money. There are no restrictions on transfer accounts i.e. on the current account payments. The profit and the dividends from the investments can freely be transferred abroad, after the payment of corporate profit tax.

There are no regulatory restrictions for foreign direct investments made by non-residents in Macedonia. Credit transactions between residents and non-residents can freely be made as long as they are registered in the Central Bank. Certain legal entities that operate abroad can hold their deposits in foreign banks, only if being given permission for this by the Central Bank. Non-residents are free to open non-resident accounts in Macedonian banks. The Law on foreign exchange operations enables liberal regime regarding capital transactions, to a great extent.

According to legislation, foreign companies and foreign citizens may own construction land in Macedonia. Construction site is offered with public tender procedure. The minimum price offer is determined by the Ministry of Transport and Communications, in compliance with the Construction Land Price Determination Methodology.

Macedonia introduced one-counter system that enables investors to register their business in 4 hours. An individual can register a company by visiting one office, getting information at one place and engaging only one administration officer. This significantly reduces the administrative barriers and the business start-up costs. Decrease was made of the pension and health insurance. According to the above mentioned, and according to the Doing Business Report 2010 of the World Bank, Macedonia was ranked third among the ten top reformers for year 2008/2009. In addition, out of 183 economies, Macedonia was ranked as 32nd on the list "Ease of Doing Business".

## 5. Conclusions

The so far worldwide experiences have undoubtedly affirmed the fact that FDI is one of the fundamentals that enables and accelerates the economic development of a national economy. Consequently, every national economy must have adequate legislation that will enable smooth attracting of foreign capital.

The analysis of the legislation in Macedonia during the last decade has approved the fact that the legal aspects are of great importance for attracting the FDI. However, to some extent the institutional mechanisms that profiled the framework for doing business are important too.

The results of research done lead to the conclusion that the legal framework, as a significant factor of the business environment in a country, has a strong influence on the FDI in Macedonia. In the last decade Macedonia has achieved significant results in this field. Still, having in mind the insufficient volume of FDI, there is a need for continuous improvement of the relevant legislation. That could be done with further research and analysis, not only over the legislation, but the influence of some other socio and economic factors should be taken into account.

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**PORTFOLIO MANAGEMENT IN BANKING INSTITUTIONS OF THE REPUBLIC OF MACEDONIA**

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**Abstract:**

*The portfolio management is a continuing process for controlling the risk and return of the securities comprising the portfolio, as well as the adaptation of the portfolio towards the changes in the environment, in accordance with the predetermined objectives of the banking institutions. The bank invests its capital in more securities, that is, he creates a securities portfolio, because although investing in one security can bring the largest return, it also means taking a great risk. Therefore, in this article, the short-term and the long-term securities in which the banking institutions can invest the available financial assets in order to optimize the structure of the portfolio are elaborated. Special emphasis is put on the derivative financial instruments, which represent an effective mechanism for increasing the performances of the portfolio. Namely, the derivative financial instruments enable investors to decrease and control the important business risks. Through them the risk of interest rates change, the risk of change in the securities or in the currency exchange rate can be controlled. That means that the transactions with derivative securities can in fact, allow to maximize the return and to minimize the risk when managing the portfolio.*

**Key Words:** portfolio, management, bank.

**JEL Classification:** M15, E59.

**1. SECURITIES AS A PART OF THE BANK PORTFOLIO**

Banking institutions could invest their funds in different types of securities, depending on their preference for risk and return. There are two main categories of securities: securities that are traded on the money market and securities that are traded on the capital market.

On the money market we trade with short-term securities, maturity to one year, characterized with low risk and high liquidity. Most of the time, they are sold as a discounted securities for which the rate is included in the face value received at maturity.

There are several money market instruments, but we are going to elaborate only the most important:

- **Short-term government bonds** (treasury bills, T-bills), are financial instruments issued by the state, with maturity term from three months to one year. Usually they are issued in order to finance the budget deficits or to re-finance previously issued bonds.
-

- This way of financing the budget deficit is very important to maintain the stability of the monetary unit. If the deficit is covered with a new issue of money from the central bank, it would increase the money supply in circulation, and it would reflect negatively on the monetary unit. Short-term government bonds are risk-free government securities with a high liquidity which makes them very attractive financial instrument for investors.
- **Deposit Certificates** are transferable securities for which the issuer has an obligation to pay the certificate holder the amount of the deposit and the interest in a pre-determined period. Commercial banks sell deposit certificates to secure funds for their credit activities or to manage the interest rate risk.
- **Banker's acceptances** are usually used in international trade as an instrument for securing the payments. A banker's acceptance is created when the bank accepts the responsibility to pay the debt to the acceptance owner in a given day. This bank has the possibility to sell the acceptance to some other bank, financial institution or business subject, and in that way to gain resources for credit activities instead of using its own potential.
- **Commercial papers** are short-term uninsured securities with maturity date of 270 days. They are usually issued by large corporations. The issuer of this paper accepts the responsibility to pay the buyer the face value and the interest after the pre-determined date. Commercial papers could be sold by an institution – issuer, or through dealers who buy a certain amount of commercial papers and then sell the debt to other investors.
- **Treasury bills** are securities for which the issuer accepts the responsibility to pay the holder the defined amount and the interests in a maturity term. As issuers of treasury bills could be the central bank or the commercial banks. The central bank issues treasury bills in order to control the amount of money in circulation. And the commercial banks are using the bills for maintaining their liquidity.

Securities that are traded on the capital market have maturity date more than one year. In this category we can include all long-term bonds and shares.

Long-term bonds are debt securities within the issuer accept the responsibility to pay the borrowed amount and the interest at maturity date to the holders. In the countries with developed capital market, investors can invest their funds in different bonds. Generally bonds could be classified in four groups:

1. Government bonds;
2. Municipal bonds;
3. Foreign Bonds;
4. Corporate Bonds.

**Medium and long term government bonds** are issued by the state in order to finance the national debt. The maturity date of the medium-term government bonds is from 1 to 10 years, and of the long term government bonds is from 10 to 30 years. Government bonds are characterized with very low interest rates as a result of their minimal risk. In couple of years the return rate could be even lower than the inflation rate.

**Municipal bonds** are issued by the local authorities in order to provide funds to finance the development of regional and communal infrastructure. The gain of these bonds is excluded from taxes, which makes them more attractive for the investors.

**Foreign bonds** are issued by foreign governments or businesses. Typical for these bonds is the currency risk because they are denominated in another currency than the local currency of the country of the investor. For these bonds the legislation applied is the one from the country where they are issued. They have very interested names in different countries.



For example in Tokyo they are known as Samurai bonds, in New York and London they are Yankees and Bulldogs, in Netherlands, Rembrandt bonds and in Spain they are known as Matador bonds<sup>249</sup>.

**Corporate Bonds** are long term securities issued by business subjects with a maturity term more than one year, in order to finance their growth and development. Corporate bonds are not guaranteed by the state and that is the reason they have high risk but also a high rent in compare to government bonds.

Corporate bonds could be issued on a domestic or foreign market and in foreign currency. What type of bond a business entity will issue depends on its capital structure, capital market conditions and management decision.

Investors could also invest their free funds in shares. There are many classifications of the shares. But the most used is the one that makes difference between ordinary and preference shares.

**Ordinary shares** are securities that gives the holder voting rights and entitles him as a part-owner of the company. Bond holders can be considered as creditors of the corporation, while the owners of ordinary shares their as true owners. Ordinary shares have no limit maturity, but they exist as long as there is a business entity which has issued them.

Another type of shares in which funds can be invested are the so called **preference shares**. They got their name because they give to their holder preferential rights to dividend comparing to the holder of ordinary shares. Preference shares are also considered as hybrid securities because they have some characteristics of bonds and ordinary shares. Dividend of preference shares is paid from the net profit as same as the dividend from ordinary shares. This type of shares has reduced risk for the investors compared to ordinary shares. For this reason they have fix dividend and don't give the right to manage the business entity. Preference shares have similarities with the bonds but the major difference is the exposition of risk, which is higher for the bonds.

## 2. THE IMPACT OF THE DERIVATIVE FINANCIAL INSTRUMENTS ON THE PORTFOLIO PERFORMANCES

When managing the portfolio, one of the most efficient ways to increase the rate of return and to decrease the risk is to use the derivative financial instruments. They allow transfer of certain assets according to a predetermined price on/before specified date in the future. The value of these instruments is changing as a result of the change of one or more market variables, such as: interest rates, exchange rates, prices of securities, credit indices and price indices. These financial instruments are taking more important place on the international financial markets, because they allow investors to reduce and control business risks. Derivative financial instruments are traded on organized markets or the stock market, but also on the OTC market (Over the Counter Market). Depending on the development of the securities market, trade with these instruments can take place either within the existing stock exchange, in particular place and time, or special markets so called futures markets. On the dderivative securities market all derivative financial instruments are traded, but the most important is the trade with futures and options.

Option is derived financial instrument that gives its owner the right to buy or sell specific financial assets according to a predetermined price within a specified time period. Basic requirement to acquire the right to purchase or sale of options in advance is to determine the price or premium. The seller gets premium as a reward for having sold the option and thus assumes responsibility to deliver the securities to the buyer, as written in the option contract.

The amount of the premium is determined on the market. It depends on the rating of the issuer of the shares, the share price specified in the contract, the deadline maturity of the option and on supply and demand of optional contracts.

The goal of investors in trading with options is to optimize the structure of the portfolio, ie. to achieve maximum returns with limited risk. In doing so, they may use different strategies: strategy covered purchase option; strategy protective sale option; strategy odds, strangle strategy and spread strategy. However, it should be noted that the application of certain optional strategies will depend on the structure of the portfolio, the propensity to risk, and in some cases on the legal limits.

<sup>249</sup> Arnold G., Corporate Financial Management, Prentice Hall, Harlow, England, 2002, p.483

Futures contract is a forward contract between two partners for the purchase or sale of specific goods on a correctly specified day in the future period, and with a pre-determined price.

It is important to underline, that at the moment of conclusion of the futures contract, there is no physical transfer of the subject of futures, and no payment is made, unless payment of the initial margin, as a guarantee for the obligations undertaken by the contracting parties. Futures contracts are characterized by standard elements in terms of volume, the trade cycle in the month in which the trade takes place, listing, the date of delivery of the subject of the futures etc.

### 3. STRATEGIES FOR INVESTING IN SECURITIES

Portfolio managers constantly make decisions related to the choice of instruments in which will be invested funds and assess, and compare the expected returns and risks of securities in order to optimize the structure of the portfolio. In addition, banking institutions apply active or passive investment strategies in securities.

Passive strategy of investing in securities is used generally in small banks that do not have sufficient resources and trained staff to actively manage the investment portfolio. The advantage of these strategies is that they are easy to understand, simple to use, do not require great expertise or big investments in hardware and software. Passive investment strategies include staggered maturity strategy and split maturity strategy.

**Staggered maturity strategy** requires the management of the bank first to determine the period of storage of the securities. Thus, the total investment portfolio is divided in equal parts within the maximum maturity. Furthermore, as the securities will become due, the bank will invest in securities with the highest maturity and will maintain steady maturity investment portfolio allocation. With this strategy the bank realized average yield, but also a good level of liquidity because every time some of the securities become due.

With the **Split maturity strategy**, the bank invests a portion of the portfolio, usually one-third or one-quarter, in securities with short deadlines maturity and with this provides liquidity. The rest, the bank invests in securities with long terms maturity, which carry high yields. So, through this strategy, the bank provides its liquidity, but achieved higher total yield of the investment portfolio, comparing the previous strategy.

The big banks have the skilled staff and adequate technical resources, and most of the time they are using active investment strategies. This requires relatively frequent changes in the portfolio in line with the expected changes in economic activity and movements in the financial markets. To apply such strategy, the banks must have the ability to predict the future movement of interest rates. Active investment strategies include yield curve strategy and the security swaps strategy.

With **Yield curve strategy** bank tries to take advantage of expected favorable movements in interest rates, which means to invest in securities in accordance with the level and slope of the yield curve.

With **security swaps strategy** bank performs the replacement of one financial instrument with another which has different characteristics (credit risk, yield, tax treatment, maturity, etc.), in order to take advantage of favorable market movements and to achieve higher yields, without taking additional risk.

### 4. STRUCTURE OF PORTFOLIO SECURITIES OF BANKS IN THE REPUBLIC OF MACEDONIA

Banking institutions in the Republic of Macedonia invest a significant portion of its assets in securities. Table 1 shows the structure of the portfolio of banks in the Republic of Macedonia for the period 2008-2010.

Table 1. Structure of the portfolio securities of the banks in the Republic Macedonia

Number	Portfolio of securities	Structure (%)		
		2008	2009	2010
<b>1.</b>	<b>Debt securities (1.1.+1.2.)</b>	<b>95,5%</b>	<b>96,80%</b>	<b>97,70%</b>
<b>1.1.</b>	<b>Money market instruments</b>	<b>72,2%</b>	<b>78,40%</b>	<b>88,50%</b>
	-Treasury bills NBRM	60,5%	51,70%	57,10%
	-Bills	11,7%	26,70%	31,50%
<b>1.2.</b>	<b>Bonds (1.2.1.+1.2.2.+1.2.3.)</b>	<b>23,3%</b>	<b>18,40%</b>	<b>9,20%</b>
<b>1.2.1.</b>	<b>Government bonds</b>	<b>20,1%</b>	<b>15,10%</b>	<b>7,80%</b>
	- Continuous government bonds	2,7%	0,70%	0,00%
	- Structural bonds	6,5%	4,70%	2,10%
	- Bond "commercial bank" AD Skopje	11,0%	8,60%	4,90%
	-Eurobond	0,0%	1,10%	0,80%
<b>1.2.2.</b>	<b>Corporate bonds issued by domestic banks</b>	<b>2,9%</b>	<b>2,70%</b>	<b>1,40%</b>
<b>1.2.3.</b>	<b>Bonds issued by foreign countries</b>	<b>0,2%</b>	<b>0,50%</b>	<b>0,00%</b>
<b>2.</b>	<b>Equity instruments</b>	<b>4,5%</b>	<b>3,10%</b>	<b>2,20%</b>
	- issued by non-financial companies	1,3%	0,20%	0,10%
	- issued by banks and other financial companies-residents	2,6%	2,60%	1,90%
	- issued by financial companies – non residents	0,7%	0,30%	0,20%
<b>3.</b>	<b>Derivatives</b>	<b>0,0%</b>	<b>0,00%</b>	<b>0,00%</b>
<b>4.</b>	<b>Total portfolio of securities (1+2+3)</b>	<b>100,0%</b>	<b>100,00%</b>	<b>100,00%</b>

Source: Report for the Banking System of the Republic of Macedonia in 2011, the National Bank, Skopje, www.nbrm.mk

As it can be seen from the table, most of the portfolio securities of the banks in Macedonia consists of debt securities (97.7% in 2010). Within the debt securities, largest part have treasury bills that occupy 57.10% of the total portfolio in 2010, followed by government securities with 31.5%, and bonds with 9.20% of the portfolio securities. Although the regulations allow Macedonian banks to invest in equity securities (with certain restrictions), they are poorly represented in their portfolio. Thus, in 2010 only 2.20% of the total portfolio is for equities. Despite the advantages that they offer banks in the Republic of Macedonia do not invest in derivative financial instruments.

### CONCLUSIONS.

Banking institutions form a portfolio of securities for several reasons: maintaining liquidity, achieving additional revenue, and reduce risk exposure. Portfolio management involves making decisions, in which instruments the bank will invest, in order to maximize returns at a certain rate risk, or to minimize the risk at a specific rate of return. In addition, banking institutions can use active and passive investment strategies. Small banks usually apply passive investment strategies, such as staggered security strategy and split maturity strategy.

The big banks that have the skilled staff and adequate technical resources are usually using active investment strategies, which require relatively frequent changes in the portfolio in line with the expected changes in economic activity and movements in the financial markets.

The structure of the portfolio of the banking institutions in the Republic of Macedonia is very poor, which is a consequence of the underdevelopment of the Macedonian Stock Exchange. In conditions when having limited supply of securities, Macedonian banks predominantly invest in government bonds and treasury bills of NBRM, which are characterized by low risk and low return. To optimize the structure of the portfolio, it is necessary to invest the funds in debt and equity securities, but also in foreign securities, in order to take advantage offered by international diversification.

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**READINESS OF THE COMPANIES IN THE REPUBLIC OF MACEDONIA FOR USING THE MODERN DECISION SUPPORT SYSTEMS (DSS-Decision Support System)**

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**Abstract:**

*The Decision Support Systems give logistic support to the process of making decisions in the contemporary companies. DSS are complex computer programs which based on the input data from the database can predict the activities of the real system and some future circumstances. DSS provides the management to test the system activities of the environment's different changes and to test the environment's reaction when different changes occur. Namely, DSS provides a very fast way to consider the effects of the made decisions. All the methods that are used as a support in the process of decision making could be based on different simulation models, optimization techniques or heuristic algorithms. When solving practical problems, large application procedures are based on combination of optimization and heuristic procedures. With an adequate combination of optimization, heuristic and experiential procedures that describe different segments of the real system for a very short time can emerge a separate satisfactory solution. In this project will be implemented a method of objective collection, analyzes, and interpretation of the data, by which the research process gets a scientific character. This methodological approach has been used through the gathered information about the application of the modern DSS through systematic, empirical and analytical research of the previously shaped hypothesis. In order to research the condition in our country is used the method of the structure survey, by which we will get information about the implementation of DSS in the business entities in Macedonia. As priority objectives that are established by this project are the following: »Assessment and conclusion on the application of Decision Support Systems; »Indicating the benefits of implementation of the Decision Support Systems ; »Providing strategic guidance under which the companies will develop in the implementation of the contemporary Decision Support Systems*

**Keywords:** *Decision Support Systems, decision-making, information systems.*

**JEL Classification:** *M20.*

**1.INTRODUCTION.**

The process of deciding is a part of the things that each manager has to do during his work. We make decisions every day, in accordance with the things connected to the classical functions, as: planning, organizing, managing with the employees, the management in general and control. The process of deciding is not an individual process, i.e. isolated function of the management but it is in realization with all the business functions. The managers (the decisions makers) at all the levels make decisions that sometimes they are "small" and sometimes they are "big". However no matter whether the made decisions will realize or not all their decision makers go through the decision-making processes. Therefore, this process should first be well acquainted, and then you can manage with it. In all approaches that are present in the contemporary management theory, the term decision-making means rational choice of one of the possible alternatives.

On the other side, the decision theory<sup>250</sup>, and the quantitative methods and models as well, were previously developed independently from the information technology and information systems. Namely a whole range of quantitative methods and models emerged (linear programming, network planning, simulation, dynamic programming, theory of waiting lines and others.) that have no mutual elements.

<sup>250</sup> Cooke, S. And Slack, N. (1991), "Making Management Decision", (second edition), Prentice Hall, New York, page 13

This development of quantitative methods and models entered in a crisis that is caused by the adjustment problem methods rather than (vice versa), i.e. insisting to optimal and not real decisions or orientation towards achieving the goal, regardless the means that will be spent, not existing an adequate theory of key problem areas etc. The efforts to overcome the crisis in the use of quantitative methods and models in the decision process led to the end of the seventies of the twentieth century appeared to support decision-support system.

The Decision Support Systems are information systems, that are similar and complementary to the standard information systems and have an aim mainly to support business for decisions - making processes. They are a symbiosis of the information systems, the use of a range of functional knowledge, and the current process of decision – making.

The Decision Support Systems<sup>251</sup> generally are defined as information systems that are built to help the decision maker in the solving the poorly-structured decision-making problems. Their main goal is to provide qualitative information for the decision-making process, in order to increase the efficiency in decision-making. The main characteristics of these systems are: oriented decision-making, orientation towards solving the poorly-structured problems and orientation towards the final user. The decision-making systems help and support the decision-maker in the process of decision-making, but they do not make this process automatic, because they do not replace the man in "judgment" about the problems of decision-making and related human functions. They help the decision-maker to make more qualitative decisions, so it is said that they serve to improve the effectiveness (the quality), instead of (the speed) of the process of decision-making.

DSS should provide the manager time exact information, that will be at the same time accurate, relevant and complete. DSS must give the information in an adequate form in order to be easy to understand and manage. The information presented with the DSS could be a result, or could be taken from outside sources. The DSS could present either internal or external facts, different opinions and predictions that could help the manager. That is the reason why he wants the right information, at the right time and in the right form.

## **1. READINESS OF THE COMPANIES IN THE REPUBLIC OF MACEDONIA FOR USING THE MODERN DECISION SUPPORT SYSTEMS.**

Information Decision Support Systems are based on a set of procedures which are used by the data processing models and making decisions models. The central place have neither the data nor the information, but the decisions. The analysis system has a form of a prototype and the description of the things is semi-structured. The system outputs are relational views while the software basis is a generator of the program

In order to identify the use of decision support systems in the companies in the Republic of Macedonia was needed to conduct a survey. The statistic sample was created out of 30 companies from various fields in order to get more relevant results about the use of the Decision Support Systems in the companies. The survey was focused on three main aspects:

- Basic indicators for existence of the Decision Support Systems in the companies;
- Using the Decision Support Systems;
- Strategic aspects.

In the first part the emphasis was added on the computer use, the Internet and the computer networks in the companies.

From the 30 companies surveyed, while performing everyday routine tasks, all the 30 companies said that they use computers. According to the answers of the companies, 20 of them allow Internet access to their working places.

The third question in the conducted survey was Whether in their company they have implemented a local computer network.

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<sup>251</sup> James A. O'Brien.(2006), "Introduction to Information Systems", College of Business Administration Northern Arizona University, McGraw-Hill, page 330

According to the answer of the interviewed companies, half of them have implemented a local computer network.

In the second part of the survey, the stress was on the use of the Decision Support Systems.

Namely, the question whether the companies use the Decision Support Systems, in the process of decision-making, from 30 surveyed business subjects only 12 said yes, 18 said they do not even use the Decision Support Systems in the process of decision-making.

From the interviewed companies, 16 of them are informed about a statistic software on the Internet that could be used as a support in the process of decision-making. From the surveyed business subjects 14 answered that they are not informed about the statistic software on the Internet.

On the question whether the manager is trained to work with a statistic software, 14 companies answered yes and 16 companies answered no.

Of the interviewed companies only 12 have developed their own Decision Support System, and 18 of them gave negative answer.

The stress on the third part of the survey was on the strategic aspects set by the companies.

24 of the interviewed business subjects answered that they plan to develop a Decision Support System and the other 6 companies gave negative answer.

Only 6 interviewed business subjects answered positively the question whether they have Decision Support System Department, and the other companies answered that they have no need of such Departments.

Only 10 out of 30 companies answered that in their mission and vision have a strategy for the Decision Support System development.

Of the 30 surveyed companies, 12 answered that they are informed about their opponents' level of development of the Decision Support System.

The question Do You think that the Decision Support Systems would reflect positively on the work of the company, 17 companies answered positively and the other 13 think that they will not have use of these systems.

22 of the surveyed business subjects answered that their company can use a Decision Support System, and the remaining 8 companies gave negative answer.

The data presented in table1, are tested by the Kohran<sup>252</sup> test which is used when more than two groups of extracts are equalized in their original properties, and each element of the extract meets or does not meet a feature, depending on the appropriate factor. In this test the value  $R_k$  based on the formula is determined:

$$R_k = \frac{\left( \frac{1}{k} \sum_{j=1}^k G_j^2 - \frac{1}{k} \left( \sum_{j=1}^k G_j \right)^2 \right)}{k \sum_{i=1}^n n_i - \sum_{i=1}^n n_i^2} \quad 1 \ 0 \ 0 \ 1 \ 286.08 \ 304.77 \ T_{\mu} \ ()$$

where

$k$  – number of columns;

$n$  – number of elements in the extract;

$G_j, j = 1, 2, \dots, k$  - sum of positive answers in  $j$  – column;

$n_i, i = 1, 2, \dots, n$  - sum of positive answers in  $i$  – column ;

The value  $R_k$  is compared to the chart value  $X_{(T_{\mu})}$  for  $k=5, n=30, k-1=4$  free degrees

<sup>252</sup> Kosta S.(2004), "Statistics", Faculty of Economics - Prilep, page 297

If  $R_k < X_{(0,05;13)}$ , null hypothesis is accepted with probability  $(1-\alpha)$ , and hypothesis is rejected  $H_0$ , with risk  $\alpha$ .

We set the statistical hypotheses:

$H_0$  - The companies do not use Decision Support Systems.

$H_1$  - The companies use Decision Support Systems

Data obtained from the chart are replaced in the corresponding formula:

$$R_k = \frac{\left( \frac{k}{n} \sum_{i=1}^k n_i^2 - \frac{\left( \sum_{j=1}^k n_j \right)^2}{n} \right)}{k \sum_{i=1}^n n_i - \sum_{i=1}^n n_i^2} = \frac{0,405 \left[ \frac{14}{229} \left( 1650^2 + 561^2 + 503^2 + 524^2 + 246^2 + 229^2 \right) - \left( \frac{14051}{229} \right)^2 \right]}{14 * 229 - 2005} = 77,17$$

For  $r = k - 1 = 14 - 1 = 13$  free degrees and threshold of significance 0,05 from the statistical chart the theoretical value is shown:

$$X_{(0,05;13)}^2 = 22,362$$

Because  $R_k = 77,17 > X_{(0,05;13)}^2 = 22,362$ , the null hypothesis is rejected it can be concluded that the business subjects in the Republic of Macedonia use Decision Support Systems.



Companies	Answers <sup>253</sup>											
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Atlantida	1	0	0	1	1	1	1	1	1	0	0	0
Alfigo	1	0	0	0	0	1	0	0	1	0	0	0
Biser	1	1	1	1	1	0	1	1	1	1	1	0
Vasidora	1	1	0	0	0	1	0	0	1	0	1	0
Geras Cuvev	1	0	0	0	0	0	0	0	0	0	0	1
Elektromehanika	1	0	0	0	0	1	1	0	0	0	1	0
Zito Vardar	1	1	1	1	1	0	1	1	1	0	0	0
Iraklis	1	1	1	1	1	1	1	1	1	1	1	1
K-15 Production	1	1	1	1	1	0	1	0	0	0	0	0
Kolid	1	1	0	1	0	0	0	0	0	0	0	1
Lerina	1	1	1	1	1	1	0	1	1	0	0	0
Makedonska Zora	1	0	0	0	0	0	0	0	1	0	0	1
Maks	1	0	0	1	0	1	1	0	1	0	1	0
Marval-Promet	1	1	1	1	1	1	1	1	1	1	1	1
Megasoft	1	1	1	1	1	0	0	1	1	1	0	1
Medika	1	1	0	1	0	0	0	0	1	0	0	0
My Market	1	0	1	1	0	1	1	0	1	0	1	0
Neptun	1	1	0	0	0	0	0	1	0	0	1	1
Net kabel	1	1	1	1	1	0	1	1	1	0	0	1
Nova Promet	1	0	0	1	0	0	0	0	1	0	0	0
Resana	1	0	1	0	1	1	0	1	1	0	0	0
RTS Elektro	1	1	0	1	0	1	1	0	1	0	0	0
Riversoft	1	1	1	1	1	1	1	1	1	1	0	0
Sabotko	1	1	0	1	1	0	0	1	1	1	1	0
Savana enterieri	1	1	0	0	0	1	1	0	1	0	0	1
Tarbsmak	1	1	1	1	0	0	0	0	1	0	0	0
Total TV	1	1	1	0	0	0	0	0	1	0	0	0
Helena	1	1	0	1	0	1	0	0	1	0	0	1
Horizont	1	1	1	0	0	1	0	0	1	0	0	1
Jordan	1	0	1	0	0	1	1	0	0	0	1	1
Sum:	30	20	15	19	12	16	14	12	24	6	10	12

Table 1

<sup>253</sup> 1-the company answers was YES; 2- the company answers was NO

## CONCLUSIONS.

If we analyze the survey, conducted in 30 companies, the following conditions can be realized:

- All the surveyed business subjects use computers in their everyday routine tasks, and most of them allow the employees access to the Internet. They have implemented the Local Computer Network (LAN) and have heard about the Decision Support Systems. Unfortunately only 40% of the companies use the Decision Support Systems, as a support in the process of decision-making.
- Despite the fact that the companies know the benefits of the implementation of the Decision Support Systems, only a small number use them. Half of the companies are informed about the existence of a statistical software for decision support, but their management is not sufficiently trained in their use, and even though they know the using the offered benefits by using the statistical software in the process of deciding.
- Despite that even 24 out of 30 companies think that they will accept the use of the Decision Support Systems, and that they plan to develop such system. However most of them have not organized a separate department for the Decision Support Systems and have not developed a strategy for development of these systems. Most of the companies are reserved that the Decision Support Systems would have positive impact on their work in the company. The made conclusions based on the conducted survey, were expected and real, mainly because of the constant economic climate of the Macedonian companies. In fact, Macedonian economy, except several bigger companies, is an economy which is characterized by small and medium sized companies. Despite the fact that the companies are aware of the benefits of using the Decision Support Systems they still have no such large production or that type of services to be able to justify economically the possible use of the Decision Support Systems.

In this context, Macedonian companies should tend to accept the global trends, that dictate rapid development, but only through the fast adaptation of the new states and economy development caused by the opponents, the t changing regulations, openness of economies, the companies in the high economically developed countries penetrate much faster on the markets than those in the not developed countries and developing countries, and change the constellations on the market. Based on this, the process of implementation of the Decision Support System in the companies in the Republic of Macedonia needs fastening through the fulfillment of the following conditions: The use of computers and information technology should be present in all the companies, and therefore will the tasks will be performed on a faster and more effective way, that are strategically planned.

The implementation of LAN networks in a large percentage will increase the flow of information in companies and therefore they will have to seek the fastest way possible and in the shortest period of time, to be installed. The global electronic network, the Internet, should be used in the everyday activities of companies, primarily to keep pace with the innovations offered by the top global corporations and the possibilities of adjusting the domestic economy to global trends and in that percentage as the financial strength of the companies is. The managers are forced to make and to implement particular decisions by which they will regulate the normal function and implementation of the corrective action at all levels. Hence, emerge the logical necessity of making decisions that are in function of the effective business deciding, in these companies the Decisions Support Systems should be fully implemented. Increasing the awareness of the management teams in the companies for the positive aspects of the Decision Support Systems use, in fact allows permanent training of the employees whose tasks are directly connected to the process of decision making and implementation of the innovative processes, that despite the experience, the experts' opinion is necessary.

Because Macedonian economy's structure is on the side of small and medium-sized companies, where the financial power for innovations and application of new techniques and technologies is at a very low level, the business subjects need to recognize the effects of the Decision Support Systems use. Most of them are available on the Internet, or they can taken from the other companies, and to use them as a model for a Decision support System which will be upgraded with the specific features of the company and will be suitable to meet the needs in making better decisions.

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[4] 1-the company answers was YES; 2- the company answers was NO

## THE IMPACT OF SERVICE PERFORMANCE OF LOGISTICS ACTIVITIES ON CUSTOMER COMMITMENT AND LOYALTY

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### Abstract:

*The aim of this study is to examine the role of logistics activities and on customer loyalty, commitment and performance. The main objective is to analyze the logistics service quality (LSQ), commitment, loyalty and performance in a supply chain context. Logistics services include activities that contribute to consistent quality, productivity and efficiency, as well as activities that help companies to better meet customer expectations and needs. Customer loyalty is increasingly recognized as a path to long-term success because finding new customers and doing business with them takes time, effort and money. Increasing the level of performance, while maintaining low costs create value for customers and for companies, too. A questionnaire based on personal survey was conducted among retail customers of a wholesale company in Albania. The study collected data from 204 companies. The hypotheses were tested using structural equation modeling (SEM) which is a comprehensive statistical approach for testing hypotheses about relations between observed and latent variables. The reliability and validity tests show satisfactory results. The conclusions confirm all the relationships hypothesized, and emphasize the crucial role of LSQ in the loyalty-commitment-performance chain of relations.*

**Keywords:** Logistics service quality, Commitment, Loyalty, Performance

**JEL Classification:** M31

### 1. Introduction

During the last two decades the idea of relationship marketing - establishing, developing, and maintaining successful relational exchanges - has gained significant importance (Morgan and Hunt, 1994). A vast body of literature supports the importance of developing and maintaining enduring relationships with customers (Ganesan 1994), which leads to long-term customer retention (Mattila 2001). In a supply chain context, relationships can be a sustainable source of competitive advantage due of their ability to create barriers to competition (Day 2000). Since an important focus of supply chain research is the collaborative relationships with select trading partners (Bowersox and Daugherty1995), an important strategic result for companies is the building and growing of customer loyalty.

Customer loyalty is increasingly recognized as a path to long-term success because finding new customers and doing business with them takes time, effort and money (Mittal and Lassar 1998). It can be more expensive to obtain a new customer than retain one, and an organization's long-term success in a market is increasingly determined by its ability to expand and maintain a large and loyal customer base (Kandampully 1998). Fay (1994) asserts that customer loyalty objectives have gained the same importance as other financial or strategic objectives. Reichheld et al. (2000) also contend that in the past, building loyalty with *select* customers was just one weapon to use against competition, but today it has become essential to survival.

As products become more commoditized, companies can no longer maintain a loyal customer base or create sustainable advantages for themselves by only having a variety of tangible products. Rather, firms form complex relationships with customers and differentiate themselves by offering goods and service mixes in distinct ways to offer convenience, reliability, and support (Fuller, et al., 1993). Improving logistic capabilities and the quality of logistic activities helps in building closer relationships with customers (Bowersox et al.,1995), gaining and maintaining customer loyalty (Bowersox et al. 1992). As the increasing competitive markets make hard for firms to find and retain important business customers (Flint and Mentzer 2000), they can positively impact customer loyalty by providing high quality logistics service.

A crucial goal of relationship marketing theory is to identify key drivers that influence important outcomes for the firm and to gain a better understanding of the links between drivers and outcomes (Hennig-Thurau et al., 2002). Therefore, understanding how logistics service can influence loyalty and commitment, and ultimately firm's performance, could be significant in examining and predicting supply chain relationship outcomes. However, logistics service is sometimes ignored as a competitive tool (Sharma, Grewal and Levy 1995).

The purpose of this study is to examine the casual relationships between Logistics Service Quality (LSQ), loyalty, commitment and firm's performance. The main objective is to help companies assess the impact of logistics service in creating loyalty and commitment and their effect on market and financial indicators of performance.

## 2. Theory review and hypotheses

**Logistics Service Quality:** Since the beginning of the 1980s, service quality has been a priority theme in for marketing researchers and practitioners, focusing mainly in quality, quality management and satisfaction (Fisk et al., 1993; Richey et al., 2007). Millen et al. (1999) contend that improved customer satisfaction is a key outcome of LSQ, while Mentzer et al. (2001), conclude that part of the value of a product is created by logistics service.

In marketing, the focus of service performance has been on service quality, or the evaluation of service performance. The definition and measurement of service quality has occupied a prominent position in the services marketing literature. The service quality paradigm started with a qualitative study, where the differences in perceptions of service between managers and consumers were examined (Parasuraman et al., 1985). The authors developed a service quality model that showed several discrepancies ("gaps") between perceptions of customer service by the supplier and the customer. In an effort to empirically examine the gaps, Parasuraman, Zeithaml and Berry (1988) developed a service quality measurement instrument called SERVQUAL for assessing customer expectations and perceptions of service quality in service and retail organizations. This multi-item scale evaluates the five dimensions of quality:

1. *Tangibles*: physical facilities, equipment and appearance of personnel;
2. *Reliability*: ability to perform the promised service dependability and accurately;
3. *Responsiveness*: willingness to help customers and provide prompt service;
4. *Assurance*: knowledge and courtesy of employees and their ability to inspire trust and confidence;
5. *Empathy*: caring, individualized attention that a firm provides to its customers.

For almost three decades there has been a stream of research addressing the definition, conceptualization and measurement of service quality. Grönroos (1984) conceptualizes service quality to be formed by two components:

1. technical quality expressed as the service being technically acceptable and leading to a concrete result; and
2. functional quality which includes the way the customer is treated during the service provision process.

The inclusion of customer perceptions in measuring service quality with SERVQUAL scale attracted logistics researchers to apply this scale in the logistics context. Beinstock, Mentzer and Bird (1997) argued that researchers should explore alternative dimensions of logistics service quality, since the service provider and the service customer are physically separated and the services are directed at "things" instead of people, thus technical or outcome dimensions are necessary for logistics service quality measurement instruments. Studies on service quality have proved that SERVQUAL items must be customized to the specific service environment (Carman, 1990; Finn and Lamb, 1991), in order to effectively address service quality in different industry contexts (Brown et al. 1993).

Logistics researchers have utilized the studies on service quality and their measurement scales, adopting them to fit the specific study context. Mentzer, Flint and Hult (2001) developed a LSQ scale with specific logistics service dimensions. They conceptualized LSQ as a process and the scale was based on qualitative research from a large logistics service provider's customer base. According to Maltz and Maltz (1998), logistics service has two components. The first is basic logistics service, involving cycle time, on-time delivery, and inventory availability. The second component is responsiveness, representing the ability to adapt to market-driven change. Collier (1991) also suggests that service consists of two distinct dimensions, but he identifies them as the internal or operations-oriented dimension of service quality performance and the external or marketing-oriented dimension. Stank, et al., (1999) and Stank et al. (2003) also developed a scale to measure both the operational and relational elements of logistics service performance.

Literature in supply chain management and logistics suggests that logistics service quality may contribute to a firm's market and financial performance (Bowersox et al., 2002). Based on previous research, the following hypotheses were developed:

**H1: LSQ has a positive influence on loyalty**

**H2: LSQ has a positive influence on commitment**

**Commitment:** Commitment is recognized as an essential ingredient for successful long-term relationships (Dwyer et al., 1987, Gundlach et al., 1995). Dwyer et al. (1987) define commitment as an "implicit or explicit pledge of continuity between relational partners" (p. 19). Also defined by Gundlach et al. (1995), "Commitment is thought to be closely related to mutuality, loyalty and forsaking of alternatives, variables which are the core of the meaning of relationalism" (p. 79). They propose three components of commitment:

1. An input or instrumental component; this involves an affirmative action taken by one party that creates a self-interest stake in the relationship and demonstrates something, more than a mere promise.

2. An attitudinal component signifying an enduring intention by the parties to develop and maintain a stable long-term relationship. This component can also be described in terms of affective commitment, with psychological attachment, identification, affiliation and value congruence.

3. A temporal dimension indicating that commitment involves something long term.

Studies of relationship marketing show that, if commitment is lacking, the relationship will come to an end (Wetzels et al., 1998). Meyer and Allen (1991) note that common to the various definitions of organizational commitment is "the view that commitment is a psychological state that (a) characterizes the employee's relationship with the organization, and (b) has implications for the decision to continue membership in the organization" (p. 67). Meyer and Allen (1997) described three components of commitment as (1) affective commitment, (2) continuance commitment, and (3) normative commitment.

Dwyer, Schurr and Oh (1987) suggest that the key distinction of the commitment phase is that the parties purposefully engage resources to maintain a relationship fueled by the on-going benefit accrued by each partner. Morgan and Hunt (1994) theorize that trust and commitment lead directly to cooperative behavior which, in turn, contributes to the success of relationship marketing by promoting efficiency, productivity and effectiveness for both parties.

Pritchard, Havitz and Howard (1999) found commitment to be strongly correlated with customer loyalty. Iwasaki and Havitz (2004) suggested that psychological commitment mediated the effects of enduring involvement on patrons' behavioral loyalty.

Fullerton (2003) investigated the roles played by different forms of commitment in the relationship between customers and service providers. They found that, when customer commitment is based on shared values and identification, it has a uniformly positive impact on customer loyalty.

Based on these previous findings, respective hypotheses are formed:

**H3: Commitment has a positive influence on performance**

**H4: Commitment has a positive influence on loyalty**

**Loyalty:** Two approaches have been employed in the study of loyalty, including the stochastic approach and the deterministic approach. The deterministic approach holds that loyalty should be viewed as an attitude; therefore, the researcher can manipulate numerous factors that lead to loyalty (Jacoby, 1971; Jarvis and Wilcox, 1976). Deterministic research examines the psychological effect of loyalty, ignoring the outcomes of loyalty (i.e., purchase behavior).

Dick and Basu (1994) define loyalty as the relationship between the relative attitude toward an entity (brand/product/service/store/vendor) and patronage behavior. In addition, researchers have noted the importance of distinguishing between true (intentional) loyalty and repeat purchase behavior (Jacoby and Kyner, 1973; Jarvis and Wilcox, 1977). The basis of this distinction is that true loyalty involves a psychological bond to the seller and requires a high degree of customer satisfaction and commitment, whereas repeat purchase behavior does not involve the psychological commitment. Repeat purchase behavior generally occurs because of time/energy costs, perceived risk, perceived absence of choice, probability or bias, temporary selling incentives, or legal and corporate policy constraints (Jarvis and Wilcox, 1976).

Dick and Basu (1994) built upon their concept of the relationship of relative attitude with repeat patronage by cross-classifying four conditions of loyalty. A low relative attitude combined with low repeat patronage indicates an absence of loyalty. Spurious loyalty consists of a low relative attitude combined with high repeat patronage, indicating the possibility of non-attitudinal influences on the consumer's behavior. High relative attitude with low repeat patronage establishes latent loyalty, where it is assumed that situational effects and market conditions are equally as strong as attitudinal effects on the consumer's behavior. The final and most desirable of the four conditions is loyalty, where there is a positive relationship between relative attitude and patronage behavior.

Yim and Kannan (1999) developed a modeling framework of consumer behavioral loyalty that is useful for segmentation. The first segment of consumers identified by the model is the hard-core loyalty group. This group exclusively makes repeat purchases of one product alternative. The second consumer segment identified is the reinforcing loyalty group. In contrast to the hard-core loyalty group, this segment predominantly makes repeat purchases of one or more product alternatives.

Dick and Basu (1994) also described several important cognitive, affective, and conative antecedents to consumer loyalty. Cognitive antecedents identified by the authors include the accessibility and ease with which an attitude can be retrieved from the consumer's memory, the attitudinal confidence (level of certainty) a consumer has about their attitude or evaluation, the centrality of the relationship between the consumer's attitude and the consumer's value system, and the clarity of the consumer's attitude or evaluation.

The affective antecedents included emotions, moods, primary affect (independent of cognitions), and satisfaction. Finally, important conative antecedents to the development of consumer loyalty include switching costs, sunk costs, and expectations.

From the above, the following hypothesis can be extracted:

**H5: Loyalty has a positive influence on performance**

Figure 1 portrays the conceptual model to be tested and respective hypotheses

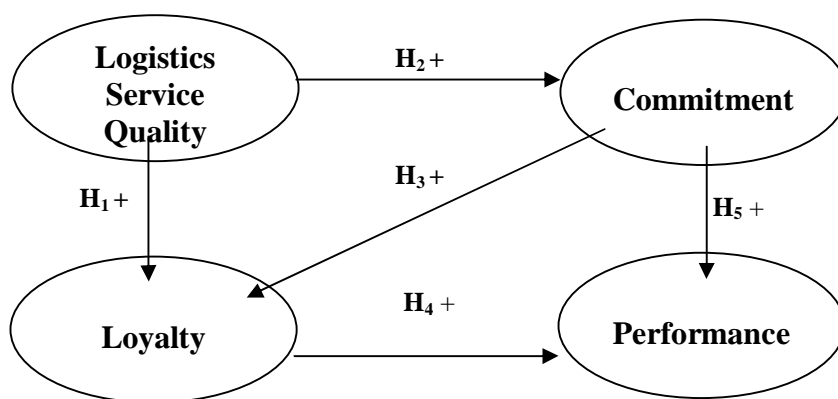


Figure 1 Conceptual model and hypotheses

**3. Research methodology and tests results**

To examine the proposed hypotheses, data were collected from the retail business customers of a powerful wholesaler in Albania. The person who managed each company contacted was also responsible for the purchase decisions, so the appropriate and necessary data could be obtained from the interview. From 251 businesses contacted, 224 agreed to cooperate, and finally only 204 questionnaires were considered valid for further examination. Thus the response rate was 81%. The managers were contacted directly, and 10 individuals were engaged in the field work of data gathering. These individuals had previous experience with interviewing; nevertheless, they were shortly trained on the specifics of this kind of study. The period of data collection was April – May 2012. Table 1 presents a summary of sample’s characteristics

<b>Relationship length with the wholesaler</b>	1 to 3 years	17	8.33%
	4 to 6 years	22	10.78%
	7 to 9 years	67	32.84%
	10 to 12 years	64	31.37%
	More than 12 years	34	16.67%
		<b>204</b>	<b>100%</b>
<b>Percentage of business conducted with the wholesaler</b>	Less than 15%	18	8.82%
	15% to 30%	57	27.94%
	31% to 45%	48	23.53%
	46% to 60%	27	13.24%
	61% to 75%	16	7.84%
	More than 75%	38	18.63%
		<b>204</b>	<b>100%</b>
<b>Annual Revenue</b>	Under 15,000 €	45	22.06%
	15,001 to 30,000	23	11.27%
	30,001 to 45,000	22	10.78%
	45,001 to 60,000	54	26.47%
	60,001 to 75,000	28	13.73%
	More than 75,000	32	15.69%
		<b>204</b>	<b>100%</b>

**Table 1 Sample's characteristics**

Development of the measurement scales for each construct in the model proceeded through a series of steps. A review of the relevant literature was first conducted to identify available measures. Since the sampling frame came from the retailing industry, it was critical to adapt the measures to fit the industry context. Based on the measures derived from the literature, preliminary interviews were conducted with the wholesale company managers, as well as with a dozen target retailing companies' managers. The interviews were particularly useful in adapting meaningful measures of operational and relational order fulfillment service to the retailing industry context. Then the complete customer survey instrument was developed.

A Likert format where 1 reflected "strongly disagree" and 7 reflected "strongly agree" was used. Measures for Logistics Service Quality were constructed first in accordance with the existing scales from Stank et al. (2003), Stank et al., (1999), and Mentzer et al., (2001).

Commitment was measured with items from both Hennig-Thurau et al. (2002) and Smith (1998). Loyalty was measured with items from Balogly (2002) and Plank and Newell (2007). The performance measures were adapted from Webster (1992), Cooper et al. (1997) and Carr and Pearson (1999).

Before hypothesis testing, scale purification was performed. Following basic descriptive analyses, including examination for coding errors, normality, skewness, kurtosis, means, and standard deviations, the purification data set was subjected to confirmatory factor analyses (CFA) by means of SPSS AMOS 18.0. After these analyses, all the items were considered valid for the measurement of the respective hypothesized construct. The measurement scales are presented in Table 2.

Construct	Measure	Loading	AVE	Construct Reliability
<b>Logistics Service Quality</b>	1. This supplier delivers its products/services on or before the requested delivery date	0.812	0.689	0.899
	2. This supplier always provides us with the quantities we need.	0.798		
	3. The shipments from this supplier are accurate	0.871		
	4. This supplier handles discrepancies with orders very well	0.778		
	5. This supplier proactively communicate supply issues that may delay our order	0.801		
	6. This supplier cooperates with us to make order processing more efficient	0.846		
	7. This supplier makes recommendations for continuous improvement on an ongoing basis	0.764		
	8. This supplier knows our needs very well	0.783		
	9. This supplier is responsive to problems that may arise	0.791		
<b>Commitment</b>	1. Our relationship with this supplier is something that we are committed to	0.931	0.784	0.847
	2. Our relationship with this supplier is very important to our company	0.894		
	3. Our relationship with this supplier is something we really care about	0.847		
	4. Our relationship with this supplier deserves our maximum efforts to maintain	0.741		
	5. We believe that this supplier and our firm are both committed to the relationship	0.852		
	6. This supplier is prepared to make short term sacrifices to maintain our relationship	0.794		
	7. I believe that this supplier and our firm	0.794		



	view our relationship as a long-term partnership	0.913		
<b>Loyalty</b>	1. We recommend this supplier to our partners	0.869	0.817	0.931
	2. We encourage our partners to do business with this supplier	0.847		
	3. We consider this supplier our first choice when we purchase the goods/services they supply	0.914		
	4. We will continue to do business with this supplier for the next few years	0.746		
	5. We are willing to maintain our relationship with this supplier.	0.797		
	6. Our firm is loyal to this supplier	0.793		
<b>Performance</b>	1. Our market share is much better than our competitors	0.967	0.794	0.924
	2. Our rate of customer retention is much better than our competitors	0.961		
	3. Our sales growth is much better than our competitors	0.849		
	4. Our current average profit per customer is much better than our competitors	0.837		
	5. Our current ROI is much better than our competitors	0.834		

**Table 2 Measure scales and respective Loadings, Average Variance Extracted and Construct Reliability**

Psychometric properties of the four constructs were evaluated in order to confirm construct unidimensionality, validity, and reliability, using Confirmatory Factor Analysis with SPSS Amos 18 Software. Within this analysis, both theoretical and statistical considerations were incorporated in developing the scales (Anderson and Gerbing 1988). The model was evaluated using the DELTA 2 index, RMSEA, and the CFI, which have been shown to be the most stable fit indices (Gerbing and Anderson 1992). The  $\chi^2$  statistics with corresponding degrees of freedom are included for comparison purposes (Joreskog and Sorbom 1996). Using these criteria, the analysis resulted in acceptable fit of the data (Table 3).

	Measurement Model	Structural Model
CFI	0.918	0.911
Delta 2	0.918	0.911
RMSEA	0.54	0.056
$\chi^2$	828	872
d. f.	331	335

**Table 3 Fit Statistics**

One criterion for establishing reliability is that the AVE should exceed 0.5 to ensure that, on average, the measures share at least half of their variation with the latent variable (Fornell and Larcker 1981). As demonstrated in Table 2, the AVE and the construct reliability criterion are met for each of the latent variables, which support the reliability of the measures.

To assess convergent validity, the overall fit of the measurement model, the magnitude, direction, and statistical significance of the estimated parameters between latent variables and their indicators were assessed (Anderson and Gerbing, 1988). As demonstrated in Table 2, the standardized factor loadings are all relatively large and positive.

Then, discriminant validity was estimated in order to verify that items from one scale did not load or converge too closely with items from a different scale (Dabholkar et al., 1997). To ensure the discriminant validity of the constructs, Fornell and Larcker (1981) argue that the average variance extracted (AVE) of any two constructs should be greater than their squared correlation. Table 4 presents the square root of variance shared between the constructs and their measures, or average communalities (the values in diagonal) and correlations among constructs (the values off-diagonal).

As it can be seen, the average communalities measures of each construct are greater than the variance shared with other constructs, demonstrating that the discriminant validity of all scales is adequate.

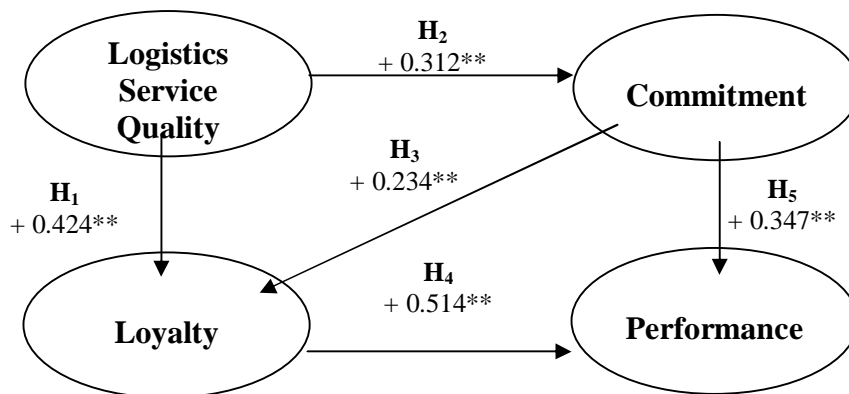
The tested model approach was utilized in order to increase the confidence that items did discriminate. Using this approach, comparisons were made between the original measurement model and successive models with correlations ( $\delta$ -s) among latent variables fixed to 1. As long as the alternate measurement models fail to demonstrate significantly better fit than the original model, discriminant validity exists (Bagozzi and Yi, 1998). The procedure included the evaluation of one pair of factors at a time, as suggested by Anderson and Gerbing (1988), and it was found that each alternate model did not demonstrate better fit.

	LSQ	Commitment	Loyalty	Performance
LSQ	<b>0.678</b>			
Commitment	0.357	<b>0.824</b>		
Loyalty	0.167	0.137	<b>0.704</b>	
Performance	0.211	0.021	0.324	<b>0.713</b>

**Table 4 Results of Discriminant Validity Analysis**

The five hypotheses illustrated in Figure 1 were tested simultaneously in a structural equation model using SPSS AMOS 18.0. The fit statistics for the structural model offered in Table 3 are comparable to those of the measurement model, and demonstrate sound model fit (CFI=0.911, DELTA 2=0.911 and RMSEA=0.056). Given the overall sound assessment of the model fit, the subsequent step was the examination of the hypotheses. The results of the hypothesis tests are presented in Figure 2.

The first hypothesis examines the direct influence that LSQ has on loyalty. The model results indicate a strong confirmation for Hypothesis 1, supporting the contention that as the wholesaler’s customer personnel develop working relationships with company’s customers, the wholesaler can learn more about the customers’ operational needs. Therefore, the processes would be aligned processes to meet those needs, leading customers to a greater loyalty towards their supplier.



\*\* significant at 0.001 level

**Figure 2 Hypotheses test results**

Hypothesis 2 suggests that LSQ has a positive influence on commitment; this hypothesis was supported too. In the interviews with some of the customers and the wholesaler’s representatives, respondents explained that logistics service quality is crucial to the retailers. In order to satisfy their customers, they rely on the performance of their suppliers’ logistics activities. The better the quality of logistics services, the more they will do business with their supplier, thus increasing their loyalty towards him.

Not surprisingly, commitment and customer loyalty were found to have a strong association between each other, positively confirming Hypothesis 4. This finding supports to studies conducted by Dwyer et al., 1987 and Hennig-Thurau et al., 2002. Because commitment has a crucial role in building and fostering long-term relationships, suppliers must exert everything possible to increase the levels of commitment. Bearing this as a “must-achieve” target, suppliers can draw and implement strategies to improve confidence and increase social and special benefits for their customers.

Taking into the consideration the impact that communication has on commitment, companies must use it in a sincere and honest manner.

Both commitment and loyalty were found to have positive influences on performance, thus confirming hypotheses 3 and 5. Having long term partnership with suppliers and being loyal to them is beneficial for companies, and one of these benefits is a better performance. These findings confirm previous research conducted by Uncles et al., 2003 and Reichheld, 2002. Both market indicators and financial indicators of performance are found to be influenced by loyalty and commitment.

#### 4. Discussion and implications

In today's changing business environment, it is hard to compete on products alone as the global marketplace provides more and opportunities for customers to find similar products and product features. Therefore, counting on products alone to create loyalty among customers will be much harder to achieve. Sellers in all positions in the marketing channel have to differentiate their products by the quality of the service processes accompanying those products (Novack et al., 1994). Because of this, every industry is now potentially a "service" industry (Anderson et al., 1994). One goal of this study was to extend the understanding the potential of Logistics Service Quality in creating customer value outcomes, reflected in the bottom line of market and financial performance indicators. Thus, LSQ serves as a crucial stimulator of customer's loyalty, commitment, and his own performance. The study has highlighted the significance of creating an order fulfillment capability in order to maintain a loyal customer base.

Another purpose of this research was to extend the discipline's understanding of commitment and loyalty. A stream of marketing literature defines and measures loyalty as behavioral intentions. However, more than 30 years ago, Jacoby and Kyner (1973) argued that loyalty is more than just repeat purchase behavior and that it also engenders an emotional connection. Intentions or purchase behavior alone stem from many factors besides a genuine attachment, so referring to this as "loyalty" misrepresents the phenomenon. In order to make this distinction, loyalty should be defined and measured not simply as repurchase intentions or as a global construct with emotional and behavioral items, but as causal relationships steaming from service quality and commitment.

Because of the increasing demands of customers to have exactly what they want when they want it, it is important to meet customer demands in a consistent manner. Understanding the impact of an improved Logistics Service Quality, i.e. firm's ability to execute order fulfillment service dependably and accurately, to provide customer personnel that are knowledgeable and empathetic to the needs of customers, can be very useful in differentiating a seemingly similar physical product. It is also important for firms to recognize that in order to meet the operational requirements; there must be processes in place to enable customer contact personnel to interface with those responsible for the operational elements. This allows for the operational processes to stay flexible and responsive to changing customer requirements.

An important goal for firms is to grow a larger share of the profitable revenue available (Bowersox, Closs and Stank 2000), and maintaining the same level of commitment for firm's entire customer base may be ineffective from a profit perspective. Managers need to determine with which customers it makes the most sense to pursue stronger relationships and develop strategies for managing a portfolio of customer relationships.

Finally, LSQ is one of many capabilities that integrate internal processes to become a strategic weapon in the dynamic and competitive environment that surrounds every company. Further research may focus on these other capabilities (such as manufacturing, new product development or human resource), and examine their potential in creating customer's commitment and loyalty.

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## THE FUNCTIONAL ANALYZE OF THE SYSTEM FOR THE HUMAN RESOURCE MANAGEMENT IN THE DISTRICT OF KORCA

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### **Abstract:**

*Today, more and more organizational evidences are conditioned by the affectivity of the management of the human resources. The most affective and successful companies in our days apply successful ways for motivating, training, compensate and encourage their employers. This is a fact for all the kinds of producing or service companies, small ones or big ones. For the success in business the performance of the management of the human resources functions are very important because it reflects all the duties and the jobs which assure and coordinate the human resources. In this point of view, through this study we will try to show how these functions are applied in the organizations which operate in the district of Korca and to conclude the problems which are shown during their implementation. Also we will try to give our recommendations for finding solutions in increasing the affectivity of the human resources functions. To assure theory data we will be based in the previous writings and the confrontation with the contemporary literature. To assure the generalization of the conclusions will be using a type of questionnaire for all the big, small and medium businesses. The collected data will be processed in the SPSS and Excel from which will be assured also the statistic data. By our research we expect to prove the hypotheses that there are differentiations in the implementation of the human resources functions in the businesses of the district mainly in variety of their size.*

**Key words:** functions, management, resources, human, business.

**JEL Classification:** M19.

### **1. Introduction.**

The pace of the economic development that is associated with the new century highlights the importance of the efficiency of the organizational operations. More and more today, the organizational efficiency is determined from the effectiveness of Human Resources Management. The most effective and successful companies of nowadays apply successful ways of motivation, training, compensation and encouragement for their employees. This fact concerns all kinds of companies, either producing or service ones, small or large ones, domestic or global. By applying the concepts of human resources management, the world has started to change.

Even in our country, not only private businesses, but also the public institutions are paying more and more attention in providing, developing and preserving a qualified workforce. In this context, in our country, the utilities that belong to the public sector, either those belonging to the private sector began to apply or perform functions of human resources such as: job analysis, planning, recruiting and selecting, training, performance evaluation of human resources, reward management, career development, providing healthy and safe conditions for the employees in the workplace. It is a positive fact that today the human resources are not seen as a cost, but as most valuable organization source.

Today, many researchers pay more attention to the recognition and deliberation of the human resources and its management. Human resources managers have an equivalent status with the managers of other important functions such as marketing, production and finance. Also the will for letting the higher managerial levels know that the managers of human resources can play a vital role in promoting success in the organization, has been increased. The department of human resources is one of the most important factors that has a great impact in achieving the expected results or the fulfillment of the objectives settled by the organization. This function is realized by performing all the functions of human resources management.

Also through management of the human resources, the business enterprises or organizations are able to make a better division or planning of the necessary tasks and jobs. The realization of these functions helps the enterprises to provide the right number, kind of employees in the right time and place.

The purpose of our work on this paper is to study the role of management of human resources, how is it realized; how much are realized the functions of human resources in the business organizations in Korça district of. In this study will be treated firstly the way how businesses realize these functions and how do they affect in their results, and secondly we will study if these functions are applied in all kind of businesses: small, medium and large ones.

- **The functional analyze of human resources management**

In Korça district a large number of businesses, which differ by their size and way of management, run their economic activity. This study aims to inform how much is the percentage of functions of human resources that these companies realize, what kind of methods do they use to realize this functions, which are the difficulties or the problems that they face during the realization of this functions, which is the impact of the syndications for the realization of these functions in the businesses in Korca district, and the opportunities that have these businesses to improve the realization of these functions. All this analysis is made to conclude which are the profits of the businesses by the application of performing these processes.

In our study we have analyzed businesses which run their activities in the city of Korça, Pogradec, Bilisht, Maliq and Leskovik. From the study resulted that 34.1% of them are small businesses, 47.7% are medium businesses and 18.2% are large businesses.

59.1% of these businesses are manufacturing firms, 11.4% are banks, 4.5% are distributing businesses and 25% are service firms.

Our study consists in that how are realized the Functions of Management of Human Resources as: job analysis, planning of the human resources, the process of recruitment and selection, coaching, evaluation of the job performance, reward and the security of healthy and safe conditions at work.

It was found from the study that in all small businesses the Functions of Management of Human Resources were performed only by the owner-manager, even in some cases on these businesses there weren't performed all the functions of the management of the human resources.

(Fig.1)

**Fig. 1. Who performs the Functions of the Management of Human Resources?**

The results are more positive in the terms of the function of the Department of the human resources in medium businesses and large ones. In medium businesses the functions of the management of the human resources in 26.7% of cases were performed by the manager of the firm, in 53.3% were performed by the owner himself, in 6.7% were performed by the Department of the Human Resources and in 13.3% of cases were performed by the owner in cooperation with the manager. We think that this happens because of the problems linked with the way of structuring the Albanian businesses.

In the large businesses we came in the conclusion that all the businesses performed the functions of management of human resources. In 12.5% of cases were performed by the manager and in 87.5% were performed by the department of the human resources.

Job analysis is the most important factor for all the functions of management of human resources. Analyzing the job positions includes a systematic study of content, responsibilities and interactions between the job positions and the requests submitted to their executives. The main methods of application meanwhile analysis is being performed are: questionnaire, interview, evaluation of experts, and study of technical-technologic conditions, reporting and other documents.

The job analysis is a detailed study of every job to identify the elements and their characteristics, also the requirements of this job. In small businesses in which the owner has clear ideas of what people he needs, prognosis is enough to execute the planning of the job, but in medium and large organizations this problem gets harder and it cannot be completed successfully without using the techniques such as the job analysis.

Let us talk concretely about how job analysis is realized in the businesses that we are studying. By the information we collected from the questionnaires, it results that small businesses do not perform the job analyze because all the other functions of the human resources are performed in 100% of the cases by the owner, while in the medium businesses the job analyze is performed in 70% of the cases by the owner and in 30% of the cases by the manager. In large businesses the job analyze is performed in 80% of the cases by the department of human resources and in 20% of cases by the owner and the manager.

According to the questionnaires was collected this information about the methods used for this process by small, medium and large businesses (Fig.2, Fig.3, Fig.4):

**Fig. 2. The methods for running the job analyze in small businesses**

**Fig. 3. The methods for running the job analyze in medium businesses**

Even by the graphic results that one of the most common methods used for the job analysis in small businesses was the survey method, in medium businesses was applied mostly the interview method, while in large businesses were mostly used the methods of surveying of the questionnaire interviews and survey of functional analyze. The other methods were less used.

**Fig. 4. The methods for running the job analyze in large businesses**

The companies must respect the definition in order to provide the sufficient number of employees in the right places, so they should realize the formula “The right person in the right place” in order to achieve efficiency in the workplace. The process of planning the human resources is determined as a “systematic evaluation of the future needs for human resources and a definition of actions that are required to fulfill these needs”.

A bad planning of these personnel needs might cost a lot to the company; a part of the products might remain uncovered, but at the same time hiring people with the unnecessary qualification in those vacancies can also cost a lot to the company.

So a question arises: *Which are the methods that the businesses that we are studying use to perform this function?*

There are some methods that are used to organize the planning of human resources which change or vary according to the size of the business that performs this function. The most used methods are those of quality and quantity, conclusion that comes out from the information taken by the completed questionnaires. By elaborating the questionnaires, it resulted that only 80% of small businesses, 73.3% of medium businesses and 50% of large businesses use the quality method to plan their human resources, where the most used are: managerial evaluations and analysis of scenarios. The method of managerial evaluation according to which the planning for the staff's human resources was made based on the past experience. These evaluations can be done by high level managers and by low level managers or a combination between them both. The method of analyzing the scenery uses the environmental data to develop alternative scenarios of the working power.

On the other hand, 20% of small businesses, 20% of medium businesses and 50% of large businesses use the quantity method to plan the need for human resources, according to the quantity method for planning the necessary human resources; it is performed in view of the old or historic data. While 6.7% of the medium businesses use the benchmarking method according to which the planning of human resources is done by analyzing the methods and procedures of the business itself, comparing them to the procedures of other businesses (Fig.5).

**Fig. 5. The methods that businesses use to plan their human resources**

During the process, or if the process of planning the human resources isn't performed effectively, there are identified difficulties or problems which are different for different enterprises. Some of these problems are: 40% of small businesses, 40% of medium businesses and 37.5% of large businesses face as a problem the growth of the cost and the lost of the time. While 20% of small businesses, 40% of medium businesses and 25% of large businesses face problems in losing their qualified staff. Also 40% of small businesses, 20% of medium businesses, 37.5% of large businesses face problems in misjudgment of the employees and don't achieve the expected results.

Not always businesses find it easy to run the function of planning of human resources, this is because of the confrontation with a lot of difficulties or problems. This conclusion came as a result by the information gathered from the questionnaires. If the process of planning of human resources is not performed properly, the businesses will not be successful in achieving their objectives or expected results. This will affect also in preventing the regular flow of the economic activity of the business.



A serious problem with which the department of human resources is being faced is the process of gathering and withdrawal of a group of people by which will be chosen the qualified candidates to fill the new workplaces or vacancies, so the *recruitment*. During the recruitment, the requests for the applicants are set related closely to the profile of the position.

This study aims to explain that what influence has this process in the equipment of the organizations with the needed staff, so that the organization can perform more efficiently.

According to the questionnaires, 100% of the businesses apply the process of recruitment. According to the conclusions of this study, the most used resource in the recruitment of the staff from the outside is the references of the employees and the casual applications (for 60% in the small businesses, 60% in medium businesses and 62.5% of the large businesses). Another widely used resource is the employment agencies (40% in small businesses, 13% in medium businesses and 50% in large businesses).

The reason of this use is that in many cases the employees that are employed through the employment agency have had a good performance. The reason of using the employee's references and the casual references is that this way is the less expensive and in many cases it resulted successful. Recruitment from the inside is a practice that is used more often by the large enterprises in a rate of 75% , in medium businesses in a rate of 60% and it is used less in the small enterprises in a rate of 40%.

The reason why this practice is used more in large and medium enterprises is that in these organizations the number of qualified employees is higher and it is created the opportunity to take these job vacancies. The inner resources that are used mostly are the transfer in the small businesses 40%, in medium businesses 33% and in large businesses 50%.

The less used resources are: the recruitment through Internet (6% in medium businesses, 12.5% in large businesses and 0% in small businesses) and the temporary help agencies (6% in medium businesses and 0% in large and small businesses). As more effective sources for the companies, as we found were the transfer and the references of the employees which made able a faster recruitment process and more effective results.

The cost that accompanies the process of recruitment takes a considerable part of the general expenses of the big companies or enterprises and it can be afforded more easily by the medium enterprises and especially by the small ones where the process of recruitment doesn't have any special importance in their activity because they cannot afford high costs and modest profits.

The quality of the employees is a strategic factor in the way that how a firm competes in the market. Therefore, **the process of selection** is a critic ingredient of success.

The professional selection includes some methods so that it can verify the competences that the applicant possesses in different forms of evaluation. A special attention during the valuation process should be paid to the characteristics of the individual that make possible the identification of the personal qualities that the individual has in the realization of the job successfully (behavior, achievements, education, experience, general intelligence, specific talents, etc).

The most used methods in the selection of human resources are the interviews and tests. The interview is used in 75% of the big enterprises, in 40% of the small enterprises and in 60% of the medium enterprises. Even though this isn't a very correct way and it leaves gaps for mistakes, is one of the most used methods. The tests are applied by 50% of big enterprises, 60% of medium enterprises and 100% of small enterprises because this form has a low cost, is fast and in this way are selected the individuals with the better results. One of the less applied forms is: The formats of application used in 37% of large businesses, 0% of small enterprises and it is applied by a considerable number of the medium enterprises, about 53%. We think that this comes as a result of the absence of genuine specialists who should be specialized for the design and valuation of the human resources.

After finishing the selection process in special enterprises, it is done the presentation of the winning applicants in the organization, which lets the employee to be oriented easily in the workplace. The economic, technologic and executive changes can make that the skills learned today, to be invalid for the future. On this change flux, succeed the organizations that are able to react and the organizations which are faster in the adaptation to the environment dynamics. The treatment of the human resources is basic for this adaption and for the development of the individual career of the employees.

From the study resulted that only 20% of the small businesses do not apply training, 80% do apply it even though it is very modest. In medium businesses resulted that 86.7% of them had a training system, while 100% of the large businesses had effective training systems. For the realization of this function were used some methods, and positively these methods were: The training form that was used by the small businesses was inside the workplace 50% and combination of training outside the workplace 50%.

More concretely see table.1:

Method	Result
Rotation	25%
Experience	25%
Practice in experience, guidelines and instructions	12.5%
Experience with consulting	37.5%

**Table1. The methods of training in small businesses**

The training form that was used in medium businesses was: inside the workplace 46.2% and the combination of training inside and outside the workplace 53.8%. Concretively the methods are in table 2:

Practice	23.1%
Rotation	7.7%
The experience with rotation	15.3%
Rotation with consulting	23.1%
Rotation with consulting and guidelines	7.7%
Practice with guidelines, consulting and instructions	7.7%
Experience with instructions	7.7%
Experience with consulting	7.7%

**Table 2. The methods of training in medium businesses**

The forms of training that are used in large businesses are: training inside the workplace in 75% of cases, training outside of the workplace in 0% of cases, a combination between the training inside and outside of the workplace in 25% of cases. Concretively the methods used are in table3:

Training inside the workplace	75%
Training outside the workplace	0%
Training inside and outside of the workplace	25%
Practice	25%
Experience with consulting and instructions	12.5%
Practice with guidelines, consulting and instructions	12.5%
Consulting with instructions and rotations	12.5%
Practice with consulting	12.5%
Practice with videotapes	12.5%
Rotation with practices of experience and guidelines	12.5%

**Table 3. Training in large businesses**

The reason of this combination is that some professions or jobs require not only training inside the workplace, but for a better result it would be required to combine it with the methods outside the workplace. This requires a much higher expense because more environments, devices and other additional equipment would be needed. The most favorite methods outside the workplace of the employees are consulting and instructions. But our concern is not only directed in the application of the training system, but it is also directed in its degree of effectiveness. There are a lot of cases when the training is seen as a reward towards the devoted people, viewed by the close personal interests. According to the self-assessment in a grade system from 1-10 that the businesses have made for their training system, the result is shown in Figure 6:

**Fig. 6. The self-assessment of the businesses for their training system**

So we see that the businesses, especially the small ones, have to work harder according to the training that they offer, so that the valuation for this process to increase. During the training things not always go as they were planned.

Therefore to manage the difficult situations you should keep calm, you should not reply, should not use sarcasm, you should find the real reason of the problem, you should remember the power of silence, etc.

One of the most delicate issues of managing the human resources is the way how the systems of valuation of the employee's performance are built and implemented. When they are drafted and applied as it should, the system of performance management not only makes the employees realize better their actual job, but it also makes clear the ways that can improve their performance. The valuation of the performance is an exercise of survey and judgment in a feedback process and in an organizational interference at the same time. It is a measuring process, but also a powerful emotional process.

To realize this process, the businesses use different methods which are well known by the current literature of management and human resources. By the gathered information we came at the conclusion that 20% of small businesses, 13.3% of medium businesses and 50% of large businesses use the method of management according to objectives to evaluate their performance of human resources. Also 20% of small businesses, 20% of medium businesses and 13.3% of large businesses use the multi-classify method for the valuation of the human resources. Another part of the businesses use other methods to evaluate the performance of human resources. 20% of small businesses, 33.3% of medium businesses and 25% of large businesses use the method of the classification degree according to the manner. 40% of small businesses and 33.3% of medium businesses use the method of job standards, which is a method used more for the employees of production (Tab. 4).

The used methods	Business categories		
	Small	Medium	Large
Management according to objectives	20%	13.3%	50%
Multi-classifying evaluation	20%	20%	13.3%
The degree of classification according to the manners.	20%	33.3%	25%
Job standards	40%	33.3%	0%

**Table 4. The methods that businesses use during the realization of the valuation process of the performance of the human resources**

The impact of valuation of the performance can be seen in many ways, but in our study we focused in four main ways and concretively at the impact of the performance valuation in the future performance of the employees, the impact in the future motivation of the employees, the opportunities for growing in the career and in the achievement of the expected results. The study result for this case is shown in table 5.

The impact of the performance's valuation	Small	Medium	Large
Future performance of the employees	40%	40%	25%
The motivation of the employees for the future	60%	33.3%	25%
The opportunities for growing in the career	0%	0%	50%
The achievement of the expected results	0%	26.6%	0%

**Table 5. The impact of the performance valuation of the human resources**

The process of the performance's valuation often faces serious difficulties. Even the businesses we are studying have encountered a variety of difficulties which vary according to the size of the enterprise that realizes this process. From the obtained results from the questionnaires:

40% of small businesses, 33.3% of medium businesses and 37.5% of the large businesses encounter difficulties or problems with the distortion that is made to the information. Also 20% of small businesses, 13.3% of medium businesses and 25% of large businesses encounter difficulties with the no collaboration of the employees to realize a qualitative process of performance valuation of human resources.

Also 25% of large businesses encounter difficulties or obstacles in achieving the expected results or in achieving the settled objectives. 40% of small businesses, 33.3% of medium businesses encounter difficulties because of the employees who dislike the valuation that is made.

To avoid the difficulties or problems that can be encountered during the realization of the performance process of human resources, it should be settled clearly the achievable objectives that the business tends to realize. But it is also important to choose the procedures, the best methods and also to have the best cooperation and communication with the employees in order to obtain very precise information.

The potential for mistakes in the performance's valuation is greater because not always is taken in consideration the information, or not always is made a fair and correct valuation of the human resources by the valuator. This has been noticed in the businesses which run their activity in our country. To study the errors during the valuation in small, medium and large businesses let us refer to picture 7.

#### **Fig. 7. The errors that the businesses make during the valuation process of the human resources performance**

It is evident that the main error in small and medium businesses is that of the personal preferences, while in large businesses is the halo effect. In addition to these errors, the enterprises may perform other mistakes as for example the misevaluation the employees, the valuation according to the first impression, etc. If the organizations would use a good system of the performance's valuation of the employees, or they would use correct information, the level of errors that the valutors of the performance would make while performing this function would be in a lower level and their results would be much better and more effective. The systems of the performance's management which are related directly with the systems of remuneration of an organization ensure powerful incentives for the employees to work more carefully and in a creative way toward the achievement of the organizational objectives.

Few things give the emotion that gives the *system of rewards* in an organization and this is for many reasons as: the job cost which takes a considerable percentage out of the cost of the products, a satisfactory system of rewards would pull in the organization high qualified people who would be satisfied and motivated to work more and better and furthermore, money influences not only economically but also in the psychological way which implies that employees pay attention to the fact that they take the reward that belongs to them because of the work made and the results achieved. The organizational system of rewards consists in different kinds of rewards that should be offered and the way of their distribution. The organizational rewards include all kinds of rewards: inside or outside rewards which are taken as a result of the employment in the organization.

The organizations with their work should be guided by the transparence and the right judgment for the inside, outside, individual or organizational. Anyway many organizations have the policy of not publishing the information about the salary. In our study we found that this phenomenon is quite evident, so we should interfere by law for minimizing this problem. We think that the syndicate has a powerful impact in setting the wages, but it is necessary to add the problem that small businesses are not influenced at all by the syndicate in setting the wages when it is known that these small businesses have an owner who plays a multiple role in company and one of this roles is influencing over the wages. In medium businesses it results that the syndications have less impact in setting the wages not lower than the minimal salary determined by the government. In large businesses the syndicates have a greater impact in setting the wages in the moment when the firm is just created, are in their beginnings or are consolidated firms which are included in our study, determining for them is the job market itself.

An important case that should not be overlooked is the preoccupation of the organizations to *ménage* as it should the life and the health of the employees. The main purpose in the process of *the management of the security and the health of the employees* is the security of the physic welfare of the employees in the workplace. Today, the management of security and health is a complex activity which requires the expertise of specialists in different disciplines as: industrial hygiene, professional medicine, ecology, psychology and the security enginary. Furthermore the attendance for the management of health and security, except the physical conditions in the workplace is considering also the psychological condition of the employees. The costs of the security management should not be seen only financially, but also ethically and from the side of the social responsibilities of the businesses. All the businesses should be aware and offer their employees safe conditions in the workplace and the protection of their health. But how often is this realized?

According to the questionnaires it resulted that small businesses which answered the questions offered conditions and security at work and for 60% it was sufficient, but for 40% this function was very important. In medium businesses it resulted that in 33.3% this function had a sufficient importance and for 66.7% had a big importance.

Even for large businesses it resulted that for 12.5% this function was sufficient and for the majority 75% the function was important. (Fig.8)

**Fig. 8. The providing of healthy and secure conditions in the workplace**

The results show that the businesses are aware about the security and offering appropriate conditions at work. The most disturbing thing is the impact of the syndicates in the realization of this function.

The majority of the businesses declared that the syndicates do not have impact at all. This is regrettable that the syndicates do not have an active role and do not protect the rights of the employees. They do not fight with the businesses to secure good working conditions to the employee, but they leave it in the hands of the businesses.

**Conclusions and recommendations**

By what we treated above, we should note that the businesses that run their activity in our region should pay more attention to the realization with effectively of the managerial functions of the human resources. But the perfection of applying the functions requires first of all specialists in the field of the management of the human resources, an active role of the department of the human resources and an moral and institutional awareness for respecting the fundamental principles of management and human resources.

It is for the good of the organization and the society that the businesses through relevant expertise to realize better the job analyze with purpose that the employees familiarize with what is required from them, to realize better the planning of the human resources with the purpose that the right employees in the right time to be taken, to have given rewards based in the results, knowledge, skills of the employees according to meritocracy.

It is for the good of all the actors that we strive for a life quality and healthy workplace, with the purpose that the employees to perceive themselves as social beings that can grow and develop inside the organization.

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## THE OPERATIONAL RISK EVALUATION AND MANAGEMENT PROSPECTIVE IN THE ALBANIAN BANKING SYSTEM

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### **Abstract:**

*Albanian banking system has recently introduced the operational risk management techniques aiming to implement all necessary steps towards a sound and comprehensive operational risk management process. It's relatively difficult for the second level banks to identify or assess levels of operational risk by facing a different approach especially where it's no possible to generate profit. That's the reason why previously Albanian banking system has accepted operational risk as an unavoidable cost of doing business even representing a real and live issue. But nowadays as per The Operational Risk Regulation in force established from Central Bank, it is focused on:*

- Operational Risk Events Identification;
- Operational Risk Assessment (Risk Map, Validation of Results)
- Operational Risk Monitoring (Incident Database, Comparison of Risk Assessment, Key Risk Indicators and thresholds);
- Operational Risk Mitigation (Management and Insurance Management);
- Operational Risk Reporting.

*Furthermore, the most important steps that remain to be achieved are the:*

- Operational Risk Management (by aggregating the previously mentioned steps);
- And the calculation of the operational risk capital under operational risk management prospective through:

- a) **Basic Indicator Approach** (BIA- based on annual revenue of the Financial Institution),
- b) **Standardized Approach** (STA- based on annual revenue of each of the broad business lines of the Financial Institution)
- c) **Advanced Measurement Approach** (AMA- based on the internally developed risk measurement framework of the bank adhering to the standards prescribed , methods include IMA, LDA, Scenario-based, Scorecard etc.) in a continuum of increasing sophistication and risk sensitivity.

*The Albanian banking system is encouraged to use an approach that is appropriate for the risk profile and sophistication of respective institutions by making reference even to the best methodology implemented from the group which they belong aiming to challenge the entire operational risk management philosophy.*

**Keywords:** Operational Risk Management Prospective

**JEL Classification:** G20, G29.

## 1. Introduction.

Operational risk is still a live issue for the Albanian banking system but despite the recognized importance credit and market risk have attracted most of the attention so far. Especially in times of crises the operational risk management becomes an emergency. The management responsibility regarding remains within the bank's management but it's difficult without guidance. This paper argues the most important steps needed to be established from the a/m system aiming a proactive and more concrete approach of the issue with the final goal the estimation and allocation of the operational risk capital.

- **A Sound Practice for Operational Risk Management**

### 1.1. Bank's Operational Risk Framework and Prospective Organisational Structure

“Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events” (BCBS 2001).

Obviously from its definition it can be understand that the operational risk management issue for the Albanian banking system is a complex duty. Thus, the efforts made from the middle management regarding should be bank-wide supported and the best practice needs to be shared with the entire system by enabling an operational risk harmonized approach.

The most effective way for the operational risk management process is the establishment of an Operational Risk Framework. It can be considered as a bureaucratic process but moralize the banking activity. The operational risk framework components are (as presented in the Fig. 1):

- Risk Identification, as per (Marshall 2001) this process consists in data collecting for identification and classification purposes.  
The operational risk identification can be done by bank employees, operational risk controllers, internal & external audit teams etc (as proposed from the Central Bank's “ On the Operational Risk Management Regulation”). The risk identification sources can be: metrics, financial events, near-misses, external events, audit reports, etc.  
The classification process instead is performed from the operational risk manager.
- Assessment: The risk is assessed on the basis of its magnitude and frequency. That's a typical quantitative approach (Allen et Al.,2004). The assessment can be performed through the Operational Risk Map (Fig. 2&3) by using a three dimensional model.
- Response: The risk assessment is compared with the risk appetite and the risk mitigation options are explored from a cost-benefit perspective. At this stage the banks should decide if the risk is to be avoided, reduced, transferred or retained. As expressed on Marshall 2001, during this step managers are confronted with a strong conflict of interest: efficiency vs. control. The preferred method regarding is the insurance management aiming the risk transfer.
- Reporting and monitoring: risk information is disclosed to risk internal and external stakeholders. Risk monitoring is suggested through: Incident Database, Comparison of Risk Assessment and Incidents, Key Risk Indicator's thresholds (Fig.4) and Scenario Assessment (Fig. 5). Additionally, the overall framework is assessed and the findings will serve as an input for the first step.

In any case the Operational Risk Framework proposed cannot totally eliminate the bank's operational risk due to the diversity and large size of activities performed simultaneously.

However the entire system should unquestionably be focused on the risk awareness and furthermore under this prospect the banks are strongly recommended to adopt their organisational structure.

#### 1.1.1. Bank's Prospected Organisational Structure.

Whilst ultimate responsibility as operational risk resides within the bank it is essential that:

- All employees clearly understand their individual role in the risk management process;

- A risk-aware environment and culture is created, which supports identification and escalation of operational risk related issues through the defence lines.

First line of defence must be the operational risk management function while the business line managers are responsible for a sound and comprehensive operational risk management.

Second line of defence must be an independent operational risk controlling function, supported by special departments (with the particular knowledge, e.g. IT security, disaster recovery team, compliance etc.).

The audit function shouldn't be part of the day-by-day operational risk management process and must perform its independent review function in order to be ensured the segregation of duties.

The risk committee might be a general committee or an especially established operational risk/incident committee. The committee should be responsible to suggest procedures and risk mitigation actions to the board wherever overall policies do not clearly define the operational risk management process whilst business line managers are finally responsible for their implementation (as described in the Fig.6).

## 1.2. The estimation of Operational Risk Capital and the alignment expectation with the Economic Capital.

- Basel II and EU Directive

The revised framework of Basel and the EU directive offer basically three ways to calculate the operational risk capital: the Basic Indicator Approach (BIA), the Standardised Approach (STA) and the Advanced Measurement Approach (AMA) in a continuum of increasing sophistication and risk sensitivity. The Albanian banking system is encouraged to use the approach that is appropriate for the risk profile and sophistication of the institutions.

- 1.2.1. Operational Risk Capital Estimation under Basic and Standardised Approach

Basel II/Brussels defines the gross income as relevant indicator for measuring operational capital charge within the Basic Indicator and Standardised Approach (as presented in the Fig.7).

The relevant indicator is the annual revenue of the bank (under BIA) as well as the average over three years of the sum of net interest income, and net non-interest income (under STA). The three-year average is calculated on the basis of the last three twelve-monthly observations at the end of the financial year (see Equation no.1). Also is suggested that when audited figures are not available, business estimates may be used.

### 1.2.2. Operational Risk Capital estimation under Advanced Measurement Approach

Generally the literature describes AMA with two components the LDA (the loss distribution approach) and IMA (internal measurement approach) which encompasses scenarios and scorecards without precise restrictions.

In any case for adopting this approach is necessary for a period of time to be under supervisor monitoring, which reserves the right to determine if the internal approach of the bank is appropriated and credible. The most important is that the internal measurement system estimates reasonably well operational risk expected and unexpected losses based on the combined used of data about internal losses calibrated with relevant external losses and use of scenario analysis adjusted with information from business environment and internal control factors as also mentioned from Rao and Dev (2006). This methodology can be implemented through a/m data integration process (as presented in the Fig.9).

By this way, using AMA instead of other much simpler alternative approaches in operational risk management such as Basic Indicator Approach (BIA) and Standard Indicator Approach (STA) it can be allocated a lower capital charge related operational risk. Thus, the proclaimed novelty of AMA is aligning regulatory capital with economic capital.

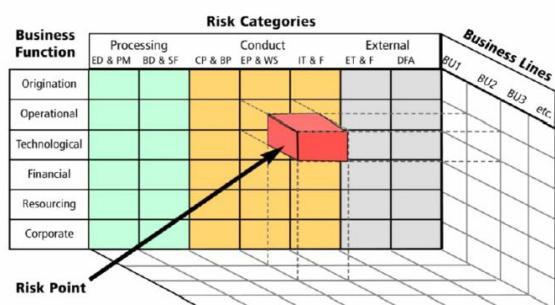
- 1.2.3. Economic Capital Calculation for Operational Risk exposure

An assigned proportion of the Risk Taking Capacity is defined as limit of Operational Risk (exactly 20%). Due to the lack of loss data, the economic capital utilisation will be a mixture of STA capital and qualitative factors. Once we have sufficient data, a combination of loss data, risk assessment and key risk indicators shall supplement the economic capital allocation process. This is all we are going to expect from the Operational Advanced Measurement Approach in the future by simultaneously ensuring a safe banking environment.



- **Technical Approach of Operational Risk Management**

(Fig.1-*The Standard Operational Risk Framework*: This framework represents the necessary steps through which a sound operational risk management can be possible, source: Risk Management Association (RMA), available- <http://www.rmahq.org/RMA/>).



(Fig.2-*Three dimensional model (Business Functions & Lines and Risk Categories)*: The risk point represents a log between business functions- lines-risk categories, source: Risk Management Association (RMA) and Risk Business International (RBI) following the principles set out in the Basel II documents, available- <http://www.rmahq.org/RMA/>).



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(Fig. 3-*The Operational Risk Map*: The operational risk map is developed according to the three dimensional model which constitutes the general operational risk assessment, source: Risk Management Association (RMA), available- <http://www.rmahq.org/RMA/>).



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(Fig.4-*KRI Template*: The KRI template represents a model through which the bank can elaborate further KRI's for operational risk reporting and monitoring purposes, source: Risk Management Association (RMA), available- <http://www.rmahq.org/RMA/>).

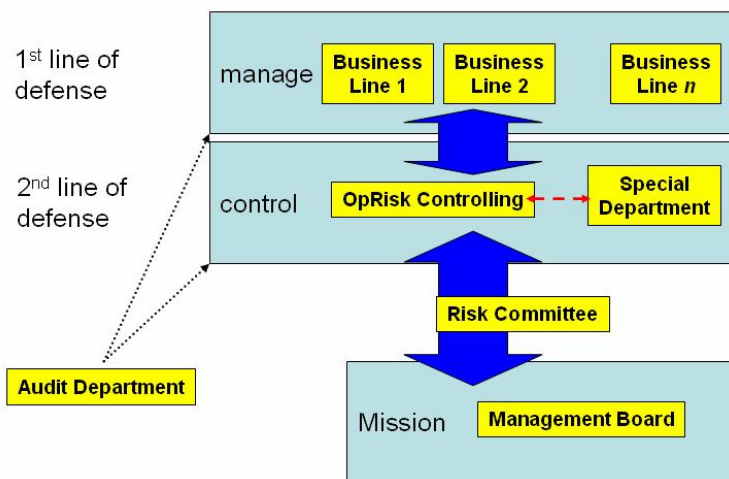
### Scenario Analysis

Scenario Name:	Stolen early repayments
Risk Category:	Internal Theft and Fraud
Risk Category 2 <sup>nd</sup> order:	Fiduciary
Affected department/unit:	Regional Office Structure ( Retail Banking)
Description:	
Possible causes:	<ol style="list-style-type: none"> <li>1. Crime</li> <li>2. Strong relation between cashier and branch manager</li> <li>3. Positive economic impact for both employees.</li> </ol>
Possible impacts:	<ol style="list-style-type: none"> <li>1. Direct impact in P&amp;L.</li> </ol>
Affected System(s):	CBS / cancelled transaction after generated the reimbursement document.
Affected Product(s):	Loans.
Business Function:	Transaction Capture, Fees Capture and Record Update

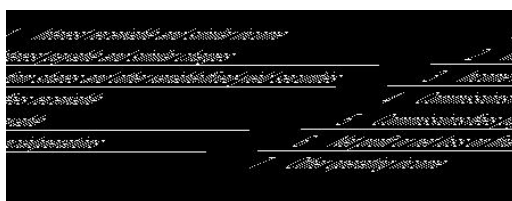
Frequency once in:	6 monthly*
Potential loss (up to):	46.400 EUR
Calculation:	Principal to be reimburse 45,000 Euro. 3% fee early prepayment *45,000 = 1,350 Euro.

(Fig.5-Scenario Analysis operational risk events the risk management steps available <http://www.rma>



to identify the potential evidence of the pre-active risk management Association (RMA),

(Fig.6 – Operational Risk 1<sup>st</sup> and 2<sup>nd</sup> defence line: With regard to the defence lines it can be possible to proactively act on operational risk management in full compliance with BCBC 2011, source: BCBS 2011, available-<http://www.risk.net/operational-risk-and-regulation/advertisement/1530626/the-lines-defence>).



(Fig.7 –The Business Line’s Gross Income Estimation: Based on the accounting categories for the profit and loss accounts of credit institutions under Article 27 of Directive 86/635/EEC, the relevant indicator is expressed as the sum of the elements listed above. Each element is included in the sum with its positive or negative sign, source: European Union Law, available-<http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31986L0635:en:HTML>).

$$K_{BIA/TSA} = \left\{ \sum_{\text{years } 1-3} \max \left[ \sum (GI_{1-8} \times \beta_{1-8}), 0 \right] \right\} / 3$$

Operational risk capital under BIA and STA is calculated according to the equation no 1.

**Where:**

$K_{TSA}$  ... is the capital charge under the Standardised Approach

$GI_{1-8}$  ... annual gross income, where positive, over the previous three years for each business line

$\hat{a}_{1-8}$  ... the proxy industry wide used for the business lines according to the Fig. 8

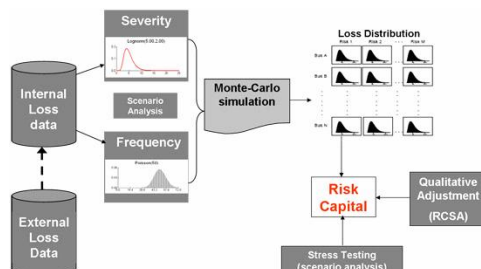
$K_{BIA}$  ... is the capital charge under the Basic Indicator Approach, by using as industry proxy the 15% and the annual revenues of the institution for three consecutive years.

	Unit		Figures
	Year	2005	2006
		<b>Using Basic Indicator Approach</b>	<b>Using Basic Indicator Approach</b>
Total Gross Income		0	
Business Line Gross Income		<b>Using Standardised Approach</b>	<b>Using Standardised Approach</b>
Corporate finance			
Trading & sales			
Retail banking			
Commercial banking			
Payment & settlement			
Agency services			
Asset management			
Retail brokerage			
Total business		0	

**Figures in EUR**

[CSV-Export](#)

(Fig.8 –**The Operational Risk Capital Estimation under BIA and STA:** The template ensures the operational risk capital estimation through BIA and STA automatically by providing only the annual revenues and the business line's gross income data for three consecutive years, source: RZB AG Operational Risk Management Policy, Dec 2010 2<sup>nd</sup> Version).



(Fig.9 –**AMA's engine:** The presented engine explains the way how the AMA's components such –internal and external data, scenario analysis and KRI's are aggregated in order to estimate the operational risk capital, source: Wikipedia, available- [http://en.wikipedia.org/wiki/Advanced\\_measurement\\_approach](http://en.wikipedia.org/wiki/Advanced_measurement_approach)).

## Conclusions

By having availability on the necessary tools, operational risk in the Albanian banking system should be treated as the risk of doing business and that's one of the reasons why its management is a common responsibility of all banks pertaining to this system. Considering the environment a sound operational risk management practice can be achieved through a positive contribution from the overall control framework (Legal, Compliance, Operational Risk Controlling, Internal Audit, etc) by acting independently and simultaneously where necessary. In the current conditions the system can implement the practice which ensures a safe banking environment and is strongly recommended to review it frequently and share with the other components aiming the ongoing operational risk combating. From the other side remains within the regulator the responsibility to build and maintain an efficient operational risk data pool which will serve to the system itself by being supported from the most innovative approaches handled on this respect from the international banking group's affiliates operating in Albania. What's important to be recommended to the system in this case:

- don't be focused only to AMA for your own operational risk management purposes;
- don't stop providing to the group and to the regulator the necessary data for AMA;
- and the last but not the less important is to think differently by ensuring a solid operational risk management within the institution according to your business typology.

The Albanian banking system should feel free to allocate the necessary resources aiming the internal modelling if it really believes that it could be interesting and effective even from cost-benefit analysis point of view and not only.

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## A REVIEW ON PRODUCTIVITY

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### **Abstract:**

*The main stakeholders in the productivity and profitability of the firm are the employees, the owners and the government. The importance of research on productivity is outlined in Mawson et al (2003). With further reviews of the literature on productivity found in: Barteslamm and Doms (2000); Mawson et al (2003). We can divide studies on productivity into three strands: Studies exploring the definition of productivity, studies measuring factors that may influence productivity and comparative studies on productivity. We conclude that the definition of productivity is crucial for the results on productivity research. There is a “menu” of alternatives in the empirical research on productivity and the lack of micropanel datasets makes the comparative studies difficult. According to empirical research we find that variables correlated with productivity are: institutional change, technological progress, IT investment, innovation and R&D.*

**Key words:** stakeholders, productivity, profitability.

**JEL Classification:** M11.

### **Why studying productivity?**

The stakeholders in the productivity and profitability of the firm are employees, owners and the government. De Toni and Tonchia (2001) build a performance measurement framework and classify productivity measurement as cost measurement. Neelu et al (2005) also classify productivity as performance measure. Studying productivity is important for any state of development.

### **Research on productivity?**

The literature on productivity is diverse and looking at different aspects of productivity. In the firm level being productive may be understood as incentivizing employees to work efficiently while in the macro level studies on productivity we may be interested in GDP and employment.

Most of macroeconomic studies finish noting the limitations on macroeconomic studies and suggesting micro studies to capture the channels to which business climate enhances growth (Durlauf et al. (2008); Straub (2008); Pande and Udry (2005).

Micro data in studying productivity are important in different fields of economics: microeconomics, macroeconomics, labor economics, international trade and industrial organization.

The main point is that the macro level studies reference there further studies should be done using micro level data and disaggregating productivity. The general conclusion that we may draw from the literature review is that productivity is likely to generate desired results for the stakeholders and therefore should be a goal for firms and countries.

Sink and Smith (p 136) use the following definition “Productivity is the relationship between what comes out of the organizational system and what is consumed to create those outputs”, while “profitability measures the relationship between revenues and costs” (p137)

“Productivity measures the effectiveness with which inputs (materials, capital and labor) are transformed into output.” (Bart van Ark, (2002), p 69).

Lazear (2000) productivity as a result of incentive effect. Diewert (2008) discusses measurement problems. Lazear (2000; p 1347) “Hourly wages that are coupled with some minimum standard could be called performance pay because an output based performance standard must be met to retain employment”. He analyses the effects of shifting from hourly wage to performance wage.

Performance pay plan does not work equally for all workers because different preferences they face. Some workers will be incentivized to work more and get paid more than the guaranteed wage. The performance indicator they use is units-per worker- per day and it result to be 20% higher under the performance pay than hourly wage and the variance in output also goes up. Thus this may indicate also that profitability may increase as a result of the switch. Their result suggests productivity is as a result of incentive effect. Also the results do not show a Hawthorne effect since the initial effect of log productivity as a result of the change in payment increases after 1 year. As a result of the switch in the pay the turnover is higher which may indicate that the less productive workers leave. But the increase in the ability is not as a consequence of the switch but as a result of selection of workers- high ability workers tend to choose performance paid jobs. Their results suggest that as a result of the switch the productivity rose by 44% and the wages increased for 7% which may also result with higher firm earnings. They discuss what happens to quality of work. Because of peer control and easily identifiable defective work (employee) and since the employee who was responsible for the work had to do the re-work it has shown that quality of work has improved after the switch of the pay. Also the customer satisfaction index rose. Their conclusion is that in this case of this specific firm the switch results with higher productivity but this does not mean that the conclusions should be general for all the forms. Just is an evidence that workers react according to incentivize theory.

Steindal and Stiroh (2001) draw difference between two concepts of output: value added and gross output

The importance of research on productivity is outlined in Mawson et al (2003). They refer to productivity as the economy's ability to translate inputs in outputs and different types of inputs give various measures of productivity. They point the difference between partial productivity and total factor productivity.

The measurement issue is very important because different measurement definitions may lead us to different conclusions. In a company is very important if the productivity measures align with respect to employees and the company since if this does not hold may lead to Principle –agent problems.

Steindel and Stiroh (2001) review measures of labor productivity and total factor productivity or the overall efficiency of transforming inputs in outputs. They draw the difference between two concepts of output: value added (Gros- inputs (sales and input should be deflated by price index) and gross output (Total value of sales; productivity measured as sales per worker). Traditional source of productivity analysis is a production function that relates labor productivity to capital, labor quality and total factor productivity.

Reviewing the literature we find that studies that try to find what may influence productivity use these approaches:

- index number studies,
- production function,
- distance function,
- DEA analysis

Malmquist index and Törnqvist index are the most common used indexes on productivity studies. For example they are used in studies such as: Fare et al (1994), Ball et al (2004); Camanho and Dyson (2006); Grifell-tatjé and Lovell (1998).

The production function relates the amount of the output to the amount of input used – a function that describes the technology. For example they are used in studies such as: Solow (1957); Banda and Verdugo (2011); Grimes, Arthur Ren, Cleo Stevens, Philip (2011); Fernandes (2008).

Distance function studies: Saal et al. (2007); Conceição et al. (2006) while Dea analyzis studies: Feng-Cheng Fu & Chu-Ping C. Vijverberg & Yong-Sheng Chen (2007).

### **Empirical findings on productivity?**

The expectation is that innovation will lead to higher productivity growth. In order to give evidence that there is a large body of literature and diverse related to productivity and profitability we bring some studies that have to do with profitability and productivity from different sector industries, different countries and looking at different variables.



We are reviewing studies on : the analysis that size and growth of German companies as a result of the institutional change; the relationship between TFP and technological progress in the electricity industry; innovation and productivity in manufacturing industry; evidence of practice principles of productive firms; evidence that computerization increases productivity, innovation and productivity; infrastructure and firm performance; IT and performance and a study on determinants of profitability.

Audretsch, Elston, Ann (2006) check the relationship between size and growth for German companies. They use three dataset the Hoppenstedt database, Deutsche Bundesbank data sources, and publicly available data from the web. Their estimates classify between Neuer Markt firm and traditional manufacturing firms. Their estimates suggest that Neuer Markt small firms grow faster whereas in the traditional firms big firms grow faster. They present parsimonious model but still the size variable is significant unless cash flow is included when it turns to insignificant. They check for robustness dividing the sample in 3 using different criteria for small firms but the conclusions remain the same- small firms grow faster. They conclude that the institutional change of Neuer Markt has enabled new technology sectors driven by small firm growth.

Rungsuriyawibo et al (2008) employ dynamic efficiency model and use two step estimation: first maximum likelihood estimation and in the second step generalized method of moment. They use electricity industry data. The time period they analyze is 1986-1999 and data are obtained from the Energy Information Administration (EIA), the Federal Energy Regulatory Commission (FERC) and the Bureau of Labor Statistics (BLS). "The empirical findings show that the allocative efficiency gain effect from the change of variable input is the most attributed factor to TFP growth, while that from the change of marginal value of capital is nearly negligible." P 186 Their study suggests that TFP growth was mainly driven by technological progress.

Baily and Chakrabarti (Innovation and productivity in US industry, 1985) study two manufacturing industries which vary in the capital intensity they use to look for the relationship between innovation and productivity. "It is at the point of commercial introduction that the new product or process is described as an innovation" p 610. Technology does not provide direct productivity enhancement but it provides the means for it. New processes and new product development improve productivity in manufacturing industry. They collected data on innovation. They have found that slowdown of innovation caused a slowdown in productivity in manufacturing industry in US. They suggest the link between innovation and productivity and also suggest that output slowdown may be as a consequence of business cycle and structural shocks.

Aaker and Jakobson (1987) demonstrated that systematic risk can impact the profitability of the firm.

Brynjolfson and Hitt (1998) note that while you can easily define productivity as output per unit of input the measurement is not that easy. They mention that it is even harder to measure in the information economy. "Productivity growth comes from working smarter" p50. They stat that the conventional wisdom does not find relationship between computers and productivity but level studies contradict the productivity paradox and find that IT investments are positively correlated with firm output. When they look at variation in productivity and investment they find positive relationship but there is difference between firms on the size of the relationship. They use a firm effect model and the benefits from IT were reduced which they interpret that half of the value of the benefit is due to firm characteristics and the other part is general for all firms. When they look at the relationship in different time periods they find that the long term benefits are larger which they explain by the fact that it investments are time consuming and costly. They conclude that computerization itself does not induce productivity but it's a component of the system which increases productivity.

"It is at the point of commercial introduction that the new product or process is described as an innovation" p 610 Innovation and productivity in US industry M. Baily and A. Chakabakri 1985, Broking papers on economic activity. On their case study for two industries (chemical and textile) the management interviews answer that the slowdown of innovation contributes to the slowdown in the productivity growth (M. Baily and A. Chakabakri 1985).

Explaining Enterprise Performance in Developing Countries with Business Climate Survey Data

Jean-Jacques Dethier ,Maximilian Hirn and Stéphane Straub in their paper provide a summary of empirical evidence on performance. They claim that the literature review shows that most papers find significant relationship between infrastructure indicators and firm performance.

Stratapoulos and Dehning (2000) are looking at the productivity paradox (the link between IT investment and performance. They note that IT investments have an upward trend and they are not expected to slow down in the near future.

In their literature review they find that the evidence is that either there is no proved relationship between IT and performance or the relationship is positive. They claim that this may be due to not distinguishing successful users and not successful ones and suggest that their study is based on the fact that IT can use effectively or ineffectively. They test the hypothesis that financial performance is the same between successful and less successful users of IT. They state that the IT investment would rather be short time improvement than long-term performance advantage. Their selection of the sample is from CWP100 list. They use a match paired design with matching variables controls for industry, size and capital intensity. Financial performance variables used are profitability (growth in net sales, gross profit margin, operating profit margin, net profit margin, ROA, ROE and ROI) and efficiency (fixed asset turnover, total asset turnover and inventory turnover) measures. To test their hypothesis they use nonparametric statistics the Wilcoxon signed rank test for matched pairs. Their results demonstrate in favor of rejecting their hypothesis. Therefore successful users of IT outperform in profitability measures such as ROA, ROE, ROI while as considered to efficiency measures only total asset turnover supports their hypothesis. Their study attributes explanation to the productivity paradox to the mismanagement. Their work is evidence that successful IT investment may lead to better performance. We can draw the conclusion that their study notes the importance of efficiently using IT investment rather than on costs of IT investments that make firms outperform.

Stierwald (2009) aims to look at determinants of firm profitability. Their dependent variable is the current profit rate and the data are for 961 Australian firms using IRESS dataset. They use GLS random and fixed effects in their estimates. They apply first differencing to correct for dynamic panel bias since GLS generates inconsistent estimates. They use a productivity estimate using log-difference between predicted and empirical cost and also control for firm level variables. Their GLS estimates with random and fixed effect and corrected for bias result with similar results. Determinants of profitability in their estimates are lagged profit rates, lagged productivity level and persistence of high productivity. Therefore their results suggest that firms with higher productivity and more profitable. Related to firm characteristics their results show that size matter i.e. larger firms are more profitable, higher leveraged firms are more profitable. Their analysis therefore is in favor of firm effect model. The limitations of the study are that they do not answer for how long is the effect of productivity on profitability.

## CONCLUSIONS

Productivity studies are an important area for the employees, the owners and the government. Productivity is a performance measure for any state of development. Productivity may enhance growth. Micro data in studying productivity are important in different fields of economics: microeconomics, macroeconomics, labor economics, international trade and industrial organization. We identify these approaches for studying productivity: index number studies, production function, distance function and DEA analysis. Besides different approaches for studying productivity we identify different empirical approaches for estimation in productivity studies and we notice that studies that use panel data are sparse. Concluding we suggest that identification of drawbacks of each empirical estimation is crucial for deciding the choice of empirical estimation.

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## CLOUD BUSINESS INTELLIGENCE-A NEW PARADIGM IN PROVIDING BUSINESS INFORMATION

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### **Abstract:**

*Effective and timely business information is essential for any company, not only to achieve some success in the area in which it operate but also for surviving of the company. In today's changing environment, gaining competitive advantages are more a result of implementing new technologies and their use in business processes, but also knowing how to use such technologies and thus to increase the level of knowledge. New information needs, led to change in decision making process in companies. To provide high quality basis for decision making large amount of data must be converted into useful information. In addition there is important the ability to convert large amounts of fuzzy data into useful information in the shortest possible time, which will represent a competitive advantage for any company. One of the technology that allows this, is business intelligence. In a broader sense, business intelligence sometimes is defined as a managerial philosophy, but in a narrower sense it is information technology that helps companies in managing business information in order to reach effective business decision. The real innovation which offers business intelligence is its ability to present business information in a quick, simple and effective way so that users can easily understand the logic and meaning of the same information. Cloud computing is new paradigm in the providing of information resources that works on principles on-demand, offers scalability and services are charged depending on time of use. In this way companies can save money by using application, on-line. Companies that use business intelligence on principle of cloud computing are facing many challenges, such as safety in operation, the availability of certain application, performance, integration, regulatory issues and limitation of bandwidth on the network. Also management of application for business intelligence can facilitated through cloud computing approach.*

**Keywords:** cloud computing, business intelligence, data, information, decision making

**JEL Classification:** C88.

### **Cloud computing**

Cloud computing is the result of the latest research and development in areas such as virtualization, distributed computing, utility computing and networking. Cloud computing implies a service oriented architecture by offering software application and platforms as a services, reducing the amount of technology that should use end-user, very great flexibility, reducing cost of ownership to a minimum and many other benefits. Main idea in using the cloud computing is taking advantages of existing information infrastructure in order of setting up all available services on the cloud and the ability to access to these same services regardless of time period and geographical location.

Very interesting characteristic of cloud computing is that the cloud computing offers a totally new view of IT infrastructure. From the aspect of hardware, by using the cloud computing are provided almost unlimited hardware resources that are available on-demand, thus reducing the necessary financial resources that companies invest in hardware.

Cloud computing has a variety of characteristics, with the main ones being<sup>254</sup>:

- Shared Infrastructure -Uses a virtualized software model, enabling the sharing of physical services, storage, and networking capabilities. The cloud infrastructure, regardless of deployment model, seeks to make the most of the available infrastructure across a number of users.
- Dynamic Provisioning-Allows for the provision of services based on current demand requirements. This is done automatically using software automation, enabling the expansion and contraction of service capability, as needed. This dynamic scaling needs to be done while maintaining high levels of reliability and security.
- Network Access -Needs to be accessed across the internet from a broad range of devices such as PCs, laptops, and mobile devices, using standards-based APIs (for example, ones based on HTTP). Deployments of services in the cloud include everything from using business applications to the latest application on the newest smartphones.
- Managed Metering -Uses metering for managing and optimizing the service and to provide reporting and billing information. In this way, consumers are billed for services according to how much they have actually used during the billing period.

Cloud computing offers a number of benefits that benefits are much larger than the costs that companies would pay for the use of cloud computing services. These benefits especially refer to processing power, storage capacity of databases, the need for information etc. As some of these benefits can be emphasized<sup>255</sup>:

- Costs. The cloud promises to reduce the cost of acquiring, delivering, and maintaining computing power, a benefit of particular importance in times of fiscal uncertainty.
- Access. The cloud promises universal access to high-powered computing and storage resources for anyone with a network access device.
- Scalability and Capacity. The cloud is an always-on computing resource that enables users to tailor consumption to their specific needs. Infinitely scalable, cloud computing allows IT infrastructures to be expanded efficiently and expediently without the necessity of making major capital investments.
- Resource Maximization. Cloud computing eases the burden on IT resources already stretched thin, particularly important for agencies facing shortages of qualified IT professionals.
- Collaboration. The cloud presents an environment where users can develop software-based services that enhances collaboration and fosters greater information sharing, not only within the agency, but also among other government and private entities.
- Customization. Cloud computing offers a platform of tremendous potential for creating and amending applications to address a diversity of tasks and challenges.

The use of necessary information resources on principle on cloud computing can be implemented very fast and easy with minimal management effort or service provider. Finally with its scalability, real-time, internet-based information technology services and resources, cloud computing can easily meet the needs of different user groups while reducing their costs to a minimum.

Despite the fact that today a number of cloud computing services are available, however many application are still in development. Cloud computing today attract the attention of the best and the biggest companies in the IT industry, in order to establish profitable business models based on cloud. Currently the most important company that is working to developing cloud computing is Google who offers a large collection of web application via its cloud architecture, while all this applications are mutually compatible. Also a number of other IT companies are involved in the development of cloud services. Microsoft offers the Windows Live Suite, Amazon with web service EC2 offers the possibility of designing application on the cloud, IBM has already established Cloud computing center for cloud services and research etc.

### **Business intelligence-current trend in R. Macedonia**

<sup>254</sup> Dialogic corporation, White paper, Introduction to cloud computing, 2010

<sup>255</sup> GTSI Corp., Cloud computing, Building a framework for Successful transition, 2009

To provide high quality basis for decision making large amount of data must be converted into useful information. In addition there is important the ability to convert large amounts of fuzzy data into useful information in the shortest possible time, which will represent a competitive advantage for any company. One of the technology that allows this, is business intelligence. In a broader sense, business intelligence sometimes is defined as a managerial philosophy, but in a narrower sense it is information technology that helps companies in managing business information in order to reach effective business decision. The real innovation which offers business intelligence is its ability to present business information in a quick, simple and effective way so that users can easily understand the logic and meaning of the same information.

According to current research, only 20 % of companies use more than 50% of the data that are available to increase its competitive advantages. Concept of business intelligence allows exploiting the remaining data and convert them into useful information.

I did one on-line research for current market conditions of business intelligence in R. Macedonia. Until now, in the R. Macedonia there are no relevant data about the Macedonian market for business intelligence and with that research i got some initial information about the size of business intelligence market, supply of the market with tools for business intelligence, companies that participate in that market, which world vendors of business intelligence are present on the Macedonian market etc. The survey covered 21 Macedonian software companies who working in the area of business intelligence.

The methodology of research is determined by the nature of research and there is applied a structured questionnaire. This is used on-line questionnaire on zoomerang.com, which website offers some simply analysis of the answers. The obtained results are analyzed by different methods, regression and correlation analysis, various statistical tests, ANOVA etc. Processing of the results is done by applying modern software solution. It will also be conducted and appropriate qualitative analysis of specific questions that provide discrete answers and such qualitative analysis will be related to the results of continuous variables.

Due to limited size of this paper will be given an analysis of those questions that are of particular importance for research. The most of the surveyed companies or 57,14%, develop own software solutions which is very positive trend of the Macedonian software market. A number of Macedonian software companies becomes competitive in the global software market with its innovative solution. This is confirmed by studies of IDC, according to which, Macedonia has 4-5 software companies who good listed on global software market with its software solutions. On the other hand, very small number of companies perform only sales, which sales mostly applies to Microsoft products, that will be seen from further analysis.

The percentage of companies who develop their own software solutions also suggests that in R. Macedonia can find software solutions that are adapted to Macedonian economy and way of working, and according to price who match the financial capabilities of Macedonian companies that operate in any part of business sector.

On the questions *Do you offer software for business intelligence*, 38% of software companies answered with yes, while 62% said no. This fact suggests that the Macedonian software companies are not yet sufficiently penetrated in the field of business intelligence.

However, the fact that business intelligence is a relatively new concept in the Macedonian market, 38% represents a satisfactory level for Macedonian condition. On the other hand, when we make comparison with the previous question, all 38% of companies that sell software for business intelligence, they develop their own software solutions for business intelligence.

Perhaps, the next stage of development of Macedonian software market would be related to expanding range of products with software solution in the field of business intelligence. Recommendation for Macedonian software companies is that the market of business intelligence is an area not sufficiently covered and in which area additionally might be working to achieve higher profits.

From the Figure 1. can be seen that a large part of Macedonian software companies have established no partnership with any world software vendors, while those who have some kind of partnership most of them have done with Microsoft. Even 55% of companies have a partnership with Microsoft and if we add those 35% who have no partnership with any world software vendors, then only 10% of Macedonian software companies have partnership with some of the other world software vendors. This indicate that still on the Macedonian software market has no sufficient supply and competitiveness.

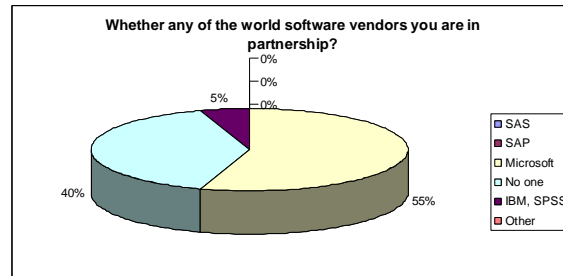


Figure 1.

When it comes to the cost of software tools that are offered on the Macedonian software market, it usually varies in the range from 1.000-10.000 €, although there are companies that offer software over 100.000 €. An interesting fact is that, companies who offer software over 100.000€ are companies who offer software for business intelligence. However, if in the past business intelligence tools could afford only large companies because of high cost of software, today we have many more companies who develop software for business intelligence for small and medium sized companies with an acceptable price. Such acceptable price even for small an medium size companies varies in the range from 1.000-10.000 €. This costs of tools for business intelligence means that any serious company who is oriented towards new advanced techniques can afford such software solution.

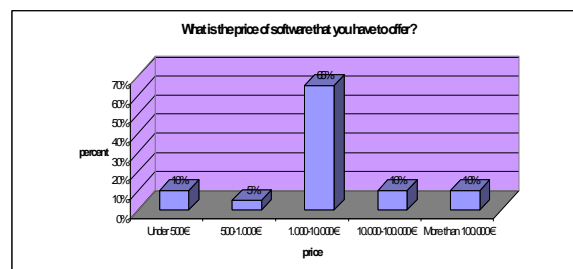


Figure 4.

The most important indicator of dependence between the price of the tools and number of sold business intelligence tools was determined by using the chi square test.

Using test of independence was found that there is no dependence between the cost of business intelligence tools and number of sold tools over the year. To determine which other factors could affect on the number of software tools sold within the last year, will be placed multiple regression model, where will include a larger number of variables. In the next table are given the variables that are included in the model, where the number of software tools within the last year is the dependent variable and the remaining are independent variables.

The results from regression model are shown on figure 5.

The screenshot shows a software regression report window titled "Multiple Regression Report 1". It contains the following data:

**Regression Statistics**

Multiple R	0.6988
R Squared	0.4884
Adjusted R Squared	0.0791
Standard Error	16.1583
# of Observations	10

**ANOVA**

	df	SS	MS	F	Significance F
Regression	4	1246.1399	311.535	1.1932	0.4198
Residual	5	1305.4601	261.092		
Total	9	2551.6			

**Coefficients**

	Coefficients	Standard Error	t Stat	P-value
Intercept	19.3617	66.0335	0.2929	0.7601
način na prodazba	-9.7334	6.2669	-1.5531	0.5114
BI	20.8528	12.829	1.6254	0.165
partnerski odnos	-0.5124	1.3005	-0.394	0.7098
informarnost za ponudat	7.6838	15.2963	0.5023	0.6368

Equation of multiple regression model will be:

$$Y = B_0 + B_1 * X_1 + B_2 * X_2 + B_3 * X_3 + B_4 * X_4 + e_{ij}$$

Where:

X1- Manner of sale

X2- Whether company sales BI or not

X3- Partnership with world vendors

X4- Information about supply of software tools

eij-standard error

The coefficient of multiple correlation of 0,7 shows certain correlation of dependent variable with independent variables. It would mean that, if on the number of software tools sold in last years does not affect the price, then there are some other factors such as variables X1, X2, X3, X4. Also the values of coefficients B1, B2, B3, B4 indicate the change of the dependent variable Y, depending on the change of independent variables.

Within this research are conducted a number of other analyzes, but because of the size of the paper we maintained only on the most important aspects of research.

This research showed that business intelligence is still a relatively new concept in business operation of Macedonian companies. Thereby, most business intelligence software that is offered to the Macedonian market is developed by companies that sell it. On the other hand, the most world vendors of software for business intelligence are not enough included in the Macedonian software market. Perhaps, this small competition on the software market brings about the sale of software for business intelligence does not depend on the price of software.

However, despite this, there are positive tendencies in the Macedonian market for software for business intelligence, which primarily related to companies that are directed towards development of the own software solution. It is already mature companies that can cope with world trends and equally to compete on the world software market.

### Interaction between cloud computing and business intelligence

Business intelligence offers number of opportunities to improve the decision making process and more advanced tools allows to analyst greater functionality and at the same time becomes available for an increasing number of users. On the other hand the IT requirement of companies grow exponentially form a few gigabytes of data a few years ago, through a data warehouse that are measured in terabytes, to most developed data warehouse which in some cases are measured in petabytes. Also many companies in today's operating environment are putting their information available to external users such as suppliers and customers in order to improve business process. In such scenario, traditional technologies no longer meet the informational needs of the companies and new flexible approach is needed to overcome a challenge.



Especially during the global economic crisis, many companies were forced to optimize their budgets and reduce the costs. Many of these companies saw way out in the use of cloud computing approach. According to all that, it was a natural step migration of business intelligence to cloud computing.

Cloud computing makes sense to business intelligence solution only if it offers benefits to customers. Some of this benefits are<sup>256</sup>:

- Lower costs-under a cloud computing paradigm, companies do not need to invest large amounts of money to acquire hardware, software, licenses and knowledge to put the business intelligence infrastructure up and running. They would only have to contract a cloud computing provider and pay for the resources they need.
- Multiple redundant sites-one of the main concerns of business intelligence professionals is to keep solution available the longest time possible. One way to achieve this is to have multiple sites that offers redundancy. Since most of cloud computing providers have sites geographically dispersed, this characteristic is achieved.
- Scalable provisioning of resources-business intelligence solution do not have the same load work during the day. This means that at certain point of time, some servers could be idle while others may reaching their peaks on processing, memory usage or I/O operations. With cloud computing, resources can automatically and rapidly scale in and scale out.
- On-demand performance improvement-under a cloud paradigm, this problem would be addressed almost instantaneously and transparently for users, by taking advantage of existing hardware and software resources.
- Usage billing-by using cloud computing, companies pay for a service as they go or pay on a monthly or yearly basis.
- Fast deployment-instead of spending long time preparing and installing required hardware and software, the platforms can be up and running in just minutes, ready to configure application and start populating the data warehouse
- Easy maintenance- most of the maintenance needed for hardware and software, like firmware, update and upgrade, are done by cloud computing provider. Also, since these application are accessed through internet browsers, maintenance on client computers is reduced dramatically.

Although there are some benefits in the use of business intelligence application based on cloud computing, there also some challenges that such application have to face in their operations. The most significant challenges can be listed: security, moving large amounts of data, performance, integration and reliability. This points to the fact that there are many challenges that need to be overcome in order to exploit the advantages offered by cloud computing to handle large amounts of data to improve decision making in companies.

### CONCLUSIONS.

The project for creating a business intelligence system usually requires several iterative procedures in order to meet customer needs. Such iteration typically include validation and adjustment. In cloud computing environment huge computing power easily and quickly is obtained by using the services offered by the cloud computing provider. All this suggest that business intelligence application can be very effective when working on the cloud computing environment. Some techniques and risk need to be overcome in the future, but companies will receive far grater benefits and will get much better quality and more timely information, which in turn will be the basis for making better decision.

When it comes to current trends in the field of business intelligence and cloud computing in R. Macedonia one of the recommendations would be that the field of business intelligence is an area that is not enough covered and Macedonian software companies in order to introduce new products. Also, the most of the world vendors for business intelligence is not enough represented on the Macedonian market, so it would be a chance for Macedonian software companies to enter in to new partnership and promote the product of world known vendors.

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<sup>256</sup> Eumir P.Reys, A system thinking approach to business intelligence solution based on cloud computing, Massachusetts Institute of technology, February 2010

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## THE ROLE OF OPERATIONAL RISK IN THE RISK MANAGEMENT FUNCTION

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### **Abstract:**

*The purpose of this paper is to discuss the different types of risk and general approaches to analyze risk in a company, and to describe the importance of implementing a formal risk management policy in a company. Business risks are diversifiable and specific to the industry and the market in which a firm operates. Part of the business risks is operational risk which incorporates the direct or indirect loss resulting from inadequate or failed internal process, people and systems or from external events. The paper explains the components of operational risk and situation of his appearance, as well as the steps for creating risk management policy.*

**Keywords:** *business risk, risk policy, corporate culture, information management*

**JEL Classification:** *M19.*

### **Introduction**

The risk as a measure of potential changes in value that can be experienced in a managed portfolio as a result of differences in the economic environment when the current situation and future point of time invoke a need for a risk management. Management of risk over specific period of time in situations where volatility exists and managers have the opportunity to change the expected cash flows is important for six primary reasons. Three of them can be classified as microeconomic in nature and they affect the performance of the individual corporation. Other three reasons are macroeconomic in nature and since they affect the overall financial system.

The importance of risk management, particularly in financial institutions, can be seen firstly with the analysis of the three microeconomic reasons. First, the management of risk reduces the volatility of earnings. Since, earnings will become more stable with the management of risk, investors are less likely to demand as high a premium for risk. As a result, the value of the firm to the shareholders increases. Second, the management of risk can reduce the volatility of cash flow from operations. Since operating income plus depreciation service debt payments, banks are more willing to lend larger sums to firms with more predictable and stable operating income. The company has greater debt capacity and can borrow more funds to invest in tangible and intangible assets. Third, because the managers of the firm have more control over earnings volatility and thus performance, a firm can more easily achieve its goals and remain competitive.

When the macroeconomic aspects are considered, there are three reasons why risk management is important. From the financial institution's point of view, managers will be able to spend more time on the improvement of financial operations instead of spending time on capital adequacy. Second, lower volatility reduces the likelihood that a financial institution will fail. With lower volatility, depositors are more secure that their funds will be available over longer periods of time. Finally, from a global point of view, if financial systems are safer and less prone to disruption, the world economy in general will benefit.

### **The risk areas**

Typically, risks are divided into systematic and unsystematic risk categories. To get a better understanding of a risk landscape faced by a business and to understand where operational risk fits into the risk areas, there is a need for breaking the systematic and unsystematic risks into their component parts. Nonsystematic, company-specific or business risk can be divided into five component parts, which are operational risk, legal risk, credit risk, liquidity risk and model risk.

Business risk is specific to the industry and market within which the company operates. If a firm produces hardware components, its business risks would be those specific to the hardware components production industry and the market for hardware components. The most significant risk among business risks are the operational risks. These are the risks arise from the failure of internal systems, or from errors by the people who actually run the business. The risks can be very minor event such as failure to update a computer program, or cataclysmic events that result in complete financial failure of the business.

The next component of business risk is the legal risk, which is related to operational risk. This risk occurs when contracts are not enforced. Companies also find that credit risk, even though it is often associated with legal risk, can occur independently of legal risk. Here, the problem is that the counterparty to the transactions recognizes their legal obligation but does not have the financial resources to make the promised payment. Another business-risk-related exposure is liquidity risk. This is the risk arising from the cost of unwinding a position. That is, if a position needs to be divested quickly, a sale at an unfavorably low price may have to be made because buyers may be hard to find. An emerging and serious form of business risk is model risk. Since financial models are becoming extremely complex, designing and implementing the models tend to be extremely technical. Unfortunately, the complexity of a model often obscures the assumption used to generate a model's outcomes. As a result, the economic validity of the model is increasingly difficult for nontechnical but market-savvy professionals to verify. Model risk is an important component of business risk because business decisions are made based on the outputs from these financial models.

Additionally to business risk, all firms are exposed to market, or systematic risks. Market risk can be divided into three components, which are interest-rate risk, foreign exchange risk and commodity price risk.

### **Operational risks**

Operational risk, as part of business risk is risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems or from external events. This definition incorporates the interaction of individuals with the company and the company's activities with the outside world. The operational risk can be divided into four component parts. The first part is risk from operations which results from a breakdown in a core operating, manufacturing, or processing capability. In an organization charged with investment responsibilities, the risk is associated with the manager, marketing, and sales behavior, as well as technology-related transactions. The second component is asset impairment risk, which occurs when an asset loses a significant portion of its current value because of a reduction in the probability of receiving expected future cash flows. This risk centers on the organization ability to look after its assets. Places where transactions are processed or where data can be manipulated are important to maintaining the integrity of the financial system and the value of the assets. The third component is the competitive risk which results from changes in the competitive environment that could impair the business ability to create value and differentiate its products and services. In financial terms, this often means the company has failed to deliver superior performance as a result of a market downturn or from managerial failures. The last one is the franchise risk. It is a consequence of excessive risk in one of the three other operational risk components listed here. It occurs when the value of the entire business erodes due to a loss in confidence by critical constituents such as shareholders, investors, or customers.

### **Bases of operational risk**

The most common reason of operational risks arising can be divided in nine different handles of control. These nine different handles detail the places to look for operational risk within a company and can be used to measure the operational risk of a company.

Graph 1: Internal risk pressures

The first row evaluates the company's growth. Errors of command or instruction can occur when senior managers pressure employees to provide a very high level of performance, when the rate of expansion is so high that existing employees do not have enough time to perform their jobs well, or when the company is forced to use untrained or inexperienced employees in important positions.

The second row shows problems related to corporate culture. The problems here usually stem from incomplete managerial information. These problems can occur when managers provide high rewards. An example of this will be large year-end bonuses for outstanding performance. As previously stated, higher returns are usually associated with greater risks. Therefore, managers may be rewarding employees for taking greater risk in comparison to the situation when there will be no bonuses. A similar source of difficulty arises when management concentrates too much on the ultimate objective. What this means is that managers only want to hear about events that are in line with achieving their goals. As a result, some managers may give employees the notion that bad news is unacceptable, and since many employees choose not to upset their managers, they do not report bad news in sufficient time for managers to take appropriate corrective actions. A final cause of insufficient managerial information arises when incentives create an excessively competitive work environment that encourages one employee to compete against the other. As a result, employees become reluctant to share information with their co-workers when certain information is needed to operate the company successfully. These reluctant employees are afraid they will be giving another employee an advantage in gaining recognition that can lead to financial rewards.

The third row discusses problems in information management. As a company grows, the nature and extend of the transactions in which it is involved often becomes much more frequent and much more complex. If employees are focused to do complicated functions and have less time to complete them, disasters can occur. A similar type of problem occurs when a company uses a system to evaluate its employees and the system is not adequate for the task. For example, suppose an employee is assigned a task that is not to be evaluated. A final cause of inefficiency and process breakdown occurs when an operation becomes so large that it has to decentralize the decision-making process. If this decentralization is not managed appropriately, transactions fall through the cracks because another division believes another division is responsible for performing the task.

### **Operational risk management**

There are different strategies that can be used for operational risk management. But, the best method used for operational risk management can be divided in five stages which explain the evolution of operational risk management that a company must recognize as it becomes more and more sophisticated with and concerned about its risk management processes. The first point is that companies have always known that operational risk exists. Historically, these risks have been managed by relying on internal controls with periodic reviews by the internal auditor. Generally, the responsibility for risk control has remained with the individual managers in the business and specialist functions. The first stage as traditional baseline includes internal controls, reliance on internal audit, individual mitigation programs and dependence on quality of stuff and culture.

The second stage identifies the fact that operational risk can have a significant impact on the profitability of the company. Usually, a particular individual is appointed to be responsible for operational risk and that person is responsible for developing a common understanding and assessment of operational risk. Risk policies are developed, early indicators of risk levels are identified, and operational losses are collected. The purpose of this stage as awareness stage is to provide a framework for risk identification, definition of controls, prioritization of issues, and collection of loss events develop simple economic capital models and establish value proposals.

The third, or monitor stage, focuses on the current levels of operational risk and the effectiveness of management functions. Risk indicators are established to monitor performance. These indicators are consolidated with other relevant performance measures to provide senior management with an overall assessment of the firm's performance. Because this stage provides a better understanding of the current operational situation, stage four concentrates on qualifying the relative risks and attempting to predict what will happen in the future. Usually, firms in this stage assign specific committees or task forces to develop empirical models and evaluate their validity. The final stage recognizes the pervasive nature of operational risk. The objective is to integrate and implement processes and solutions while, at the same time, recognizing the different levels of management needs. At this stage, operational risk management becomes a fundamental part of the strategic planning process.

In today's world the business must make profit to remain successful and the management of risk requires expenditure of a firm's financial resources. Appropriate risk management is not without expenses. The final goal of risk management is either the creation or protection of shareholders value. The risk management must incorporate knowledge of the effect of risk on the performance of the company, the amount of risk the company can tolerate, and the impact of volatility on financial performance.

### **The need for a risk policy**

The main reason for a risk policy is the need for establishing guidelines for the management in the company and the need for describing the role of the different parties involved in the investment functions and the control of activities related to managing risk. Most policy guidelines are designed to meet or exceed any regulatory standards and to ensure that managers take a prudent course of action in the management of corporate operations and overall financial risk. There are two different reasons that can be analyzed as purposes of policy statements in a company. The first is that the policy statement is designed to protect the shareholders of the company from the management of the company. The second is to protect the managers from themselves. Giving the specific actions that manager should and should not take, these policies force managers to work together within a unified structure that will achieve the general goal. The policy statement should outline the appropriate approval procedures that decision making must follow so that everyone knows who is responsible for what decision. Having the policy statement in a company, well-informed independent outsider can look at the investment decision and understand exactly why it was made.

The first step in establishing a company's risk policy is to define risk specific to that organization. The second step is to determine a level of risk aversion based on management's and other stakeholders' risk desire, or how much risk exposure the company is willing to take. After this, the management must define the investment philosophy. One of the basic purposes of an investment philosophy statement is to define how much risk a firm is willing to accept. The preparation of this document is one of the first steps to ensure that management has accurately identified the nature and extent of the risks faced by their firm. Management must decide whether they want the certainty of cash flows or the flexibility to earn additional profits. The third step is to identify the objectives of the risk management policy. At this point, senior management must decide which exposures are important enough to manage and how much of the corporate resources should be spent in the risk management process of these exposures. This discussion requires that they define and measure the exposures on several dimensions such as present vs. future transactions, the effect of historical vs. accounting reporting, and the economic impact of the future cash flows. Some of the policy objectives include the preservation of the value of the company in the long term regardless of the variation in underlying economic variables, ensuring the total risk position of the company managed in a prudent fashion through the imposition of reasonable limits, and also ensuring that within the limits imposed, the company receives a reasonable return for the risk it does take. The last step is to identify the areas where risk management will be required and the identification of the responsible parties for this risk management. So, the limitations that the risk management has to work within must be specially identified.

### **Conclusions**

The implementation of the risk management strategy must have the following characteristics: acceptability, consistency and quality. Acceptability is needed because the strategies must make sense to professional who will implement the strategy. Consistency is needed because the strategies must make sense in the context of managements' stated values and objectives and the strategies must have a logical flow from period to period. Quality is needed because the strategies can be seen to improve management decisions that is, management's beliefs with market realities. With those characteristics, the risk management process will become an important element in the strategic planning process.

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**SECTION VII: GLOBAL MARKETING AND ECO-MARKETING****CREATING VALUES THROUGH GENEALOGY TOURISM**

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***Abstract:***

*Construction of values is not easy and complex task. In a globalizing world, the survival of the individual is a matter of value thinking. Value system itself is constantly changing. In its essence has a major role as a science and genealogy. The associated genealogical tourism contributes to this. Presented is a survey with students from the Economy Faculty. Its purpose is to reflect students' knowledge in this area.*

**Keywords:** genealogy, family memory, quest research.

**JEL Classification:** M19.

The very busy everyday live in a globalizing world often deprives us from the values which make the sense of human life. In a big extend we can say that the world of values is a part of human's spiritual culture. The values have the sign of common ideals which help the human to create his worldview according to his active relations with the environment. They are formed under the influence of both elemental factors, and in particular organized educational activity, especially when the person alone produces, manages and implements the formation of his views. The Values of the modern society are constantly changing, which affects the image of the world for everyone. This can cause a real "shock" in the values of the individual stand if he is not prepared for quick and painless changes from an early age.

The globalization leads to homogenization, the creation of a common culture, it leads to the unification of certain aspects in the life of the modern man, have some common values, and reduces or eliminates the differences between people from different countries, ethnicities or religions. There is one global common culture. Nowadays the world rages terrible value relativism and there is a strong process of devaluation of all values. To stay against the relativism can be made only by restoring the rights of absolute and universal human values which the humanity has achieved in his spiritual development. One of the most difficult thing for everyone is to find his proper place in the world and to find exactly where he belongs. It's important to find out our place connected with the relationship with other people and the way they perceive us.

The family memory is an old and not clear item in the history books. The family memory is the only saving idea which can protect us in the sea from useless information and mass "culture". The family memory is the missing but very important part between me and my family by one side and my country by the other. If we don't have a clear and well known family memory we can not understand the real meaning of the words country, homeland, Bulgaria...

If we know our family, our ancestors, their history, their strong and weak sides, their successes and failures, if we know the history of his native region, customs, traditions, livelihoods, and we will realize how much time, effort, blood, sweat and tears are invested by the people before us, those who have inherited and which created us as people and personalities. We will realize that we should be grateful to them for everything tangible and intangible that we have and about what we are and what we want to be.

The family memory gives us the base, the direction and motivation for our development. It is our primordial culture, our natural environment in which we feel, we live and develop best. The most complete and useful we are, if we know our people and protect our family memory. We feel more confident when we are connected to the basics of our origins we have confidence that we are part of a larger whole, which had contributed goods for the society. We realize that life doesn't begin with us and doesn't end after us. We think about the true value of the things that we do and that we will leave behind for our children, grandchildren and great-grandchildren. That is how the family history makes cultural sense of our life.



Something more - our ability to look into the future is predetermined to a large extent by inherited values and view of the world that adults often determined by the question: "Which of you was you? Belonging to a particular genus is a condition to be perceived 'serious' in this small community and also to have a future in it. Conversely – the absence of strong tribal identification is a problem that can be overcome in many different ways. For example the restoration or creation of a genealogy (pedigree) is an opportunity to legitimize (justified) the wish to be a part of the community. All these messages are provided by the family. The importance of the problems connected with the family is because this is the strongest social factor creating the child. The family as a social system with its own internal structure and interactions will not be passive in culture, but rather inculcate in the mind of the child, including the child in a complex family relationships. During its development the child enters the system of social relations through the family. Through it, as a building component in the structure of society, the child, even indirectly is contacting with large social structures. That is how the child joins to the society's culture and becomes its member. At the date of birth the child is receiving a surname as a mark of belonging (family, gender, ethnicity, etc.). All and all moral life "assets" and "liabilities" of the family passed on him. Since the primary socialization takes place within the family, which began to form personality and became its incorporation into adulthood, are essential the personal qualities of the parents and the status of education in the system of family values.

The family is one of the most important institutions of the society. On one hand it is a social institution, and on the other- micro social group. It is the center of marital, parental and child relationships. The common motives, attitudes, interests and aims in the same family are called family values. They determine the similarity between children and parents. The family traditions, festivals, rituals and symbols provide continuity of generations, affection and responsibility towards their family and children's emotional sphere, with a sense of love and dignity, civilized family, family honor and patriotism. Children can not remain neutral values that keep family and everyone has to decide himself whether to comply or not with them as they grow. With the help of the family is realizing the continuous change and continuity between generations and giving social experience, values and norms of behavior. The family education is unique in consistency, intensity and results because it is based on the heart connections and they are done in natural conditions, continuous and prolonged, while covering all aspects of the emerging personality. The family education is an extremely important aspect of the theory of education of pedagogical science as a whole. Historically, its nature, importance, role, functions, structure, etc. are viewed and interpreted in different ways, but it always remains at the center of public attention. And so it should be because in the family the child gets his first lessons in education. Although rarely focused and organized, they are rather the example of the environment in which they grow and form the child as an individual person. In the family children receive lessons for the first time in patriotism - the parents first understand what race, nation and homeland, what previous generations have created, what should be proud of and how to preserve it. There they learn memories, traditions and rituals, see photos. These are all documentary traces of collective memory, part of which is the family memory. That is how a man is recovering his lost identity, finds its place in the world and its surroundings.

To study the construction of values through genealogy tourism is conducted survey among students of Economy faculty of SWU "N. Rilski ". These are students majoring in Finance, Accounting and Control and Business Management. In the study is used partly standardized written questionnaire. There is a representative sample in terms of the population from which it was taken. It covers most of the students taught in the summer semester of the academic years 2011/2012. In the questionnaire are included 10 questions, which are pre-defined and arranged in a particular sequence.

"Open" questions, in which respondents construct their answers in a free-form are 3. (Questions <sup>1</sup> 3, 4 and 10).

Other issues are defined as "closed", with predefined possible answers as follows: alternative, with two possible answers "yes" and "no" (Question <sup>1</sup> 5) and scaled where respondents indicate not only a positive or negative markedness of the mark, but this degree of markedness. (Question <sup>1</sup> 7). Questions <sup>1</sup> 1 and 2 are with introductory nature, where questions <sup>1</sup> 6, 8 and 9 should prioritize these indicators.

Quantitative (mathematical and statistical) analysis of questionnaire data was carried out using computers as partial answers to standardized questions are pre-classified into specific categories.

It is crucial to achieve the research goals is the quality (meaningful) analysis of questionnaire data and their visualization using a circular (sectoral) and column charts.

Respondents were 116 students, of whom 53 (46%) were men and 63 (54%) - women: **fig. 1**

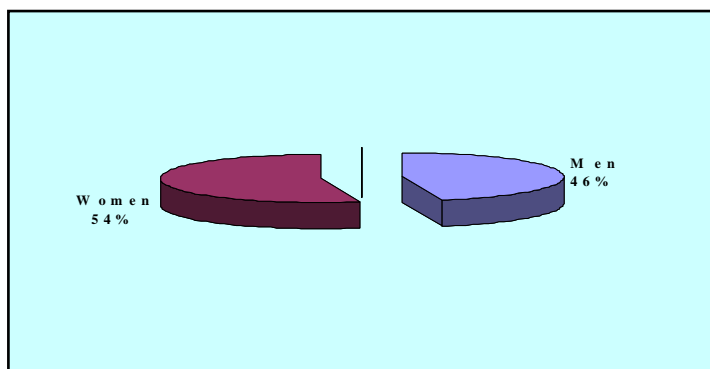


Figure 1

Most of them live in cities - 99 and 9 in the capital, while the remaining eight were from the village: **fig. 2**

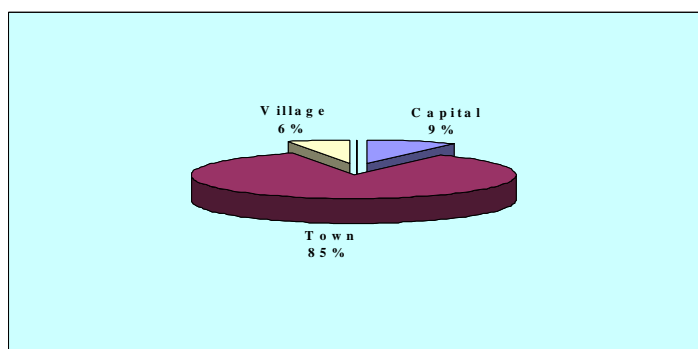


Figure 2

When asked: "Do you know what science means" Genealogy "?" almost all gave a negative answer. This is an expected and logical result. After clarification of its nature, students answer correctly on many other issues.

Most of them (65) know their ancestry to the level of great-grandparents. Only a few know and those after them (36).

The fifth question is "Have you made up a family tree?" In his answers are grouped as follows: **fig. 3**

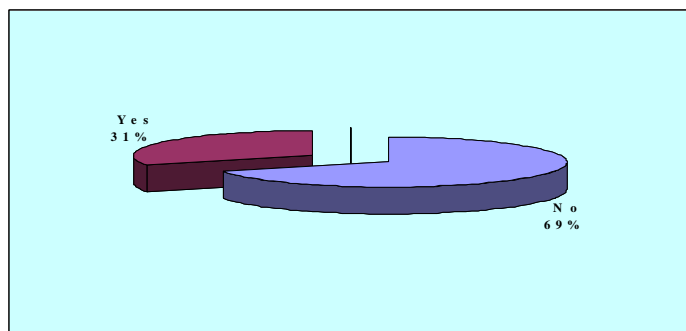


Figure 3

According to the sixth question must be arranged in specific types of tourism importance. The chart looks like this: **fig. 4**

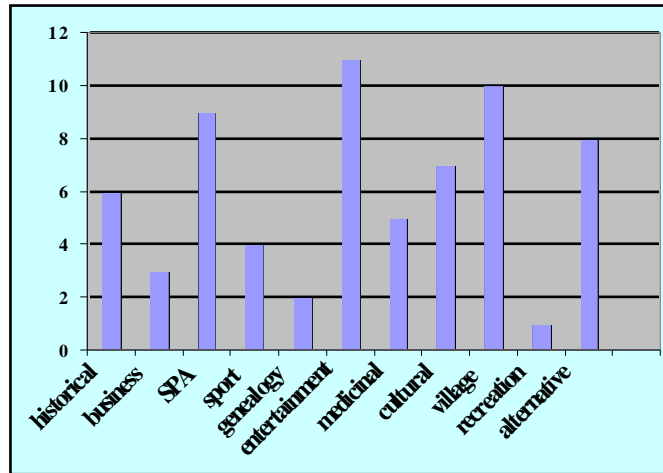


Figure 4

The first place is for the leisure tourism. Followed by rural, spa, alternative and culturally. Genealogical tourism as a new honorary occupies tenth place.

The following questions are for the development of genealogical tourism, as well as time and resources are devoted to it. The question "How is the genealogical tourism based on your observations?" Students answer this: **fig. 5**

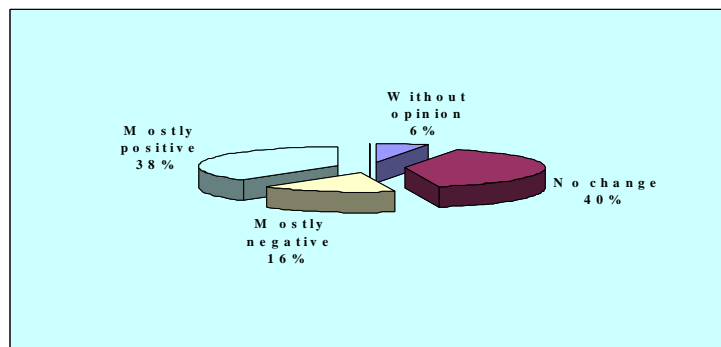


Figure 5

Most of them spend up to 250 lev for genealogy tourism and from 3 to 5 days in duration.

The last question is for genealogy favorite tourist destination. Most students do not have. They just love to travel, to explore their ancestry.

Education is very important, essential and important social phenomenon. Education is a social phenomenon and is unique to humans and human society. Its goal is the formation of attitudes, beliefs, traits, qualities and abilities, norms and rules of behavior and relationships. Education requires mastery of certain norms of behavior, understanding of human values, build certain personal qualities and equal participation in interpersonal communication.

Systematic, purposeful and adequate educational impact is favorable, positive impact on the elements of the human psyche which reflects on his mind and behavior. As a basic cell of the social organism, the family lived in a rhythm with it and reflects both general ideas and goals, and the upheavals that occur in it.

Today's modern family has changed too much their internal structure as a result primarily from changes in the economic sphere, it is so important to build something lasting family memory as something that will remain for generations to come.

## DOES MARKETING RELATE TO FINANCE? - "... MARKETING IS FINANCE?" THEORETICAL PERCEPTION

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### *Abstract:*

*As market develops and grows continuously and internationalizes, the confusion among companies increases regarding their orientation of the business. They find it each day more difficult to grab new shares in the market, to capture and gain new customers, to hold their clientele, to increase continuously their customers' satisfaction, to position properly in the market and to face competition, as well as to answer to the spontaneity of the market evolution. This tells for an increasing role of marketing in the companies' organization, and of course in their performance and profitability. Even this necessity, the top management and other departments, but especially the finance ones are often debating on the marketing role and its contribution in the overall profit of the company, as marketing is very much oriented and familiar with performance indicators rather than financial results and profit in itself. There are views recently which emphasize that marketing is finance too, as it completes the value chain and realizes indirectly all the company's targets. To this logic it has become necessary to measure its performance not only using marketing KPI (Key Performance Indicator) but financial metrics too.*

*The study aims to show the reasons why marketing and finance are closely related and why "marketing is finance". This is a deduction-induction-deduction theoretical review and treatment of the question, based on some facts and arguments both, from the world wide experience, as well as from Albanian reality of business and marketing.*

**Key words:** Marketing, KPI, Metrics, Performance, Profit.

**JEL Classification:** M30, G0.

How can marketing integrate with the company's strategy in terms of performance and pay-offs?

1. What is marketing? Why is it important to the company?
2. What should a company do in order to be nearer to its customers?
3. How can we react and answer to the needs and wants of the customers?

As we shall see in this theoretical study there is a lot of confusion answering these questions on marketing in a wide range between companies.

### 1. A short review on the actual situation of the market and marketing

Most of the companies and businesses in Albania, nevertheless big companies or SMEs, do not have a clear view on marketing (nine out of 117 business people had adverse views and concepts on marketing, but not complete view, the rest identify it mostly with advertising or selling)<sup>258</sup>. Almost all of them are not clear on the role of the customer and its importance for the business.

The businesses do not measure their performance and do not define and use standards and indicators on this regard. Still, marketing is forgotten or even not considered as a main and last step to the final result for the company. They suffer lack of cash, networks, sales' force, skills related to negotiation and integrated marketing communication, as well as do not control and manage efficiently and effectively their inventories and logistics, due to the lack of knowledge on marketing and its mix.

There are sectors where we find abundance of products, services, ideas, other forms of offer and brands. The people, even in a status of matured demand, find it difficult to choose how to fulfil profitably their needs and wants.

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<sup>258</sup> Field research conducted interviewing 126 business people, 26 women and 100 men through administrators, sales' persons, owners, finance and accounting people, managers and marketing people in the regions of Elbasani, Tirana and Durres

This increases their confusion and diminishes their bargaining power in a transaction, and in the same time increases their fear on being imposed and defrauded. We find that they generally are apparently inert to the promotion and they do not go willingly to chose and buy. That is mainly why, we need to divide and segment them in order to conjure them and fulfil their needs efficiently and effectively.

There are points of views stating that marketing is nonsense. They state that everything counts is technology and finance. There are views stating that management is the one to find out the solutions and others just have to work hard. There are other views stating that what counts are costs and prices. Other economists state that logistics often can make more customers than money spent for product modification and high management salaries for brighten minded managers. Image also counts and gives to the enterprise what money saved and other tools can give. At the end, everybody talks for enterprise, products, prices, logistics, image, costs, technology, but none of them considers customers and their important role in our value creation. Who else but marketing can do better to understand their needs and wants, can gather their opinions, understand their state of spirit in a transaction and increase sublime perception on company and its products? Isn't it, all the others in an enterprise here above do, marketing mix? Then comes the other question, "Should we still think of our business without doing marketing?" Of course not! It is in the essence of the concept itself, "mark-eting", to target the mark, to target customers and capture them. The essence stands for the results mark-eting can provide for the company, and which way to measure those.

Marketing research on customer behaviour, as well as other data and information gathered from different sources, giving a better view of the market and its stakeholders are needed to judge and reason on customer profitability for every market segment.

At this point I think companies must search and fight to win and hold their customers taking care of their needs and wants, as well as building strong ties and familiarity with them, with the target finding and having our main partner in them.

We need to measure customer profitability, in order to project and design the marketing mix targeting for profits and benefits. And further more we need to measure marketing impact on the overall result of the company.

## 2. Definition of marketing metrics

There are many elements and variables influencing and measuring marketing efforts' and expenses' pay-offs. We call those metrics of marketing. To understand better these metrics, we need first to define the results to be measured. Generally, marketing can produce three categories of results:

- Awareness - the rate of notarization of our brands, products and the company itself among customers. They can have different knowledge on the company which together compound their awareness on the existence of the company and its offer.
- Perception - the position the company and its offers occupy in the customers' mind. It is very important to know customer reaction toward the company and its offer and their estimation on those. It can be estimation expressed in different ways, to which the most important ones are the customer relation estimation and the competitive position compared to other companies in the market.
- Behaviour - The reaction the customers have on the company and its offer due to their awareness, perception, as well as the market conditions in the moment they are induced to react on.

And these three categories are translated in concrete terms like increase in sales volume; reduce of the payback for the investments done; speeding up the return time increasing the internal rate of return; increase in ROI, ROMI and ROIMI. These are some of the main indicators used to measure the marketing pay-offs.

But, what are marketing metrics?

Marketing metrics are signposts on a firm's route towards meeting its strategic goals<sup>259</sup>. Uncles comes up with a multidimensional definition of what marketing metrics are. He states that on one level metrics are used to gauge the effectiveness of specific programmes and activities, on the next level there are product and service metrics. These are concerned with brand health and customer satisfaction<sup>260</sup>. Finally, there are metrics that link general investments in marketing and market related activities to overall measures of success for the corporation. Ambler states that these metrics "should be tailored to the company's strategy"<sup>1</sup>.

It is important to understand what we measure and what it represents integrated to the strategic goals of the company. We find that, even mostly operative and entrepreneurial, the activities of marketing have great impact on the final results of the company.

<sup>259</sup> Ambler, Tim. "Marketing Metrics." *Business Strategy Review*, 2000: 59-66.

<sup>260</sup> Uncles, Mark. "Marketing Metrics: A can of worms or the path to enlightenment." *Brand Management*, August 2005: 412-418.

Being at the outside door or window in the company and often “holding” customers side in the value chain, they are precariously perceived for their importance in the company. This is one of the main reasons why they are often not given the proper place and importance in the company, even though almost all the company people unanimously state that “... we are doing well, but, ... we need marketing to increase our results”<sup>261</sup>. This and other statements and perceptions on the necessity of marketing in the company, emphasize the need to measure the marketing performance in order to increase accountability of the last in front of the rest of the company.

So, marketing metrics could be defined as measurements that help with the quantification of marketing performance through figures, indexes or else in order to prove and display the pay-offs of marketing in an enterprise.

They provide evidence on customer experience, on service delivery, on customer loyalty, on increments on sales, image, customer perception on the company, audience coverage, profit and return on investments.

So far marketing metrics has been challenging researchers and scientists of marketing. On 1979 Churchill stated that “Marketers, indeed seem to be choking on their measures.” Clark in its study on marketing metrics gives a view on the how we came into this KPI on time, showing also the increased importance of marketing in terms of investments and pay-offs. This process passed through four stages:

The first stage belongs to studies on the measurement of marketing results as functions rather than departments focussing on single and divided financial output measures such as profits, sales revenue and cash flow, which measured the productivity of marketing efforts in producing positive financial results generically. This is due to still not clearly classified functions of marketing as a main and important link in the value chain of the business.

The second stage belongs to the development of other KPI, this time non-financial measures, such as market share, quality of services, customer satisfaction, customer loyalty and brand equity. Diversely from the earlier stage, these KPI/metrics move in another direction than financial ones, and regard more to the behaviour and loyalty of the customers. The measurement of these indicators was merely easy to be perceived by the marketing people as they were oriented to the customer and the relations with him. They counted to measure efforts to capture new customers, efforts to build customer satisfaction, efforts on retention of the customers, image building and brand equity etc, arguing that if a firm has loyal and satisfied customers, it can increase its revenues and profits, as well as reduce costs of retention and transaction costs too.

The third stage evolves on other metrics such as marketing assets, marketing audit, marketing implementation and market orientation. These measure the relations and the integration of the company with the marketing environment. We find here the first efforts on CBA (Cost and Benefit Analysis) to evaluate marketing programs and their appropriateness with the market segments the company operates.

It becomes important at this stage the establishment of MIS (Marketing Information Systems) in the companies and the emphasis of the market orientation of the company. The fourth stage belongs to our modern era where multiple measures are necessary such as efficiency, effectiveness and multivariate analysis. This calls for an integral process of combination of all the metrics of marketing in order to measure and control the marketing activities as they tent to run faster and farer than the company often perceives toward new markets, targets and results of performance. Clark argues that efficiency examines how best to allocate marketing assets and activities to produce the most output. Reviewing the literature we can note that once the marketing increases its role in an enterprise, it takes more sense to measure its performance and compare its results with the other departments in a company. Referring to Rust, companies should place a greater emphasis on models that link marketing tactics to financial impact of a firm<sup>262</sup>. This tells us for more attention on the integration of marketing with the other functions in a company and forces us into adoption and understanding of methods to measure marketing at the same levels we do with the other functions and departments in the company. While, O'Sullivan & Abela identify three main branches of measuring marketing performance research. These are measurement of market productivity, identification of metrics in use and measurement of brand equity<sup>263</sup>. The selection of marketing metrics to use is a starting point to evidence the role that marketing plays in the overall performance of a company. While, to measure brand equity we can usefully combine KPI and the house of quality, using Quality Function Deployment in order to deploy the set of product mixes whose performance and equity should be measured under various market conditions and segments.

## 2.1. Marketing metrics

<sup>261</sup> Field research conducted interviewing 126 business people, in the regions of Elbasani, Tirana and Dures. 123 of the interviewed people state that “they are doing well, but they still need some more marketing to do better”.

<sup>262</sup> Rust, Roland T, Tim Ambler, Gregory S Carpenter, V Kumar, and Rajendra K Srivastava. “Measuring Marketing Productivity: Current Knowledge and Future Directions.” *Journal of Marketing*, 2004: 76-89.

<sup>263</sup> O'Sullivan, Don, and Andrew A Abela. “Marketing Performance Measurement Ability and Firm Performance.” *Journal of Marketing*, 2007: 79-93.

Gronholdt and Martensen in their study arrived at a short list of marketing metrics which is shown below:

**Table 1. Short List of Marketing Performance Measures based on Literature Review Gronholdt and Martensen<sup>264</sup>**

<b>Mental Consumer Results</b>	<b>Market Results</b>
Brand awareness <sup>1</sup>	Sales (volume and value) <sup>1</sup>
Relevance to consumer	Sales to new customers
Perceived differentiation	Sales trends <sup>2</sup>
Perceived quality/esteem <sup>1</sup>	Market share (volume and value) <sup>1 2</sup>
Relative perceived quality	Market trend <sup>1 2</sup>
Image/reputation	Number of customers <sup>1</sup>
Perceived value	Number of new customers
Preference	Number of new prospects (leads generated/inquiries)
Customer satisfaction <sup>1</sup>	Conversations (leads to sales)
Customer loyalty/retention (intention) <sup>1 2</sup>	Penetration
Likelihood to recommend	Distribution/availability <sup>1 2</sup>
	Price
	Relative Price (SOM value/volume) <sup>1</sup>
	Price premium
	Price elasticity
<b>Behavioural Customer Results</b>	<b>Financial Results</b>
Customer loyalty/retention <sup>1</sup>	Profit/profitability <sup>1</sup>
Churn rate	Gross margin <sup>1</sup>
Number of customer complaints <sup>1</sup>	Customer profitability
Number of transactions per customer	Customer gross margin
Share of wallet	Cash flow
	Shareholder value/EVA/ROI
	Customer lifetime value

The signed metrics (1) according to Ambler and Puntoni (2003) are the 15 most commonly used metrics, and the signed (2) according to Davidson (1999) are the 10 most commonly used metrics by the businesses.

This table has been reviewed and developed by other researcher too like Farley, Hoenig, Ambler, Kokkinaki and Puntoni, whose metrics have been quoted widely in the marketing metrics literature.

The categories of marketing metrics in the table represent a broad range of marketing activities as identified in the literature. The measurement of these metrics can give wide information to a company on the performance of their marketing efforts that eventually lead to increased business performance.

Companies fight continuously with all the competing forces in the market and they face different problems as fall of the sales volume, increase in the costs of services they offer, diminishing of the profit because of different discounts on price they are obliged to do, unstable positive cash flow, problems with the return on investments, especially on the assets where some times the loans are too high, problems due to the moral depreciation of the solid active and technology etc. Ambler says that companies can't survive without marketing as the money they need come from customers which make possible positive cash flow. While O'Sullivan and Abela state that reason why companies should use marketing metrics is that their use will lead to improved firm performance, placing marketing in conditions of accountability and synchronizing it with the rest of the company especially with finance management.

Ambler, Kokkinaki and Puntoni identified a series of metrics, to be considered as primary general metrics to measure marketing performance of the company. They classified these metrics in six categories:

1. Consumer attitudes - measuring awareness, perceived quality of the offer by consumers, relevance of the products and services to the consumer, brand image and product knowledge as perceived from the customers etc.
2. Consumer behavior - measuring the total number of consumers, number of new consumers, loyalty of consumers, and the number of consumer complaints.
3. Trade customer - measuring customer satisfaction of trade customers and the number of complaints.

<sup>264</sup> Gronholdt, Lars, and Anne Martensen. "Key Marketing Performance Measures." *The Marketing Review*, 2006: 243-252.

4. Metrics relative to competitor - measuring the relative satisfaction of consumers and the perceived quality of the products compared to the competitors' offer. These measure the consumer consensus on our products comparing those with the competitors.
5. Innovation degree and position of the company - measuring the number, revenue and margins of new products, as well as the advantage in the use of the new technologies.
6. Last but still the most accurate one is Accounting and Financial KPI - which are traditional metrics concerned with sales, gross margins and profitability.

They state that accounting and financial metrics are the most dominant metrics' categories relative to consumer behavior, trade customer, competitor and innovativeness even those count for one sixth of all the indicators.

Recently, we see too many efforts by the marketing managers to develop and use different marketing metrics to measure their performance, with a strong focus on two principal indicators, increase in sales and market share, very close related to the financial overall goals of the company.

As we can denote here, most of the researchers on marketing metrics partially ignore, that there are some financial metrics absenting like ROI, ROMI, ROIMI and other financial ones which help measuring better and directly the pay-off of the marketing investments, to which we shall talk hereunder latter.

What we can discover by this literature review and the suggested use of marketing metrics is that marketing should be a data-driven one at least in its simplest form, "keeping score", in order to enable justification of marketing investments per each program or action. It can improve marketing performance by evidencing what and which marketing part is working in terms of efficiency and effectiveness, ensuring that the money are invested where it is measured to have high results and pay-offs. So, it can serve also as a preemptive step to new investment in different marketing campaigns and programs. Once completed this stage, the use of data-driven marketing and its analytic marketing metrics or KPI can importantly improve marketing performance, nevertheless our business is large or small.

Referring to Porter, at his "Competitive Advantage of the Nations" on the famous Five Forces of Competitive Position model he defines "sustainable competitive advantage as the coordination of activities that are not easily duplicated.

At the highest level, strategic advantage from marketing is created by the coordination of activities that are not easily duplicated, and data-driven marketing and measurement are significant components of those activities."<sup>265</sup> This certifies once again the importance of the marketing metrics in the measurement of the marketing performance and in its accountability to demonstrate the importance of marketing along with other departments in the enterprise.

Generally, the marketing metrics are distributed and used according to the relevance of the activity; strategic, tactical or operational.

There is a group of marketing metrics, the financial ones, which are basically four; profit, NPV (Net Present Value), IRR (Internal Rate of Return) and payback. While, ROI and ROMI are applicable to more than 50% of marketing activities. According to Jeffery more than 55% of the marketing officers are not familiar, nor have knowledge on these metrics and their importance to measure and evidence their work. These metrics together with other financial metrics combined give a clear view on marketing results in terms of profit and efficiency on investments done. While, the situation with our sample in Albania is even more tragic, when more than 97% of the interviewed business people do not use the here above mentioned metrics or KPI to measure marketing efficiency and effectiveness. They perform marketing by case and very random. They try to use those only in case of loan application in the banking system.

## 2.2. Financial marketing metrics

Does Marketing relate to Finance? This seems to be a very generic question. To understand the right meaning we need to realize what marketing per se means and why finance and in what relations we consider? We are given mostly to think about marketing as an externally oriented function of the company, based more than in anything on the performance towards market and its stakeholders. In fact, considering the role it plays in the company, finalizing the value chain, it stands true that marketing is the window linking the enterprise with the external environment in all its meaning. As such a function, it is often seen not very much integrated with the other functions and departments of a company<sup>266</sup>.

Even these views, it is already known now the importance of the functions of marketing and of marketing people in an enterprise. They are not just the last step toward market and customers, they are part of all the company and present in every step, since the start of the business and later on to follow with their functions on providing convenience related to time, space, quantity, quality and price, building image and market standards in every link of the value chain, speeding the locomotive to higher acceleration and creating partnership in all directions and dimensions in and out of the company's environment.

<sup>265</sup> Competitive Advantage of Nations, by Michael Porter, Free Press, edition 1998

<sup>266</sup> Only five out of 76 businesses interviewed in our sample have shared function of marketing in their business, and only one has a shared administrative unit (so called department) of marketing.



Most of the companies do not measure the performance of marketing in financial terms. They use integral indicators to calculate for the results of marketing in a generic way, such as ROI or EVA (Economic Value Added). But this is not enough. These indicators and other generic ones does not give a correct answer to the questions; “How much marketing? Do we need more services? How much inventories? Do we have the right product? What is the right price to be set? Which marketing mix should we choose? And by top management company view the question stands for “What is the marketing result in financial terms?”.

At this point, the choice to be done is whether to use one or the other set of indicators, ore both of those combined together resulting with another kind of yield, volumes upon costs, which increases once the costs are managed to be reduced or the volumes increase under the same cost regime. The model is a matrix with two set of variables KPI and financial metrics.

To this end, we need to adopt specific indicators, in order to give answer to our questions. We need to measure efficiency of the investment done on marketing - Promotion, distribution, sales, customer relations etc. As the marketing officers are too much given to entrepreneurial skills, as well as very operative in their decision making, focussing more on performance rather than in financial results, or pay-offs in financial terms, it would be very useful and important to measure the effect of their actions and the profitability of the investments done in marketing.

### 2.2.1. ROMI metrics

We shall now analyse some of the main and mostly used metrics and more related to marketing performance and ROMI. The first essential marketing metric is “net profit”. It is a simple one which can easily be used by businesses at any level of classification according to sales volume, investments done, and position in the market. But still there are e few points to consider based on what we touched here above. First, we must understand that marketing as a function rather than just and activity exists divided apart in a considerable number of companies because some of those have decided to invest more or distinctively in demand generation marketing, running more on sales and promotion, effort which drive sales to increase but still reduces the profits, as they do not consider the marginalization of the profit due to marginalization of the needs and wants in the market. This last phenomenon pushes marketing divisions toward more services and benefits, as well as other discounts offered to the customers killing profit of the enterprise. The large and leading companies invest more in image building through prestige branding and customer equity and are able to charge premium prices, gathering higher prices and covering marginalization of profit for a longer time in the product life cycle. While small and medium enterprises suffer this phenomenon and face more difficulties in supporting marketing initiatives all along the life cycle of the product. This is why not just the sales revenue is essential in measuring marketing performance and researchers do not consider it as an essential metrics. This does not mean that we could ignore the importance of the sales revenue in our analyses and often targeting marketing with this indicator. But, we must keep our attention both on sales revenues and the net profit realized through these revenues and the marketing expenses done.

There are a few companies which can decide to compete on price since it distinctively reduces profitability and make it difficult to build loyalty among customers, which of course is not an Albanian case<sup>267</sup>. The companies which can do this have highly representative market channels and a high control and performance in their supply chain allowing driving costs down to minimum. It is related to the main strategy chosen by the firm between three ones:

1. Product leader
2. Operational excellence
3. Intimate customer orientation

Only companies positioning as leader in the market as the operational excellent one and holding competitive adequate position in the two other dimensions can consider competing on price. In this case the main target for marketing and an important metrics to be used in order to measure its performance could be the sales revenue. But, to the remaining firms, using marketing to drive profit is a better strategy, this of course asks for the use of net profit as a metrics to measure marketing performance, rather than sales revenue and market share. Most of the large firms target to grab market shares considering it as sustainably important. But, if you start losing profit grabbing market shares and this does not promises for future incremented profits, it can result a losing strategy.

To this arguing exists a conflict between sales and marketing, since the first are often driven on volume rather than profit realized from those. And continuing with the analysis on the sales force performance and effectiveness having sales revenues as main target and metrics, those sales force who are considered the highest performing ones result often to be the least profitable, and may sometimes be even negative in profitability.

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<sup>267</sup> All the interviewed of our sample consider the price as the only important mean to competition and customer attractiveness.

Considering this arguing companies need to design and establish incentive systems of marketing metrics to measure marketing people performance based on the profit for brand and product sold, not on sales revenue. This can induce marketing people to cost attention and to revenues/cost consideration in their activity naturally pushing for two main goals, market share and profit being rewarded as profit centres too.

The question in our case is not to decide on which price to charge, even to measure per se the operational costs, however we want to discuss and create a clear view on the importance of marketing metrics and consult the businesses on how to use those in order to prevent damages and to improve their marketing pay-offs.

The insight of the problems for marketing, though, is that facing difficult times and competitive pressures, the inclination is to compete by cutting price, to the detriment of profitability. At this point of discussion, marketing has too much to do in order to increase company's profitability through increase of the performance and the net profit metrics is very useful.

The second essential financial marketing metrics is NPV on which we have largely spoken in basics of finance and financial investments. In terms of marketing performance evaluation it gives us a view on what will be our investment in terms of return on time. We take the money spent on marketing to the future discounting those with the cost of depreciation due to time inflation and increase in costs of capital use, understanding what their value is today. NPV enables us to compare marketing campaigns or programs that have different costs; hence, the cost of the campaign is subtracted from the present value. More specifically, the cost of the marketing is spread over time, so this metric can be written<sup>268</sup>:

$$NPV = -C_0 + \frac{(B_1 - C_1)}{(1+r)} + \frac{(B_2 - C_2)}{(1+r)^2} + \frac{(B_3 - C_3)}{(1+r)^3} + \dots + \frac{(B_n - C_n)}{(1+r)^n}$$

$C_0$  are start up marketing costs,  $B_n$  are the cash benefits for each period and deriving from marketing activities, and  $C_n$  is the cost of marketing per period. The difference  $(B_n - C_n)$  is the increment on profit due to marketing investments per period. So we calculate the benefit minus cost in each time period related to marketing investments, which is just the profit metric of the net profit and discounting by the  $(1+r)$  market factors for the time value of money. This tells us that the profit worth less in the future and the longer the time on return on investments the smaller the profit measured for the marketing investments. At this point it becomes important the calculation of "r", which is the rate of return we expect to get by investing money in the same conditions with the average and representing companies in that industry. Marketing managers have to decide to invest if NPV is greater than zero and to not invest if NPV is less than zero. NPV positive means the average benefit is larger than the cost of marketing in each time period, considering the inflation and the depreciation of the money in the future periods, as well as the startup marketing costs/investments.

This essential marketing metrics can be applied too in the estimation of the net cash flow of the company in the future periods and discounting those back to today. Dividing this figure with the total assets we can calculate the yield per unit of money spent in marketing, and in case the company has no debts embedded in its assets, divided by the number of shares outstanding tells us how to calculate the price per share. The CMO (Chief Marketing Officer) could easily say what could be the share price increment for unit of investments done in marketing. In this case the reason to invest in positive NPV marketing programs and campaigns is that the share price will increase, and vice versa. All this discussion on NPV is more worthy in normal development economic times. This is not very useful in times of economic recession for it contains several uncertainties and risk in the assumptions, the benefits, costs, and discount rate 'r' in its calculation. In order to reduce the error it contains in during hard economic times (economic and financial crisis on 2009) as well as in irrational and inefficient trading markets (Albanian market due to its high level of informality and competition distortion)<sup>269</sup>, we can always get use of the other basic and important financial marketing metrics, ROI. It is measured dividing the net profit metrics resulting from marketing functions and activities with the total of marketing investments, talking this way for ROMI. It seems easy by a generic point of view, but it becomes rather difficult when we must first calculate the net profit due to marketing investments. We shall talk on this here later.

The third metrics very much related to NPV and its components is IRR, rate that money is compounding internally to the campaign or program<sup>270</sup>. Actually it can be calculated by setting NPV to '0' and solving the equation for 'r' equal to IRR.

<sup>268</sup> Data-Driven Marketing, The Fifteen Metrics Everyone in Marketing Should Know, by Mark Jeffery, John Wiley and Sons, Inc. 2010, pp 110

<sup>269</sup> 67% of the interviewees claim for distortion of competition, 83% claim for informality in business and dirty competition, 89% state that they increase each year diminishing profits and cash flows, and the market seems deeply paralyzed due to low level of cash transactions in front of barter ones

<sup>270</sup> Data-Driven Marketing, The Fifteen Metrics Everyone in Marketing Should Know, by Mark Jeffery, John Wiley and Sons, Inc. 2010

The 'r' rate is also called the hurdle rate as it represents the main reasons out of the marketing competences and possibilities to be controlled, discounting the future value of the investments done in marketing to the present days. If IRR is greater than 'r' the firm can invest and generate profits, otherwise it should retire or not invest other money in marketing.

As we can distinguish from the other metrics, it is an operative ongoing metrics showing coherently the marketing pay-offs and the possibilities of EVA positive on the marketing investments. It makes possible for the marketing in the company to intervene and improve the performance.

The fourth essential marketing metrics to ROMI is Payback. The payback is the time period when campaign or program of marketing has paid back the cost, investments, as well as loses diverse to profits.

At the end of this reasoning on these four essential financial marketing metrics, the return on marketing investment is a compound one comprising NPV, IRR and payback. In order to quantify the value of marketing we use what is called in the literature ROMI - or the result of the abovementioned three essential metrics.

Generally we can easily say that  $NPV > 0$   $IRR > r$  is good and  $NPV < 0$   $IRR < r$  is bad. Also consider short payback good and long payback bad.

This tells us clearly that ROMI metrics makes possible much more effective and efficient marketing decision making than the static ex post ROI. Classifying all the marketing activities and investments apart and finding out through an analytical algorithm process the impact of marketing in the financial result of the company, ROI, we can calculate ROMI measuring directly the efficiency of the marketing investments. The question stands for finding out the contribution margin of marketing in the gross margin or incremental revenue.

- ROIMI - a very useful metric to measure direct return on incremental marketing investment done in a certain period, or in a specific situation. This gives us a direct result on how the action we undertake influences on sales. We can certainly use this to measure also the pay-offs for each "milestone" in a marketing program, as we can easily distinguish between the stages of the program. It would help do divide too the contribution done by sectors and elements of the marketing mix in an enterprise.
- MEROMI - Media Exposure Return on Marketing Investments, also very important metric, even not directly measuring financial outcomes from media activity, but measuring the yield of a promotional activity, the cost per contact, or the cost per achieved audience. On this basis we can certainly measure then the rate of achievement of the audience and the internal rate of return on the money spend on this audience expressed in revenues for contact or audience unit. If we have the total amount of the investment done in media or generally in marketing campaign, the total planed audience expressed in contacts or individuals, the planed number of contacts per period (day, week, month, year) and the return rate on incremental marketing campaign investments for each period in the net profit, we can measure the IRR on the marketing campaign investment planed in the marketing program of the company.

Generally speaking these are the financial marketing metrics used to measure performance of marketing, explained conceptually.

### 2.2.2. How to use ROMI in practice

The approach of ROMI analysis shown here above is a very useful tool to measure marketing performance and to enable ongoing interventions to improve or modify marketing programs and ensure the target achievement and high performance. We can pass through six steps to the final decision or performance measurement and final decision making.

The first step, comprises a business analysis to discover and understand the existing situation with marketing mix and to evaluate the potential improvement through a new marketing mix.

The next step, is to calculate the revenue and costs expected in the future if the business continues in the same situation and with the same marketing mix.

The third step, is the definition of the new potential marketing program or campaign costs, or the total new marketing investments to be done. This may assume the complete diversification of the marketing program or campaign into a new one, or additional investments respective to the new marketing intervention, counting apart the increment in marketing investments.

In the fourth step, first, calculating and assuming the impact of the new marketing or product launch we come to the fifth step, calculation of ROMI:

$ROMI = [\text{Revenue attributed to new marketing investment} * \text{Contribution margin of marketing in the overall net profit} - \text{Investments in marketing}] / \text{Investments in marketing}$

or

$ROIMI = [\text{Increment in revenues due to marketing investments} * \text{contribution margin of marketing} - \text{Increment investments in marketing}] / \text{Increment investments in marketing}$

Sixth step, is the sensitivity analysis testing the new model through various assumptions to define what could be the best, the worst and the results of the new case (marketing program or campaign).

This process is easy to be used even in the cases of our businesses which are mainly micro, small and medium enterprises as they still are not clear on the role of marketing and the pay-offs it can induce in the companies result. at this point this may involve a dummy variable considering the division of labour and functions and the classification of the marketing apart and shared as function and employment, having a unit value in case shared and '0' in case mixed ore embedded in other functions.

### 3. CONCLUSIONS.

The hypotheses raised here in this study are:

$H_0$  - Marketing is not necessary to be a shared function and employment in the enterprise.

As we refer to all the arguing in this study, this hypothesis fails.

$H_1$  - Marketing is a shared function based only in performance and we can measure it by mean of KPI.

As we argued here in the study, this separates and removes out marketing by the rest of the team in the enterprise, as they consider marketing people costumer advocates rather than their front office and pioneers toward the marketing jungle, ensuring customers for the company's products and services, as well as profits.

$H_2$  - Marketing is finance.

As we argued here, it is neither enough marketing to be a shared function and employment, nor a function based and rewarded only on market performance, rather than and decisively a cost and benefits measured function, organizing and working with a unique goal, increase of the profits of the company through increase in marketing performance, which is the philosophical line of the discussion in this study.

For one thing marketing and finance disagree, is how well current programs measuring the ROI of expenses such as advertising and direct mail actually perform. At many companies the two functions do not work together to develop measures; sometimes they battle one-another.

One study, by Marketing Management Analytics (MMA), finds that generally just 7 percent of finance executives are satisfied with their companies' ability to measure marketing ROI. A higher portion of marketing executives, 23 percent, think they are doing a good job of measuring returns. But this is not the case of Albania. Here we don't have figures on these arguments.

"Marketing executives are under a lot of pressure to show exactly how investments in the brand translate into sales," says Ed See, co-president of MMA.

Considering the literature we find that companies that sell through retailers are almost four times more likely to measure marketing ROI than those that sell through a sales force.

Lack of cooperation between marketing and finance also hinders efforts to develop ROI measures, as well as ROMI and ROIMI too.

Marketing metrics and especially financial marketing metrics are very useful to measure marketing performance, as they increase accountability of marketing functions and activities in a company.

Some of the metrics are generic and can be used in the micro and small businesses too; net profit, sales revenue and ROI.

Other metrics could give a very important incentive to the marketing people and departments where there exists the possibility to measure those, ROMI metrics.

It is also important for the businesses not to measure just their net profit, even EBITDA, but they must measure EVA too.

This would give a more accurate perception on the financial results of the investments done in business programs and in the marketing programs and campaigns in particular.

Measuring ROIMI is the final step they must undertake to share and evidence the marketing role in the overall profitability of the company.

But, the most important step Albanian companies and SME must do is to deepen the division of labour and functions in the company and to divide apart the marketing as a highly important function to be fostered and measured on an ongoing basis.

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## INTERNATIONALIZATION OF THE COMPANY IN THE PROCESS OF GLOBALIZATION OF MARKET

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### **Abstract:**

*Nineties of the 20th century the first decades companies worldwide begin to think globally. The development of rapid communications, is a major movement, factors of international marketing. Although there are large differences in economic development and permanent resources in individual countries can generally be said that no country in the world live in conditions of full economic and market closure. On the growth of international marketing involvement affect three key factors: the continuing integration of world economy, technological changes and the creation of competitive environment on a global basis. Some of the former multinational companies with extensive operations in their home country and most foreign subsidiaries transferred to transnational companies, with activities and responsibilities evenly all over the world, profits and income from abroad is higher than back home. Such companies are losing their national identity. The reasons for the internationalization of international activities is the fact that today: competition becomes comprehensive, complex, strong and international, technological change is very rapid, and technological development is expensive, in order to maintain the competitiveness of the company needs a more appropriate economies of scale and the knowledge economy. Business people can not count on domestic competition space, but must embrace the vision of expanding competition relations in accordance with trends in international and global scales.*

**Key words:** globalization, competition, internationalization, multinational companies.

**JEL Classification:** F02.

The most important reason for involvement in international flows of products, markets, competitiveness and financial nature. Production reasons related to the full production capacity, extension of product life cycle management flexible product ranges and modernization of production monitoring of technological change. Market reasons are based on undeveloped potential or growth in the domestic market, following its major customer, market diversification, reduce dependence on the domestic market, using the advantages of different goods in different countries and thus the existence of different market potential. Competitive reasons informing the strength and capabilities of international competition, the acquisition of internationally competitive and business experience, defense using favorable konkurensta structure of the current competitive position and image management on the domestic market. Financial reasons are providing the necessary foreign exchange, efficient management structure of fixed costs, a fast return on invested etc.. The company's culture plays a significant role in the execution of strategy.

It aims to: Provide mental and emotional guide, all managers and employees should follow and support when you formulate and execute strategy. Relies on the base, according to which people will better relate to one another and they will create a specific sense of identity in relation to other companies.

The company's culture by its nature can be: culture based socialization and market-based culture. The first kind of culture is a long-term and apply the detailed process of socialization, strong and powerful norms and control system. The second type of culture is such that the company functions and procedures managers do not differ from procedures for the external market. Norms or lost or missing, the process of socialization is limited, and the control system is based only on performance and quantitative measurement.

Company that conducts international strategy applying the first type of culture has advantages because it creates a long-term employee commitment and a sense of international control, operating under conditions of reciprocal interdependence. International companies that implement the second kind of culture, lead managers to create real marketing concept, which is applicable in different regional conditions.

Although there are differences in the understanding that culture becomes pohomogenizirana and globalization of markets occupies an important place in today's advanced technologies in transportation and communication, yet continuously occurring multicultural business mistake, that are becoming reality in international business.

This means that the formulation of global multinational strategy assumption of cultural homogeneity beyond geographical boundaries, may be inappropriate. Achieving success in international activities, largely depends on the company's strategy adjustment requirements that highlight the culture of the host country.

Culture is important in determining the fate of nations.

Culture is a collective phenomenon, and cultural differences can be presented based on the analysis of the previous factors. Thereby we conclude that national culture is difficult to change, and the culture within the company quickly changing, but there are certainly here problems and resistances. Joint work culture can be nurtured and maintained by attending seminars, lectures, participation in these projects and the like, which establish uniformity in behavior. Same behavioral culture is obtained and if managing people completed the same faculties, so learning these courses has been developed behavioral similarity in knowledge and other parameters, which allow achieving similar results in operation. Typical example is the uniform behavior of employees at McDonalds restaurants worldwide. With industrialization which began at the end of XVII and poshetokot XVIII century, the economic literature increasingly began to talk about the internationalization of production.

Internationalization of production implied that most of the national production major industrial powers are exchanged on the international market. Globalization as a process of increasing interdependence and integration of the world has two basic components, namely: First Globalization of production - a tendency to take advantage of national differences regarding costs and quality factors through abstraction of goods and services from locations spread all over the globe. Such companies minimize their costs and increase the quality of its product which increases its competitiveness market.

This first became possible after the Second World War through the establishment of the GATT.

Second Globalization of markets - merging of historically distinct and separate national markets into a global market. Yet the globalization of markets has some limitations of the significant differences between different national markets. Based transnational companies are companies that have a national economy that is considered parent, ie it is the economy of origin and production and all other economic activities organized by various national economies in the world by creating subsidiary companies or affiliations.

TNC in developed countries perform activities in services, and in depressed industrial production. They act in a way that allows to overcome the established barriers in international trade, thus: First: Encourage growth in the volume of total international exchange of goods and services; Second: Contribute to the creation of new jobs and reduce the unemployment rate in less developed countries; Third: Play a key role as carriers of movement of technology and scientific research work in the world; Fourth: Through investments in the form of foreign direct investments, represent one of the most important additional funding sources in the international economy.

The process of industrialization, which began in the phase of liberal capitalism, led to the creation of significant differences in the level of economic development among the economies that failed to follow those that failed to fit into it. This led to the emergence of so-called developed countries and developing countries. Developing countries, concluded that the only way out of this situation is possible if both them start process of industrialization, which would enable the creation of far more appropriate economic structure, increasing the export potential and competitive advantages, and thus the general welfare in national economy. In order to encourage the process of industrialization, they have accepted the so-called import substitution strategy. This development strategy consisted in encouraging industrial production will cover the needs of the domestic market with its own industrial processing, which is supposed to be much more rational than their delivery at a very high prices of developed countries.

To ensure the implementation of the strategy of import substitution countries development using open protectionism newly established industrial production. But after ten years of application of this development strategy has shown that she has given expected results. Practice has confirmed that the high protection does not necessarily lead to the achievement of competitive advantages in domestic productions. Rather than protectionism more increasing costs in the countries that have opted for a strategy of import substitution, which were without high. This was due to the fact that the newly created production from developing countries very hard fail provide a breakthrough in foreign markets with products that developed countries already had led to perfection, and on the other side these new productions drew a lot of money from the budget of their economies. Strategy of import substitution was given by the problem of dual economy in developing countries. Everything said above confirms that the strategy of import substitution and protectionism proved to be a flop in the development strategy of the less developed countries. Cutting shorter leg, or restrictions on imports, in the long run lead to a reduction in export capacity for developing countries and allow them to find their proper place in the international division of labor. In addition, rather than a reduction, led to increasing gap between developed and developing countries.



International product life cycle theory seeks to explain international exchange, depending on the speed of introduction of innovations in the production process. Author of this theory economist Vernon believes that every product has a life cycle that consists of four separate phases:

First Export product of the country of origin - as soon as you arrive information on new products to foreign consumers, if they want to have a product, you must order the foreign firm has found. With it began exporting the product from its home economy.

Second Start of production of the product abroad - this stage occurs after the product become known in the international market and its export from the home economy experiencing intense growth.

Third Emergence of market competition from foreign firms that managed to conquer new production - this phase occurs at the moment when firms abroad fail to so improve production comes to a reduction in production costs.

Fourth Import competition in the homeland of the product - the genesis of this stage is a sign of stem companies begin to leave this type of production and oriented towards the production of new types of products. Given the limitations of available resources in the world, according to Lester Taro countries in the world are forced to develop strategy gets lost. This means that each country, fighting to increase their well-being, can succeed only if they threaten another country and its welfare. Or, in other words, the success of one must result in the failure of others, because total level ostrvareniot profit on a worldwide scale can not increase overnight, but only redistributes among individual participants in international exchange. Because each of the developing countries striving to find a way to hit as much as possible of the world market. This is achieved by encouraging exports and limiting imports. The combination of measures and their actual implementation is so-called strategic trgovka policy. Strategic trade policy has zadachada achieve three major objectives: First To encourage the development of those industries that provide a high rate of newly created value per employee Second To encourage the development of those indostrii providing viskoki wages for employees Third To encourage the development of new technologies Economic development in recent decades has raised the problem deinstrualizacija means more efficient use of resources by allocating their service instead of industrial sector. One of the primary reasons for insisting on the use of strategic trade policy is the existence of í âi âðð âêðí à competition for most products on the international market. This situation raises the problem of so-called zatvorenichna dilemma. In existence unperfect competition, trade policy aims to select and establish a set of measures that will contribute to the correction of market failure. When would there was perfect competition, there would be need for use of additional measures. But in the opposite case, the selected measures represent the so-called vroto best solution. Under conditions of perfect competition, competitive advantages megjinarodniot market sozadava lowering the price. But in terms of competition í âi âðð âêðí à export competing advantages are achieved through the imposition of quantitative restrictions, because the products exporters in this model are substitutes to each other, and increasing the production of one leads to reducing the production of other products. In such conditions, the strategic trade policy gives best results with the use of subsidies. On the import side, however, qualitative trading instruments give positive results for the economy as it applies only in the case of single-elastic demand for the type of products in the domestic market.

All effects of introduction of strategic trgovka policy, or vice versa, from the liberalization international trade, can not always be measured using quantitative methods. Because it is very difficult to get a complete picture of all effects (direct or indirect) that the strategic trade policy has on the national economy as a whole.

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## SOCIAL MEDIA AS A MARKETING TOOL

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### **Abstract:**

*Internet can certainly be seen as an invention, even as the greatest of all time. It has developed from a small university network into a worldwide communication tool. Today, Albanian can do their shopping, listen to music and read the latest news, pay the bills, socialize with their new friends and watch movies and TV shows using the web. The social media is becoming an increasingly important platform for consumers to position themselves in relation to their peers in, and as a medium for identity creation. Social media offer their users opportunities to interact with individuals with similar interests, with other members in the same social group or with individuals in groups in which they wishes to belong. But, the social media also creates a framework in which users can market themselves like product, many times reaching more consumers of their created selves than in real life. This paper analyzes and explores how Albanian companies could use social media to promote and improve their business to consumer relationship. There are two questions: what benefits could companies achieve from using social media? How to coordinate the use of social media with business? The paper consists in three parts. The first is focused on literature review on social media. The second describes the methodology used by authors. The empirical material is gathered through qualitative interviews with social media consultants and marketing managers. The third present the result from the study. However, the representativeness of our samples limits our ability to generalize to social media users, and other study on factors that influence on attitude towards social media might be needed.*

**Key words:** social media, advertising, marketing communication, face book

**JEL classification:** M31

### **1. INTRODUCTION**

In the beginning Internet was primarily a static place, but now Internet has become a social medium. Social media is any kind of information we share with our social network using social networking websites or services. Social media allows people with no special knowledge to post and share content with the world instantly.

Social media is a relatively new phenomenon in the academic research field. Indeed social media is an unexplored area both for companies and the academic world. Studies and articles published up to now indicate that much of the current research in the social media area focus on either a business-to consumer perspective, or on a consumer-to consumer perspective, concentrating on social media's effects on individuals everyday lives. Many companies are not sure how to improve their business by using social media. Social media is already huge amongst individuals. In the last few years social networking has become increasingly popular with hundreds of millions of users worldwide. So, Facebook by June, 2012 accounts over 910 million active users.<sup>273</sup>

Everyone, from students to business people to celebrities to politicians has embraced this new channel. Social media is even thought to have played a major role in helping the US President Barack Obama win the election in 2008 (News Blaze, 2009) [1].

Social Media is top of the agenda for many business executives today. This has lead to companies understanding that, to reach the customers, they have to be present in this new communication channel. The phenomenon of social media has changed the platform of doing business as well as the private use of the Internet (Qualman, 2009). The main benefit of using social media when doing business is the efficient way of marketing. Traditional newspapers are diminishingly important when it is possible to instantly be updated online for free.

Social media is substituting traditional media, but is equally important as a complement, maybe mostly due to expectations of users to be present in other channels than the regular ones (Qualman, 2009) [2].

Some companies are aware of these new channels and want to find new potential customers and relations by using them. There are a few companies in the world that successfully using social media and in Albania not easy to get such that know how to use, but the tendency is to go towards improvements to have further results.

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Increasing the time that a young people spend by navigate the Internet, has increased the interest of advertising companies. This interest in Albania is confirmed by Top Channel [3], where this site is one of the most clicking Albanian portals. This page has up to 30,000 clicks a day, where 40% are from abroad

Other data have also been quite impressive. Marketing director of *News 24* and *Balkanweb* [4], shows that revenue from advertising on *Balkanweb* for 2011 amounted to EUR 312,000 (an increase of 25% on annual basis), following the addition of interest to navigate to the web pages.

## 2. LITERATURE REVIEW.

### 2.1. The concept of social media and social media networking

Marketing has gone through significant changes during the last couple of decades. The concept of the marketing mix and the four “P”-s of marketing was introduced around 1960 and quickly became treated as the unchallenged basic model of marketing. The four “P”-s are still considered as *the* theory of marketing. However alternative theories of marketing have been developed since the 1960s. The 1990s presented a growing interest in studying the economics of long-lasting relationships. Trends like the globalization of business and the evolving recognition of the importance to keep the customers and of customer relationship economics reinforce the change in mainstream marketing (Grönroos, 1997) [5].

The concept of relationship marketing consists of two important key principles, the long-term continuity of the relationship through repeated interaction, and a facility for two-way information exchange between each individual customer and the company. Running in parallel with relationship marketing there was an unprecedented growth of Internet technologies. The capabilities of the Internet evolved to a point where repeated interaction and various forms of dialogue between customers and companies were not only possible but also increasingly easy to implement (Srirojanant & Cresswell Thirkell, 1998) [6].

One of the popular digital media channels which revolutionized communication is social media. Social media networking and how it used in the communication campaigns of products, services and events has become an important trend. Because of the change in communication mix tools that has taken place the traditional grouping of promotion tools can no longer be assumed to be the most effective form of communication. The arrival and state of growth of digital media in the global market represents new opportunities and challenges to marketers (Prakash & Sharma, 2010)[7]. Mangold and Faulds (2009)[8] point out that the traditional communications paradigm, which relied on the classic promotional mix to craft integrated marketing communication strategies, must give way to a new paradigm that includes all forms of social media as potential tools in designing and implementing integrated marketing communications.

Some authors underline that there seems to be very limited understanding of what the term Social Media exactly means. The literature offers different definitions on social media. Some of them are listed below:

*“The democratization of content and the shift in the role people play in the process of reading and disseminating information (and thus creating and sharing content)”* (Solis & Breakenridge, 2009)[9].

*“A group consisting of different Internet-based applications created by the ideology and technology of Web 2.0, and also it is the tools that give online users the opportunity to create and share User Generated Content”.* (Kaplan & Haenlein, 2010) [10].

*“Basically, social media is the software which helps people to exchange content with others online.”* – (Demopoulos, 2006)[11].

Based on these definitions, authors then provide a classification of Social Media which groups applications currently subsumed under the generalized term into more specific categories by characteristic: collaborative projects, blogs, content communities, social networking sites, virtual game worlds, and virtual social worlds.

The social media have been developed through web 2.0. It is any content that forms our social networks on Internet. Social media includes a large number of tools used for online communication, such as instant messaging, text chat, forums, social bookmarking, wikis, blogs and social network services (Warr, 2008, p. 593, Eley & Tilley, 2009) [12].

A social medium is an online forum where people can connect, communicate and interact with each other and their mutual friends through either *instant messaging* (real time based communication) or *social network sites*.

A social network is a web-based service which allows its users to construct a public or semi-public profile within a bounded system, to articulate a list of other users with whom they share a connection, and to view and traverse their list of connections and those made by others within the system (Correa et al, 2009) [13].

Social media includes many different applications which could be social networking sites like Facebook, virtual worlds such as Second Life, or blogs. In order to be able to understand what social media really is, Kaplan & Haenlein (2010) considers a short explanation of these related concepts is needed: Web 2.0 and User generated Content.

The term Web 2.0 was coined during the year of 2004 to represent a new way of using the Internet. Kaplan & Haenlein (2010) [14] describe that the differences were concerning the content and applications on the Internet.

## 2.2. Why social media marketing?

Looking back at the history of marketing, the ability to listen to the customers was weaker and the customer engagement got lost since very little effort was put into creating a true dialogue with the customers. The one-way messages were communicated and these techniques worked for decades even though they created skepticism for marketing. The shift to consumer conversation promoting the brands of the companies created a breakthrough success. So, marketing can no longer be only about capturing the customers, instead the company must focus on both capturing and engaging them through both traditional and social media. The consumers tend to trust more each other's opinions. Being able to take the interactions and applying this information to something meaningful is a key element when it comes to social media. The opportunity to observe the social interactions is according to Cooke and Buckley (2008) [15] a great benefit that enables the understanding of advertising and marketing. A company wants to achieve customer satisfaction and this kind of information can be used to deliver value to the customers (Linask, 2010) [16]. According to Eley and Tilley (2009) [17] people like their work to receive attention and feedback. Asking for feedback is one way to make the customer feel like someone is listening which is sometimes what people want to achieve.

Web 2.0 has changed the view of marketing and many marketers are still struggling with the techniques of the first generation of Web 2.0. It allowed complex connections with the customers online and the new generation of relationship marketing is a direct response to the challenges that the first generation provided. The rules of marketing have changed. Traditional marketing, such as television advertisement will still create sales but social media is become more evident to purchasing decisions as well as to brand awareness online.

The businesses can use social media successfully in their marketing strategy. The research studies and the marketing literature indicate a positive relationship between social media and the ability for a company to attract more potential customers to their webpage.

Social media enables *more rapid sharing of information*. It may take hours, or even days, for a new announcement to reach the end consumer through traditional channels (example: when a press release is issued, a journalist must first wade through all the sales and marketing lingo to find the key points. Then, the content must be re-purposed in article format, and sent to an editor before it is published). Social media allow for instantaneous dissemination of not just news, but images, audio, video, and other multimedia content as well. The releases geared toward social media outlets contain only key highlights, pertinent facts, and hyperlinks to related statistics and quotes, so the information can be immediately picked up and posted by bloggers and other online journalists. Social media also provides more widespread coverage, enabling breaking news to reach a much larger and broader reader base than standard media outlets alone.

Social media can be a highly useful tool for *enhancing both awareness and image*. It can offer quickly information and facts about a company, its products, and its services to more people, dramatically increasing brand recognition and awareness. Additionally, social media can enable decision makers to gather input and feedback directly from their target audience, and use that intelligence for more effective reputation management. The businesses through social media can announce new products, promotions and special offers, sales, contests, etc. Linask (2010) [18] underlined that the growing use of social media makes it easy for customers to submit their feedback to the company with the possibility of an instant reply.

According to Meadows-Klue (2008) one of many consequences considering the rise of the web is that conversations in marketing replace the control. This is something that marketers have to understand to make it possible to build relationships with their customers. If customers are able to submit feedback they feel more engaged with the products and/or organizations. Mangold and Faulds (2009) [19] claim that to engage customers', contests can be used.

Through social media the businesses can *quickly build a network of core supporters*, which is essential for any up and coming business to keep growing and expanding. It is that group of loyal followers that will keep bringing a company business and referring it to others if they are pleased with what they are finding.

The marketing based on social media is the *most cost efficient method possible*. (no paper, ink, and printing). *Interactivity* is what characterizes the social media with users freely sending, receiving and processing content for the use of others (Aula, 2010) [20]. All questions from customers should be answered quickly. Businesses must be prepared for this kind of instantaneous nature of social media so they can respond to the customer feedback as soon as they receive it (Linask, 2010). The popularity of the social media makes it a forum that cannot be overlooked.

For the strategic corporate corporation, social media has several implications. Aula (2010) reports that in terms of corporate community strategy, social media and similar Internet services are characterized by easy searching, open participation, the fact that it is easy to publish content, dialogue, community, networking and the fast and wide spread of information through a feedback and linking systems.

But there are different social media communications. Businesses need to understand what impacts social media brings on their communication.

Lindberg, Landin and Nyman (2010) [21] have identified some characteristics of social communication channels (table 1)

<b>Channel</b>	<b>Interacti on</b>	<b>Informatio n quality</b>	<b>Control of Image</b>	<b>Type of communicati on</b>	<b>Main purpose of usage</b>	<b>Cost</b>
<i>Wikipedia</i>	Low	Medium	Low	Text based	Brand awareness, driving traffic	Low
<i>Blogs</i>	Low	Medium	Medium	Text based or video based	Create long-term relationships	Low
<i>Content communities</i>	Medium	Medium	Low	Text based or video based	Inform the target audience, compliment with multimedia	Medium
<i>Social networking sites</i>	High	Medium	High	Text based, image based or video based	Obtain real feedback and drive traffic to the webpage	Medium
<i>Virtual game worlds</i>	High	High	Low	Text based and action based	Inform and interact with the target audience	High
<i>Virtual social worlds</i>	High	High	High	Text based and action based	Inform and interact with the target audience	High

Table 1: Characteristics of social communication channels

Source: Lindberg, Landin and Nyman (2010)

The social media is not just a channel for communicating. It creates a chance for a company to interact with the community. These interactions create impressions that are important for each organization. Social media channels are therefore places where the users are active participants in the continuing process of influencing decision makers.

### 2.3. Albania Statistics.

In the world today, we see an explosion of new information and communication technology as an integrated part of society. 43.4% of the population in Albania uses the internet, something that has changed drastically over just a few years.(see table 2)The social networks on the Internet have become part of the everyday life of the younger generations what is confirmed by social networking statistics ([www.socialbakers.com](http://www.socialbakers.com)).

YEAR	Users	Population	% Pop.
2000	2,500	3,083,300	0.10%
2002	30,000	3,084,586	1.00%
2006	75,000	3,087,159	2.40%
2007	471,200	3,087,159	15.30%
2008	580,000	3,619,778	16.00%
2009	750,000	3,639,453	20.60%
2010	1,300,000	2,986,952	43.50%
2011	1,441,928	2,994,667	43.40%
By June 2012	1,086,980	2,994,667	36.39%

Table 2: Internet and Facebook user in Albania

Source: <http://www.internetworldstats.com/euro/al.htm>

(\*) these data are added based on the <http://www.internetworldstats.com/stats4.htm>

According to these data most of social network users in Albania prefer facebook. In the following figure is shown age group distribution on facebook, and in terms of gender 66% are male (see figure 2).

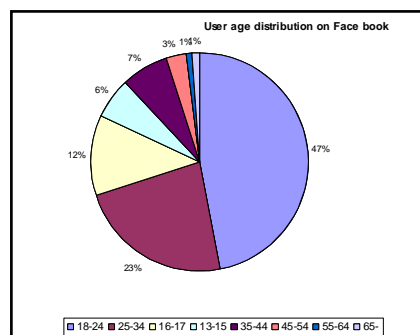


Figure 1: User age distribution on facebook

Source: <http://www.socialbakers.com/facebook-statistics/albania> (September 3,2012)

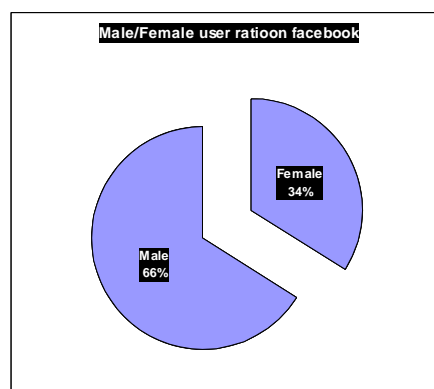


Figure 2: Male/Female user Ratio on Facebook

Source: <http://www.socialbakers.com/facebook-statistics>

### 3. METHODOLOGY

#### 3.1. Qualitative research

We have used the qualitative method. Open interviews are more flexible. It allows for the possibility to adjust the data sampling to the reality that the subject represents. Due to the size and different interpretations of social media, we have tried to be as open as possible for new information and interpretations when interviewing our respondents.

We have also used a mix of academic articles, Internet sources and books. We were faced with the fact that there is a limited amount of academic studies on social media field.

We interviewed four respondents from advertising companies that are using social media marketing for their companies or their clients. In the selection of companies has influenced the staff of the specialized agency on services in Digital Marketing, *One Up*. This agency has listed some companies which are judged as the most active in social media in terms of the Albanian market. There is not an advertising company in Albania that deals exclusively with the implementation of social media marketing strategies. Logically the people who have many years experience in this area is impossible to find. The main object was to study the company had to deal Forums; how the company obtained in the study was to use social media services like web blogs, Facebook, Twitter, etc.. The respondents were:

**E. K** – administrator of a new business in the Albanian market that is trying to market itself to customers even through the use of social media. He's very dedicated to Facebook and Twitter, which puts to use for his business.

**S.C** - Account Manager and Senior Specialist in the application of marketing strategies in social media advertising agency.

**S.Sh** - Journalist and regular user of Facebook blogs. His profession has required using of social media to affirm himself as well as articles that it publishes.

**R.S** - General Director of only electronic media advertising Agency in Albania.

### 3.2. Interviews.

**An Interview guide was developed. It was based on some key questions. The respondents provided the following comments:**

Respondent	Comments
<b>Question</b>	<b><i>Do you think it is important to have a relationship with the customers?</i></b>
<b>E. K</b>	One of the most important things a company can do is to work with customer relationships. It is important for marketers to be where the customers are and statistics show that the numbers of online users are increasing. Through genuine communication with the customers it is possible to build relationships. Customers can interact with company in many ways. The result of this is that the company gains valuable information that is used to improve their products and the relationships with customers. We believe that customers have become more demanding of their resource providers and claim that customers only visit websites when they know exactly what they are looking for.
<b>S.C</b>	We need to prioritize our customers and this is shown through constant interactions. It appears to be a clear correlation between the Pull strategy and how the company adjusts their offers to the customers. Pull media is thought to encourage interaction and a two-way feedback process. When actors of a Pull platform connect with other users through their shared interest it will create trust and build relationships.
<b>S.Sh</b>	The customer relationship gives us an opportunity to collect feedback and use this to develop products that are in demand by customers. This can lead to a higher grade of customer satisfaction
<b>R.S</b>	
<b>Question</b>	<b><i>Why your company has chose social media as a marketing channel?</i></b>
<b>E. K</b>	The social media facilitates keeping contact with a broader group of people. Building relationships through social media is of high importance. A face to face conversation is preferred but social media comes close to that.
<b>S.C</b>	The social media have made us easier to talk to clients about the things they really want to know. Reaching specific groups interested in specific product categories with a low cost is a great reason why the company is involved with social media.

Internet and the virtual reality open up for new ways of communicating with the symbolic value in brands or products. Through social media employees are supposed to promote a list of content/links/blogs that are given to them every week. With social media marketing it is possible to reach the specific niche market which is beneficial. The virtual reality allows individuals to associate themselves with a brand by simply joining a page, post a related link, or just write something about it.

S.Sh

Companies' cannot really go far without social in today's market and many brands have been doing this for a long time. Using social media in general as a powerful marketing tool leading to sales. Social media is free, engaging and probably the most powerful kind of marketing on a broad level. It has a low cost of value since it can reach so many people for such a low cost.

R.S

**Question**

***What are the benefits that companies receive from using social media?***

E. K

The possibility of having dialogues that include both positive and negative opinions; quickly response from our audience or target audience

S.C

A dissatisfied customer usually does not contact the company in question, it is more common that to talks to friends. The company has a chance show users the good will of the company, since the discussion is public others will inevitably see it.

S.Sh

Heavy social media users appreciate companies that use social media. This means that if a company, are not active at social media networks it will not be able to reach these customers but of course it depends on what kind of business it run.

R.S

Social Media is not more a new phenomenon in Albania. It is very important that every company to use of social media because in the near future everyone will use social media. One of the main advantages is certainly two-way communication with the public of all ages.

***How can you measure the benefits of social media?***

E. K

It is very important that the benefits from social media should be measured. The measurements particularly should focus on activity and customer satisfaction. Some indicators that we use are: the number of unique visitors, the number of comments. Social media is difficult to measure, especially ROI, this, because it is not possible to measure the actual benefits from each customer relation. The benefits should be measured qualitatively by asking the customers that have a social media relationship with the company. Some suggested questions could be how the customers experienced the interaction, if it results in changes in attitudes about the brand or if it lead to a purchase or not, and so on.

S.C

S.Sh

It is difficult, and maybe not even possible. We do not know what we really want and what should be measured.

R.S

Benefits from using social media should not be measured through quantitative methods, but through the parameters that focus on quality. The use of social media affects how the company internally and outside. The marketing related to sales would be the focus of measurement. In fact, everything should be measured, but belongs to the company to decide what is important. It is possible to measure attention (ROA), engagement (ROE) and earnings (ROI). Should not be forgotten brand monitoring.

**Question**

***How can coordinate using social media with business activity?***

E. K

It depending on how big the marketing budget is and what goals are. Social media is not just a buzz, the names of the services might change, but the basic idea will stay the same.

S.C

The strength of social media is the possibility to maintain good relations with current customers, which in turn will help you getting new customers. The companies should use social media to become more transparent and to improve the dialogues with customers. It is necessary to listen what the customers are talking about. It is preferable to use Facebook, since it has the most users. The social media is not necessarily for every company. It should be sure to be present at the same place as customers.



Social media maybe is not necessarily for every company, but if a company decide to use it is important to be committed and consistent in usage. We try to use different style of language towards customers, the key is to be personal. Some customers expect a more formal behavior from us while others may prefer more informal behavior, therefore it is important to be responsive to the customers and adapt to the situation.

**S.Sh**

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Normally the company should choose the method that suits the target company and what seems most appropriate for it. It is common for customers to follow a brand in more than one social media. Considering this may be posted the same message in different services. Given that, social media has to do more personal and informal behavior. However post the same message in different services help us to achieve an even greater audience. Whether choose or not to participate in social media, customers will talk about the product.

**R.S**

**Questions** *How can spread the use of social media within an organization? Has your company any guidelines/strategies to keep in mind when using social media and interacting with people/posting content? Do you allow your employees to spend unlimited time during business hours on social media?*

Can not answer to who within the company should be the social media user. It depends on what kind of goals are, and what budget we have. It is important to know what company wants to achieve with social media efforts.

**E. K**

It depends on what kind of message the company want to send out. The company guidelines for social media usage should be in line with the regular communication guidelines.

**S.C**

Does not matter who is the person inside the company that uses social media. More important is what the message should be forwarded. Generally, anyone who has something to say customers may be the sender of the message and turn anyone who needs to know the views of clients should be part of discussions. Social Media has to do with practical thinking. It should also be noted that any thing written on the web is likely to remain there permanently, so be good thought to what will be said. Company guidelines on the use of social media should be in line with general communication.

**S.Sh**

Normally we try to get the method that suits the target company and seems most appropriate for the company. No any specific recommendation What is most important is keeping the community in an active line in the event by event. By making constant updates;

**R.S**

**Questions** *Who do you think has the most power on today's market – the customer or the company? How do you think has influenced the use of social media on the relationship between customer and business?*

It is now possible for companies and customers to have dialogues at the same conditions and being on the same level.

**E. K**

Humans have always been social, it is in our nature to comment, recommend each other. Social media is not something new, the Internet able us to communicate with each other over it, so through it the dialogues became more public.

**S.C**

Today, customers have become much more demanding compared to the past. Web has given them power and whether we like it or not clients will speak for the company and the product. In addition there are not more regular work schedules, customers can claim to contact the company day and night. Customers in some way have become ambassadors for the company, who can consider more efficient than expensive advertising campaigns in traditional media.

**S.Sh**

It depends on the company goals. We advise that social media policy should include elements similar to any other communication policy.

**R.S**

## 5. CONCLUSIONS:

Social media marketing is something that we thought would be interesting to know more about. The question raised was regarding the most optimized way to build a long relationship through social media marketing. This communication channel has a lot to do with communicating core values and building images. Since social media improves relations with consumers it will probably turn potential consumers into customers, and help to maintain current customers. Social networking has always existed, but with the introduction of social media on the web, it is today much faster and has a much more potent marketing power. As humans, we live by our social network, more than we can imagine. When social networking is on the internet, it is much more observable and companies can harness its potential marketing power. The number of companies that are using social media (most of them are using facebook) is growing and the perspective looks promising.

The social media should be used as a complement to traditional marketing and should be used as a two-way communication. They need also to consider how to suit it with other marketing tools; how to motivate the staff to use it successfully.

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## AN EXAMINATION OF PERCEIVED VALUE DIMENSIONS IN THE ALBANIAN HOSPITALITY INDUSTRY

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### **Abstract:**

*It is argued that products and services offering value for money not only influence customers' choice behavior at the pre purchase phase but also affect their satisfaction, intention to recommend and return behavior at the post purchase phase. Despite strategic importance of the concept of perceived value for marketing, it did not receive enough investigation in the hospitality literature. This study is an attempt to test the validity and reliability of the perceived value dimensions in the evaluation of hospitality services. To do that, two-dimensional instrument was adapted from the one presented by Grewal, Monroe and Krishnan (1998). The scale was applied to two types of hospitality services, hotels and restaurants. Although the scale was found to be reliable, there were some issues involved about its validity across the two studies. In particular although the dimension of acquisition value was valid, the validity of transaction value was found to be very poor. In conclusion, this study suggests that a new conceptualization of transaction value and a better scale should be developed for the evaluation of hospitality services.*

**Key words:** value dimensions, Albania, industriality

**JEL Classification:** D0

### **Introduction.**

The concept of perceived value has recently gained its importance and wide popularity in the business environment because of its effect on consumer behavior and providing strategic implications for the success of companies. It is recommended that products offering value for money not only influence customers' choice behavior at the pre purchase phase but also affect their satisfaction, intention to recommend and return behavior at the post purchase phase (Dodds, Monroe and Grewal 1991; Parasuraman and Grewal 2000; Petrick 2001). Hence, perceived value is claimed to be a major tool to help the service provider to gain a better competitive position in the market (Woodruff 1997; Parasuraman 1997; Huber, Herrmann and Morgan 2001; Naumann 1995; Stahl, Barnes, Gardial, Parr and Woodruff 1999). However, despite its strategic importance for marketing, perceived value did not receive enough investigation in the literature (Dodds et al. 1991). In particular, very few efforts have been made to measure this construct in the hospitality industry (Bojanic 1996; Jayanti and Ghosh 1996; Kashyap and Bojanic 2000; Oh 1999). Although the conceptualization of perceived value goes back to late 70's, researchers recently began to give reasonable attention to its operationalization (Sweeney, Soutar and Johnson 1997). The existing efforts have been hampered by various difficulties mainly arising from inadequate conceptualization and the wide spectrum of other constructs involved in the formation of value judgement. Perceived benefits, perceived price, monetary price, psychological price, and behavioral price are all concepts that are associated with conceptualization of perceived value. Furthermore, perception of value is recommended to be affected by stimulus and personal response factors such as characteristics of product, interest in product, different needs, motives, expectations, personality and social status (Ateljevic 2000; Solomon 1999).

Therefore, evaluation of this construct is claimed to vary among individuals and this has made the process of perceived value measurement a complicated and challenging task (Semon 1998). Despite the presence of the above-mentioned issues, there have been some attempts for the assessment of perceived value through a variety of techniques (Anderson, Jain and Chintagunta 1993). For example, if the objective of the research is to explore the concept of value, focus group interviews are used. If the study aims to decompose the overall value judgement into various benefits sought in consumption, conjoint analysis is recommended (Anderson et al. 1993). Some scholars relied on secondary data analysis originated by consumer reports (Bojanic 1996; Bolton and Drew 1991).

In the recent literature perceived value is usually operationalized using a single item scale which aims to capture customers' overall value judgement on a statement (e.g. the hotel is good/bad value for money) (Jayanti and Ghosh 1996; Kashyap and Bojanic 2000; Oh 1999). However, such practice suffers from two apparent shortcomings. Firstly, that approach fails to reflect the widely accepted theoretical definition of perceived value which states that it is the consumer's overall assessment of the utility of a product based on perceptions of what is received and what is given (Zeithaml 1988). By implication, perceived value is a trade-off between two components; benefits and sacrifices. The former is known as get component (what customers get from a product) and the latter is known as give component (what customers give in order to get a product; usually refers to the money paid) (Dodds et al. 1991; Kotler, Bowen and Makens 1999; Naumann 1995). Secondly, the concept of perceived value is proposed to be multi-dimensional (Kotler 2000) and therefore the use of a single item scale would not capture dimensions of this construct adequately.

In accordance with the recent argument, perceived value is consisted of two dimensions called acquisition value and transaction value. Acquisition value is perceived net gains associated with the products or services acquired in consumption (Dodds et al. 1991; Grewal, Monroe and Krishnan 1998; Zeithaml 1988). Acquisition value has a close relationship with the perceived benefits as well as perceived sacrifices. Hence, it is positively influenced by the product benefits and negatively influenced by the money given up to obtain the product.

Scholars argue that the most important element of this is perceived quality (Grewal et al. 1998; Parasuraman and Grewal 2000; Thaler 1985). Transaction value is defined as the difference between consumers' internal reference price and the price offered within the context of a special price deal (Grewal et al. 1998). From the customer point of view, a deal is assessed by comparing the selling price to the customer internal reference price (Grewal et al. 1998; Thaler 1985). Therefore, a buyer, on examining the financial terms of the price offer, might perceive additional value beyond that provided by acquisition value. Thus, transaction value can be conceptualized as the psychological satisfaction or pleasure obtained from taking advantage of the financial terms of the price deal (Grewal et al. 1998; Lichtenstein, Netemeyer and Burton 1990; Thaler 1985). This distinction between acquisition value and transaction value is particularly important when considering the impact of perceived value on consumers' willingness to buy, information seeking behavior and/or comparing alternatives. Although it is the acquisition value that is usually meant when addressing perceived value, transaction value has also been claimed to have a profound effect on the consumer perception of value. This is especially relevant in purchasing situations when customers take advantage of a special price deal. Grewal et al. (1998) argue that the influence of transaction value on behavioral intentions is mediated by acquisition value. The likelihood that the buyer intends to purchase the product is positively related to overall perceptions of acquisition and transaction value (Della Bitta, Monroe and McGinnis 1981; Monroe and Chapman 1987; Zeithaml 1988).

A few efforts have been done for measuring the perceived value construct (Dodds et al. 1991; Grewal et al. 1998; Sweeney et al. 1997). Grewal et al. (1998) stated that past research has not addressed the conceptual distinction between acquisition and transaction value. Therefore they made an effort to test the validity of these two dimensions with two empirical studies. Their research was experimental and concerned with perceived product value and customers' choice behavior in the pre-purchase phase. In their study, the perceived value construct was operationalized by a twelve-item scale split into two dimensions. As a result, these two dimensions were found to be valid and reliable.

However, despite of their pioneering effort, the research was experimental and applied to product evaluation rather than services at the preconsumption stage.

Zeithaml (1997) argues that goods contain more search quality attributes whilst services contain more experience quality attributes, which can only be recognized during or after consumption phase. In line with this view, perception of benefits and sacrifices (the two components of perceived value) associated with a product or service consumption during or after use situations might be different from the pre-purchase (Woodruff 1997; Woodruff and Gardial 1996). The purpose of this study is to test the dimensionality of perceived value of hospitality services and explore the nature of the relationship between this construct and other theoretically related constructs at the post-consumption stage. At the mean time, an effort is made to investigate whether the two-dimensional scale developed by Grewal et al. (1998) would maintain its validity and reliability for the evaluation of hospitality services.

## RESEARCH METHODS.

The study investigates the validity and reliability of the two perceived value dimensions with two empirical studies applied in hotels and restaurants. To do that, the 12 item perceived value scale developed by Grewal et al. (1998) was adapted to the evaluation of hotel and restaurant services. The following section illustrates the scale adaptation and questionnaire development procedures.

### Measurement of Perceived Value: Scale Adaptation Procedure

Grewal et al. (1998) used nine statements to measure acquisition value and three statements to measure transaction value. The scale was accompanied by a seven-point Likert type rating scale marked strongly disagree (1) and strongly agree (7). The study involved two empirical applications concerned with two different samples, undergraduate students and employees of a university. According to the factor analysis results the scale is found to be valid.

The internal consistency measured by Cronbach Alpha statistics indicates that the scale is reliable (alpha coefficient was .95 for the acquisition value scale and .85 for the transaction value scale). As Grewal et al. (1998) applied this instrument for the evaluation of a product (bicycle) in pre-purchase setting, modifications were needed to regulate this instrument so that it can be applied on hotels and restaurants in post-purchase evaluation. Using Grewal et al.'s instrument for the measurement of perceived value, their definitions of both perceived acquisition value and perceived transaction value were also accepted and adopted as the operational definitions for this study. According to Grewal et al. (1998, p. 48) perceived acquisition value is ...the perceived net gains associated with the products or services acquired. That is the perceived acquisition value of a product will be positively influenced by the benefits buyers believe they are getting by acquiring and using the product and negatively influenced by the money given up to acquire the product..

Grewal et al. (1998, p. 48) also defined perceived transaction value as the perception of psychological satisfaction or pleasure obtained from taking advantage of the financial terms of the price deal..

The scale items. modifications included changing the tense of the statements from present to past to capture post-consumption evaluation and rewording some of the statements so as to suit the attributes of hotels and restaurants. In accordance with the definition of the acquisition value, all of the nine statements exemplify the process of trade-off between a component or a product benefit (e.g. good quality) and a component or a sacrifice (e.g. money paid).

The acquisition value statements used for the evaluation of hotel services were as follows: (1) I received a good quality service for a reasonable price,

(2) considering the quality of the physical environment of the hotel, the price was appropriate,

(3) if I had stayed in that hotel at a price lower than the price I paid, I would have got my money's worth,

(4) I valued this hotel as it met my needs at a reasonable price,

(5) I got good value for the money I spent,

(6) given the features of the room, it was good value for money,

(7) this hotel fulfilled both my high quality and low price requirements,

(8) compared to what I was willing to pay, the price I actually paid was good value, and

(9) this hotel met my specific needs (e.g. comfortable accommodation, convenient location) at a reasonable price.

In accordance with the definition of transaction value, the three statements used for its measurement embodied the pleasure associated with taking advantage of a price deal. These are:

(1) reflecting on the price I paid, I feel that I got a good deal,

(2) it added to my pleasure knowing that I got a good deal on the price,

(3) beyond saving money, there was a good feeling attached to making a good deal as was the case here.

The questionnaire consisted of three major parts. The first part included respondents' profile. Since the study did not target any specific market segment, both questionnaires started with an attempt to draw a profile of the respondents as hotel/restaurant customers. This included questions about the frequency of purchase, the last service experience, the type of hotel/restaurant visited, the purpose of travelling/meal occasion, in addition to whether or not the respondent took advantage of any kind of price deal. The questionnaire also ended with the personal demographic data to help complete the respondents' profile. Demographic data included gender, age, nationality, occupation, and income.

Second part included the perceived value scale. As mentioned before, perceived acquisition value was measured using nine Likert statements modified from the scale presented by Grewal et al. (1998). Respondents were asked to rate the attributes on a 7-point scale marked strongly disagree (1) and strongly agree (7). Similarly, using the same 7-point Likert scale, transaction value was measured by three statements. The acquisition value statements used in the Restaurant Study were virtually the same as those used in the Hotel Study. Just the word hotel was replaced with the word restaurant, in addition to some other limited changes in the wording to suit the nature of the product investigated. For example, the statement "This hotel met my specific needs (e.g. comfortable accommodation, convenient location) at a reasonable price." was reworded as "This restaurant met my specific needs (e.g. tasty food, convenient location) at a reasonable price..". On the other hand, the three transaction value statements were exactly the same in both studies.

Third part included the measurement of related constructs. As detailed above, we endeavored to measure perceived customer value with its theorized two dimensions. As value is claimed to be a higher-order construct (Kashyap and Bojanic 2000; Zeithaml 1988) that is dependent on other lower-order independent latent constructs (price and quality), we also measured other variables to establish the scale validity. These were overall value, behavioral intentions, overall customer satisfaction, overall quality, and perceived price.

**Overall value.** Respondents were asked to rate their evaluation of the overall value of their last hotel stay or meal experience for the price they paid. A 7-point bipolar rating scale was used ranging from extremely bad value to extremely good value. The purpose of this question is to test the concurrent validity of the perceived value scale. According to Churchill (1979), the concurrent validity of the scale is established if it shows to be highly correlated with other measures of the same construct.

**Behavioral intentions.** According to theory, perceived value is correlated to behavioral intentions. Hence, behavioral intentions were detected using two questions asking about the return and recommendation intentions. Subjects were asked to plot their intentions on a 7-point numeric scale marked "extremely unlikely (1) / extremely likely (7)". If the perceived value scale correlates with behavioral intentions as theorized, this will establish the predictive validity of the scale (Jacoby 1978).

**Overall customer satisfaction and overall quality.** Value has been argued to play a mediating role between quality and satisfaction, that is the higher the quality the higher the value, and the higher the value the higher the satisfaction. Additionally, to majority of scholars in this domain, quality is the most important, if not the only, constituent of the get component of perceived value. However, despite the expected positive correlation between perceived value and both customer satisfaction and perceived quality, an extremely high correlation will pose some doubts on the discriminant validity of the perceived value scale. Thus, both overall satisfaction and overall quality were measured using 7-point bipolar rating scales marked "very dissatisfied.

(1) and "very dissatisfied. (7) for the first, and very poor quality (1) / excellent quality (7). For the latter.

**Perceived Price.** As monetary price represents the major sacrifice of the perceived value equation, two questions were used to assess the respondents' perception of the fairness of the price paid, based on both their internal feeling and their knowledge about other alternatives in the market place. In the first instance, respondents were offered three choices to pick the one that best describes their feeling about the price they paid. Each respondent was asked to choose whether s/he thinks the price was a fair price, more than the fair price, or less than the fair price.

Then, respondents were asked to rate the price they paid for that hotel compared to other alternatives in the market place. Three options were offered to pick one, indicating the price was around, higher, or lower than the average market price.

Before sending the questionnaire to our sample, it was tested on a group of university employees and postgraduate students. The clarity of questions and scale items was explicitly discussed with the respondents. As a result, a few corrections and adjustments in the wording and structure of the questions were done.

## FINDINGS OF OUR STUDY.

The scale was applied on two different samples; hotel customers, and restaurant customers.

### Study 1. Hotels

#### Sample

The study was conducted on hotel customers whose last hotel stay was less than six months before. 400 questionnaires were distributed through a hotel reservation company that offers its services within the Albania. The questionnaires were sent to customers who contact the company for a future reservation along with the reservation confirmation letter. Subjects were instructed to fill in the questionnaire based on their last actual hotel stay. 120 questionnaires were received back with a response rate of 30%. Four questionnaires were excluded due to excessive missing values. The respondents were 28% females and 72% males. Most of them had their last hotel stay in hotels located in a city center (38%) or a city suburb (25%).

#### Reliability of the Scale

Cronbach coefficient alpha is the most commonly accepted formula for assessing the reliability of a measurement scale with multi-point items. (Peter 1979, p. 8). Although both acquisition value and transaction value scales were highly reliable, one statement if I had stayed in that hotel at a price lower than the price I paid, I would have got my money's worth was excluded from the acquisition value scale because of its low correlation magnitude with the other scale items. This increased the alpha score of the acquisition value scale (Alpha = .97). As for the transaction value scale, it was also found to be reliable (Alpha = .93).

#### Validity of the Scale

Validity refers to how well the scale measures what it sets out to measure (Litwin 1995, p.33). Construct validity is the most important type of validity. It refers to how well the measure conforms with theoretical expectations. (De Vaus 2002, p. 54). Two types of validity were essential in order to establish the construct validity; concurrent validity and discriminant validity.

Firstly, the concurrent validity was established as the correlation between overall value and both the perceived acquisition value and perceived transaction value was extremely high (.91 and .82 respectively) which indicates that both measures seem to measure the same construct.

Secondly, the discriminant validity of both scales was tested using principal components analysis. According to theory, the two perceived value dimensions should emerge from this analysis. According to the latent root criterion technique regarding the number of factors to extract, only factors with eigenvalue greater than 1 are considered significant (Hair, Anderson, Tatham and Black 1998). In this case, only one factor was extracted. This single component explained almost 79% of the total variance. This result lays doubts on the discriminant validity of the scale, and leads us to questioning the multi dimensionality of perceived value and whether acquisition value and transaction value are two distinguished dimensions as theorized or the same thing as the findings indicate.

A series of calculations was conducted to further investigate the validity of the scale by looking at the correlation between the two scales. This resulted in some significant findings. The correlation between the total acquisition value and total transaction value scores was .86. This is quite a high correlation that supports the argument made on the results of the principal components analysis. On the other hand, the correlation between both of the perceived value scales on the one side, and repurchase intention and recommendation intention on the other side is strong as was suggested in the literature (.71 and .83 for acquisition value, and .58 and .79 for transaction value respectively). This means that behavioral intentions can be predicted by measuring perceived value. This supports the predictive validity of the scale.

In addition to that, it can be noticed that the correlation between acquisition value and transaction value on one side and the internal reference price and market reference price on the other side is moderately strong (.54 and .48 for acquisition value, and .51 and .43 for transaction value respectively). It is not an extremely strong correlation as the correlation between acquisition value and transaction value. By considering this fact, and recalling the role of the price deal in creating a perception of transaction value, we suggest that comparing actual price to both the internal and external reference prices may be a more appropriate measure for the dimension of transaction value that could not be captured using Grewal et al.'s technique.

#### Study 2: Restaurants

##### Sample

The study was conducted on fast food customers. The questionnaire was distributed by hand on customers of the food court of a town-center shopping mall and a university coffee shop.

A total of 130 questionnaires were distributed. Subjects were instructed to fill in the questionnaire based on their last in-store fast food experience. A total of 122 questionnaires were received back. Two questionnaires were excluded due to excessive missing values. The respondents were 72% females and 28% males. Most of them had their last fast food meal experience in a burger, pizza, or chicken restaurant with percentages of 41%, 28%, and 15% respectively.

##### Reliability of the Scale

Moving to the perceived value scale, the reliability score was calculated for both of the acquisition and transaction value scales. Both scales were highly reliable (Alpha = .93 and .86 respectively). It is worth mentioning here that the statement that was excluded from the acquisition value scale in the Hotel Study was also excluded in this study for the same reason, that is low correlation magnitude with the other statements of the scale. Again, this increased the Alpha score of the scale.

##### Validity of the Scale

Like the Hotel Study, the multi dimensionality of perceived value was reinvestigated using principal components analysis. Similarly, only one component that had an eigenvalue of greater than one was extracted. This single component explained almost 66% of the total variance. These support that all the eleven items in the perceived value scale are measuring one construct rather than two.

It was also found that the correlation between acquisition value and transaction value was almost as high as it was in the Hotel Study (.87). All these results are consistent with the results of the Hotel Study. Furthermore, the moderate to weak correlation between acquisition value and transaction value on one side and internal and external reference prices on the other side (.41 and .13 for acquisition value, and .41 and .12 for transaction value respectively) supports our suggestion that the missing dimension of transaction value can possibly be captured by comparing the price paid to the customer reference price. All the other findings were consistent with the findings of the Hotel Study and in turn support all the arguments made earlier.

## DISCUSSIONS.

To summarize, the most significant finding of the two empirical studies is that despite the fact that the refined perceived value measurement scale was found to be reliable, there were some issues involved about its validity across the two samples. In particular, although the dimension of acquisition value was found to be valid and generic, the validity of transaction value was very poor. Using principal components analysis, the scale items that were supposed to measure transaction value did not discriminate from those of acquisition value. Thus, the discriminant validity of the scale is doubtful, as it was not efficient in discriminating the two dimensions and posing them as clearly distinct components of the perceived value construct, assuming there are two dimensions.

One justification for the lack of discrimination between perceived acquisition value and perceived transaction value in the two studies might be the operational definition of transaction value. Defining transaction value as the perception of psychological satisfaction or pleasure obtained from taking advantage of the financial terms of a price deal makes the concept a bit confusing. This definition makes transaction value in a position to be confused with acquisition value.



As a result, the statements quoted from Grewal et al.s (1998) to measure transaction value do not look to be exclusive to transaction value. For instance, the first item on the transaction value scale, reflecting on the price I paid, I feel that I got a good deal can not be seen as limited to those who got a discount on price, which is one of the prerequisites of the transaction value to assume its existence according to the definition. In other words, a customer who did not get any discount on price may still have the feeling that s/he got a good deal on price if s/he perceives the benefits acquired as being worthy, or more than worthy the money s/he paid.

In this case the construct validity of the perceived transaction value scale is questionable, as it seems that the scale items' measurement of the construct does not match the conceptualization stated by the operational definition. This might have contributed a great deal to the overlap between transaction value and acquisition value.

Furthermore, having another look on the definition of transaction value the perception of psychological satisfaction or pleasure obtained from taking advantage of the financial terms of the price deal., it seems that the three items Grewal et al. (1998) used to measure transaction value emphasized only the first part of this definition. That is to say, the scale items were explicitly asking about .the pleasure. the respondents might have felt from taking advantage of a deal rather than asking them about their perception of the price deal and whether they see it as a deal or not! Hence, an indirect, but probably more efficient, approach of measuring the actuality of transaction value is to assess the customers. perception of the service price as compared to their reference price. This will sound consistent with the conceptualization of transaction value as a judgement of the value of the deal. (Urbany, Bearden, Kaicker and Borrero 1997) or, in behavioral context, the consumer.s reaction to a price, relative to the price she expects to pay for the service (Thaler 1985). Following these definitions, one of the acquisition value scale items seems to be more fitting in the transaction value scale (compared to what I was willing to pay, the price I actually paid was good value.) All this might have contributed to the mix-up of acquisition value and transaction value.

Moreover, in marketing literature, price is defined as .the summation of all sacrifices made by a consumer in order to experience the benefits of a product. (Buttle 1997, p. 235). Based on this definition, offering a monetary discount to customers does not necessarily mean that customers will perceive it as a good deal if they see other sacrifices associated with experiencing the service as being much.

Furthermore, as refers to a temporary reduction in price, its influence is expected to be more apparent on price-sensitive segments of the market than it is on non-money conscious people. Hence it is logic to expect that the pleasure from taking advantage of a deal (known as transaction value) will not be the same for subjects from both sides. Measuring price sensitivity along with a carefully designed instrument for measuring transaction value might be helpful in providing a better understanding of the latter, using between-groups analysis techniques. Another consideration that can not be overlooked is that the pleasure associated with transaction value might be a short-term mental status related to finding and taking advantage of a price deal. In turn, it might be more appropriate to measure it in the pre-purchase phase rather than the post-purchase one, or using experimental settings like what Grewal et al. (1998) did.

Regarding the acquisition value scale, a further look on the definition on which Grewal et al. (1998) based their instrument raises some questions. Initially, is the trade-off between benefits and cost in the acquisition value concept all about the internal benefits associated with the product or service and .the money given up to acquire the product.? This assumption ignores the fact that there are some other factors that may affect the customers readiness to pay more or less for the room/meal and, therefore, can not be neglected in any attempt to build a comprehensive value model.

From all the above, two possible interpretations for these two studies. results need further investigation. The first interpretation is that the instrument is appropriate in tracing the concept with relevant scale items, but actually the two concepts that lie beneath are the same thing. In other words, the model that hypothesizes that there are two dimensions of perceived value is not appropriate in the hospitality environment, and the instrument used was good enough to prove that. The second interpretation might be that the subjects were not able to discriminate between the two scales, that is, they saw the statements of both scales as the same. In other words, the model might be right but the instrument was not good enough to extract the empirical evidence that supports the model. This means that the instrument validity needs to be improved so that it can do the job more efficiently. The strong theoretical base as well as previous efforts in this domain suggest that this supposition can not be ignored.

Based on all the above, further research is needed to develop a better instrument for the measurement of service perceived value.

This new instrument should be based on a solid theoretical background. First, regarding the perceived acquisition value, the whole spectrum of possible benefits a customer may seek in a service should initially be defined, and so should the whole range of sacrifices that customer could possibly endure. A good starting point for this might be previous research efforts on benefits. Then, these benefits and sacrifices should be the foundation for new perceived acquisition value scale. These new scale items should be constituted by interchangeably interlacing the predefined benefits and sacrifices to reflect a trade-off between their various components. On the other hand, for a better measurement of perceived transaction value, a new technique should be used. This new technique is to be based on tracing the customer perception of the price paid compared to his reference price. This way, transaction value will no longer be limited to, and can no longer be seen as indispensable to price discounts. Then the validity and reliability of the measurement tool is to be investigated.

## CONCLUSIONS.

This study empirically tested the dimensionality of perceived value in hospitality setting. The tool that was tested before with products did not maintain its validity when applied to hotels and restaurants. The content validity of both scales needs more investigation, as the items of the scales might be measuring the same constituent of the perceived value construct rather two dimensions (Gregory 1996). This is specifically relevant to the transaction value scale items that might have not been exclusive to transaction value and, in turn, failed to guide the respondents to the intended meaning. As for acquisition value, one factor that may positively contribute to the instrument content validity is to consider other types of benefits (for example, intangible benefits) and costs (for example, non-monetary costs) that were not considered by this instrument.

We believe that developing an effective tool for measuring customer perceived value would be a substantial addition to the service evaluation literature. From a professional point of view, perceived value measurement will have major implications for marketers as it offers them a major source of competitive advantage, and a proficient tool to help them hone their strategies. A better understanding of the customer perceived value, and paying enough attention to its measurement will enable marketers improve their marketing practices.

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## EXPLORING THE RELATIONSHIPS BETWEEN SERVICE QUALITY, SATISFACTION, TRUST, AND STORE LOYALTY AMONG RETAIL CUSTOMERS

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### **Abstract:**

*The purpose of the study is to investigate the relationships between service quality, satisfaction, trust, and store loyalty in a retailing context. All these variables have considerable importance on store performance, be it measured by financial indicators or market ones. The data were collected from a sample of 258 students in two universities in Albania, during the first quarter of 2012. The items included in the survey measured the variables of the study, as well as demographic characteristics of the sample. Confirmatory factor analysis (CFA) and structural equation modeling (SEM) were used to evaluate the hypotheses regarding relationships among model constructs. All the hypotheses developed in the study were positively confirmed, reinforcing the theory and previous research on this field. The study also reveals interesting implications on service quality, satisfaction, trust, and store loyalty, useful to both academics and practitioners. Managers will find this research helpful in better understanding these variables and their role on their companies' performance.*

**Keywords:** Service quality, Satisfaction, Trust, Loyalty, Retailing

**JEL Classification:** M31

### **1. Introduction**

In response to the increasingly competitive marketplace, retailers are continually seeking strategies to insulate and increase profit. These strategies often concentrate on improving service quality, increasing customers' satisfaction and trust, and fostering customers' loyalty. Service quality has gained tremendous attention from managers and academics due to its considerable influence on business performance, cost reduction, customer satisfaction, customer loyalty and profitability (Chang and Chen, 1998; Cronin and Taylor, 1992; Gummesson, 1998; Leonard and Sasser, 1982; Newman, 2001; Sureshchander et al., 2002). Often and more the quality is considered as an investment for company, where the efforts for its improvement result in an increased clientele, increased levels of purchase from existing customers, and a rise in the company's profits (Parasuraman et al., 1985; Reichheld and Sasser, 1990; Rust et al. 1995).

Satisfaction is also a much desired target for businesses, since a satisfied customer is likely to buy more, return to the store and spread positive word-of-mouth opinions to other customers (Anderson, Fornell and Lehmann, 1994). Customer satisfaction leads to greater customer loyalty (Anderson and Sullivan, 1993; Bolton and Drew, 1993), reduces the costs of future transactions (Reichheld and Sasser, 1990), positively impacts firm's revenues (Bolton 1998; Fornell 1992), and minimizes customer defection if quality falters (Anderson and Sullivan 1993).

Trust involves one person's expectations that another will behave in a certain way (Deutsch 1958; Schurr and Ozanne, 1985). Trust between two parties requires that, if one part does not behave as expected, the other party will experience more negative outcomes than if the other does behave as expected (Deutsch, 1958). Trust is considered to be an important element of consumer perceptions about brands and companies (Aaker, 1997). Trust is beneficial for both customers and companies: customers benefit through a reduced perception of risk toward service provider and through social benefits derived from a trusting service provider; companies benefit through increased sales, reduced costs, positive word-of-mouth and even employees retention (Moorman et al., 1993; Schurr et al., 1985).

Customer loyalty is considered an important key to organizational success and profit (Oliver, 1997). Firms with large groups of loyal customers have been shown to have large market shares, and market share, in turn, has been shown to be associated with higher rates of return on investment (Raj, 1985; Reichheld and Sasser, 1990). Dick and Basu (1994) suggest that brand loyalty stimulates positive worth of mouth and makes loyal customers more resistant towards competitive strategies.

The focus of this study is to identify what consumers consider to be important in terms of the services they receive in a retail setting, and to explore possible explanations of consumer attitudes and intentions (customer satisfaction, customer trust, and customer loyalty) due to the perceived services quality. It will also assess the effects that satisfaction has on trust and loyalty, and the effect of trust on loyalty. Thus, the study aims to explore the possible relationships between perceived service quality and consumers' behavioral attitudes and intentions (i.e., customer satisfaction, customer trust, and customer loyalty) in the context of retailing.

This will lead to an integrated model which provides a clear structure of service quality and its impacts on customer satisfaction, customer trust, and customer loyalty in the retailing setting. It also permits a development of practical retailers' service improvement programs based on the suggested Service Quality- Satisfaction-Trust-Loyalty model.

## 2. Theoretical framework and Development of Hypotheses

### Service Quality

Service quality has been perhaps the most explored topic in services marketing. Early efforts in defining and measuring quality were mostly centered in the tangible products (goods) sector, while the seemingly more difficult services sector was ignored. Grönroos (1984) notes that service quality delineates two rather distinct facets of the construct: a technical dimension (the core service provided) and a functional dimension (how the service is provided). Product quality was traditionally linked to the technical specifications of goods, with most definitions of quality arising from the manufacturing sector where quality control has received prolonged attention and research (Grönroos, 1990). Garvin (1983) defined quality as something that involves eliminating 'internal failures' (defects before the product leaves the factory) and 'external failures' (defects after product use); while for Crosby (1979), quality is 'conformance to standards'. While these product-based definitions of quality may be appropriate to the goods-producing sector "knowledge about goods quality . . . is insufficient to understand service quality" (Parasuraman et al., 1985).

Literature published in the late 1970s and early 1980s provided a clearer understanding of service quality and its measurement. For example, Bateson (1979), Shostack (1977), Chase (1978) and Lovelock (2000) recognized the intangible characteristic of services and that most services are performances rather than objects and are experiences rendered, unlike goods which are tangible objects to be possessed. Bowen and Cummings (1990) suggest that "an organization's overall climate of service, the atmosphere or feel of the setting, is very important in shaping both customers' and front-line employees' attitude about the process and outcome of service delivery".

Carmen and Langeard (1980), Grönroos (1983) and Lehtinen and Lehtinen (1982) have discussed another characteristic of services which makes service quality definition and measurement difficult its simultaneous production and consumption. Particularly in labor-intensive services such as restaurants or retailing, quality is created during the process of service delivery, and in encounters between staff and patrons. This then suggests that an instrument to measure service quality must have adequate means of assessing patrons' perceptions of service quality during these service encounters. A third characteristic of service is its heterogeneous nature, especially in those services with high labor content. This means that service performance will vary from producer to producer, from patron to patron and also from one encounter to the next. Booms and Bitner (1981) and Zeithaml (1981) have suggested that the heterogeneous nature of service hinders the consistency of service delivery and thus, assessment of service quality. What the establishment had intended to deliver might be quite different from what the patrons received (Booms and Bitner, 1981). An understanding of the characteristics of service is necessary in the selection of an appropriate instrument to measure service quality. Such an instrument needs to accommodate the difficulties raised above and recognize that the quality of services is more difficult for customers to evaluate than the quality of goods, and that quality assessments are made not only on the service outcome, but also on the process of service delivery (Parasuraman et al., 1985).

### Satisfaction

During the past decades, customer satisfaction has frequently been advanced to account for customer loyalty (Newman and Werbel, 1973; Oliver, 1981; Bitner 1990; Fornell, 1992; Dick and Basu, 1994, Oliver 1996; Zeithaml et al., 1996; and Ruyter and Bloemer, 1999). Oliver (1996) defines satisfaction as the summary psychological state resulting when the emotion surrounding disconfirmed expectations is coupled with a consumer's prior feeling about the consumer experience.

Since the early 1990s, service and satisfaction research has grown to include an emphasis on cumulative satisfaction, defined as a customer's overall evaluation of a product or service provider to date (Johnson et al., 1995; Johnson and Fornell, 1991). Grisaffe (2001) suggests that satisfaction is an indicator of met or exceeded expectations. Satisfaction is one driver of recommend and repurchase intentions. If a customer received what she or he expected, the customer is most likely to be satisfied (Reichheld, 1996). Gustafsson and Johnson (2002) note that Volvo is an example of a company with many loyal customers who spend more and more money with the company. Their findings show overall satisfaction and loyalty in Volvo's satisfaction-loyalty-performance indicator.

Jones and Sasser (1995) indicate that the link between satisfaction and loyalty is non-linear. They measured loyalty as the customer's state of intent to repurchase; they found that moving customers to a higher level of satisfaction helps to develop long-term loyalty. Olsen and Johnson (2003) found a positive relationship between satisfaction and loyalty and found that equity had a mediating effect on loyalty. They defined loyalty as a behavioral intentions construct.

Studies by Anderson, Fornell and Lehmann (1994), and Rust and Zahorik (1993) found satisfaction to be a leading factor in determining loyalty. Shamdasani and Balakrishnan (2000) examined the determinants of relationship quality and loyalty of personalized services.

They found that trust and satisfaction significantly influence loyalty to particular service providers. McAlexander, Kim and Roberts (2003) investigated the impact of satisfaction on customer loyalty. Their empirical survey results indicate that satisfaction is a key driver of loyalty.

Anderson and Srinivasan (2003) investigated the impact of satisfaction on loyalty in the context of electronic commerce. They found a positive relationship between e-satisfaction and e-loyalty. Soderlund and Ohman (2003) empirically studied the satisfaction-intention link with respect to different intention constructs. They suggest that the selection of one particular intention indicator over another will generate different conclusions about the role of satisfaction as a determinant of intentions.

Olsen and Johnson (2003) found a positive relationship between satisfaction and loyalty. Gustafsson and Johnson (2002) measured the satisfaction-loyalty-performance link at Volvo. They concluded that Volvo maintains a large number of loyal customers who have repeat purchases with the company. Ranaweera and Prabhu (2003) examined the combined effects of customer satisfaction and trust on customer retention and positive word of mouth (one element of loyalty). Their data from this large-scale survey confirmed that both satisfaction and trust have a strong positive association with customer retention and word of mouth.

### **Trust**

The construct of trust has taken on a more important role in the marketing literature over the last decade (Dorsch et al., 1998; Morgan and Hunt 1994; Moorman et al., 1992; Moorman, et al., 1993; Morganosky and Cude, 2000; Brashear et al., 2003). Moorman et al. (1993) define trust as "a willingness to rely on an exchange partner in whom one has confidence" (p. 82). Morgan and Hunt (1994) define trust as "the belief that a party's word or promise is reliable and that the party will fulfill his or her obligations in an exchange relationship" (p. 23). Doney and Cannon (1997) define trust as "the perceived credibility and benevolence of a target" (p. 36).

Wilson (1995) states "Trust is a fundamental relationship model building block". Numerous researchers have concluded the importance of trust. Zaheer et al. (1998) found trust to have an important role in facilitating closer buyer-supplier relationships by reducing the tendency of firms to take advantage of each other. Lewicki et al. (1998) states that "Trust is critical for success in relationships involving cross-functional teams, temporary work groups, strategic alliances and socially embedded partnerships" (p. 439). Reichheld and Scheffer (2000) state that "To gain the loyalty of customers, you must first gain their trust".

Chow and Holden (1997) define trust as the expectancy held by an individual that promises - or verbal or written statements of an individual or group - can be relied upon. Their empirical research showed that trust held by a buyer toward a seller is an important antecedent of loyalty. Morganosky and Cude (1999) examined trust and loyalty among food retailers. They suggest that what appears to be a "small" mistake in the mind of a retailer (e.g., inaccurate price scan) is a very "big" mistake in the psychology of the consumer, resulting in a lack of trust.

Macintosh and Lockshin (1997) examined the linkages among trust in the salesperson, trust in the store, and repeat purchase intentions. Their findings reveal that, for those with an interpersonal relationship, trust and commitment to the sales person are directly linked to purchase intentions. Brashear et al. (2003) investigates trust-building processes and outcomes in the sales manager-salesperson relationship. Their results show that trust is directly related to job satisfaction and relationalism, and indirectly related to organizational commitment.

Bitner's (1995) findings confirm that loyalty to the firm increases when consumers have perceptions of trust in the service provider. Bowen and Shoemaker (2003) emphasize that benefits may be the first element of loyalty; the second major element of loyalty is trust because trust cannot be easily copied by competitors. Chow and Holden (1997) investigated the importance of a trust-loyalty relationship on the buying behavior of electronic circuit boards in seven different industries in Massachusetts. They found a strong positive relationship between trust of the company and loyalty intentions to the company.

### **Loyalty**

Loyalty is a primary goal of relationship marketing and sometimes even equated with the relationship marketing concept itself (Sheth, 1996). Jacoby and Chestnut (1978) explain that loyalty is not merely a behavior; it is a function of underlying psychological factors as well. They propose the definition of brand loyalty as "... the biased (i.e., non-random) behavioral response (i.e. purchase) expressed over time by some decision-making unit with respect to one or more alternative brands out of a set of such brands and is a function of psychological (decision-making, evaluative) process". Attitudinal loyalty is "the consumer's predisposition towards a brand as a function of psychological processes" (Jacoby and Chestnut, 1978). Drawing from the attitudinally-based approach used by Jacoby and Chestnut (1978), there are three types of information - belief structure, state of affect, and behavioral intentions - that can be represented on a continuum of learning.

There is no consensus in the marketing literature on how loyalty should be measured (Bennett and Rundle-Thiele, 2002). Keller (1993) suggests that loyalty is present when favorable attitudes toward the brand are manifested in repeat buying behavior. Gremler and Brown (1998) state that both attitudinal and behavioral dimensions need to be incorporated into measurements of loyalty.

Evolving out of, and contradictory to, early definitions that were solely behavioral, customer loyalty today is usually viewed as comprising both behavioral and attitudinal components (Day, 1969; Jacoby and Kyner, 1973; Gremler and Brown, 1998).

Grisaffe (2001) suggests that how one constructs a loyalty measurement depends upon his/her chosen theoretical position on how behavior and attitude work together, a reflective latent variable, or some other means or statistical combination of the attitudinal and behavioral components of loyalty. Gremler and Brown (1998) identify three attitudinal measures of loyalty, which are: (1) the likelihood of continuing to do business or re-purchasing, (2) the likelihood of expanding the business or purchasing, and (3) the willingness to recommend or serve as a reference.

There is a growing body of research that indicates that loyalty is developed in ways that are more dynamic and complex than reflected in the common "satisfaction builds loyalty" models (Fournier et al., 1998; Oliver, 1999; Chaudhuri and Holbrook, 2001). Oliver (1999) presents an evolutionary model in which satisfaction makes important contributions to the decision to repurchase early in the ownership cycle. In this model, as customers gain experience, a "convergence of product, personal, and social forces can lead to the emergence of ultimate loyalty" (p.42).

Loyalty extends beyond simple satisfaction. Reichheld and Aspinall (1993) found that 90% of customers who changed from one supplier to another - in this case their bank - were satisfied with their original supplier. Loyalty intentions are important in marketing because they serve as predictions of consumer decision making. Loyalty intentions represent a willingness of someone, such as a customer, employee or friend, to make an investment or personal sacrifice in order to strengthen a relationship.

Based on previous research and theoretical review, the following hypotheses were proposed:

**H1: Service Quality positively influences Satisfaction.**

**H2: Service Quality positively influences Trust.**

**H3: Service Quality positively influences Loyalty.**

**H4: Satisfaction positively influences Trust.**

**H5: Satisfaction positively influences Loyalty.**

**H6: Trust positively influences Loyalty.**

Figure 1 presents the proposed model:

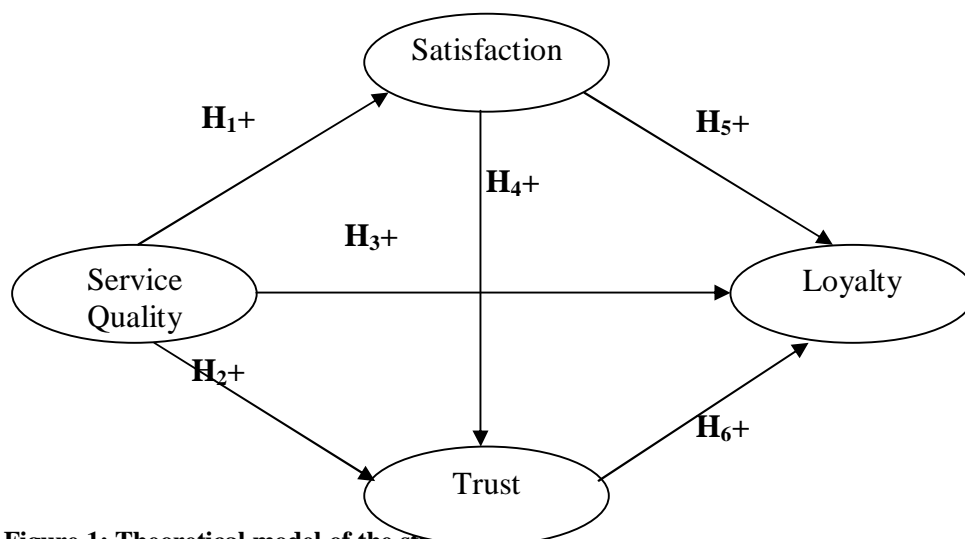


Figure 1: Theoretical model of the study

### 3. Research Design and Procedures

This study hypothesizes that satisfaction and trust, rather than service quality, are focal intermediate constructs in a latent structure model. Thus, in the structural equation model, service quality is an exogenous construct and satisfaction, trust and loyalty are endogenous constructs. (Figure 1)

Table 1 presents the socio-demographic data, such as gender and household income per year. These data were included in the survey instrument in order to explore the characteristics of customers. The population of the study is young people who are attending their studies in Albanian universities. The sample was drawn from students of two universities in the central part of Albania. Data were collected during a two month period (February-March 2012) by personally contacting each respondent. The data collection team was comprised from students who have experience with field work and data gathering. Being themselves students made easier and more convenient for them to engage in such a study were the target population was also comprised of students. From 300 surveys distributed, only 258 of them were considered usable for further analysis (response rate 86%).

Characteristics	Categories	Percentage
Gender	Male	41%
	Female	59%
Household income	Less than 360,000 (€2,666) per year	13%
	360.001-720,000 (€2,667-€5,333) per year	30%
	720.000-1,080,000 (€5,334-€8,000) per year	28%
	1,080,001-1,440,000 (€8001-€10,666) per year	22%
	More than 1,140,000 (€10,666) per year	7%

**Table 1 Socio-demographic characteristics of the sample**

The instrument was composed of 20 measurement items. The measurement items relate to the constructs of satisfaction, trust, commitment and loyalty. This study used items which have effectively measured these constructs based on their high level of reliability and validity in previous research. However, modifications have been made on certain measures to make them more appropriate for the context of this study. All constructs were operationalized by using multi-item measures. A five - point Likert scale, ranging from "1 = strongly disagree" to "5 = strongly agree" was used. Table 2 presents a listing of the constructs and measures employed in the study.

Latent Variables	Manifest variables
Service Quality ( $\hat{i}_1$ )	SEQ1: My overall opinion is that physical aspects of the store are convenient and visually appealing. SEQ2: My overall opinion about retailer's reliability is very positive. SEQ3: My overall evaluation about staff's personal interaction is very positive. SEQ4: Store's personnel are always ready to handle potential problems. SEQ5: My overall opinion about store's policy is very positive.
Satisfaction ( $\zeta_1$ )	SAT1: Compared to other stores, I am very satisfied with this store. SAT2: Based on all my experiences with this store, I am very satisfied. SAT3: I am satisfied with the price/quality ratio offered at the store. SAT4: In general, I am satisfied with the service offered at this store. SAT5: In general, this store offers a satisfactory assortment of products.
Trust ( $\zeta_2$ )	TRU1: I am sure that the staff of this store act in my best interest. TRU2: I am sure that this store's personnel would do everything to satisfy me. TRU3: I have great confidence in this store's staff. TRU4: I believe that the price/quality ratio offered at the store is very reasonable. TRU5: I consider myself loyal to this store.
Loyalty ( $\zeta_3$ )	LOY1: I can highly recommend this store. LOY2: If I could decide again, I would choose this store again. LOY3: I like to be a customer of this store. LOY4: I can identify myself with this store. LOY5: I will prefer this store to other stores at any time.

**Table 2 Latent and manifest variables used to test the hypotheses of the study**

In this paper, the items of antecedent factors of service quality were mostly adopted from the model of SERVQUAL (Parasuraman et al., 1988; Parasuraman et al., 1991) and later studies in terms of service quality (e.g., Asubonteng et al., 1996; Cronin, 1994; Leung and To, 2001). Customer trust was developed upon the studies of Anderson and Srinivasan (2003), Ribbink et al. (2004), Pavlou (2003), and Genfen et al. (2003).



Further, customer satisfaction and customer loyalty measures were mainly based on qualitative studies by Zeithaml et al. (1990), Parasuraman and Grewal (2000), and Ribbink et al. (2004).

### Reliability analysis

Reliability is conducted to assess data quality. A reliability test was used to assess consistency in measurement items. Cronbach's alpha was used to measure the internal consistency of the measurement items. The value of Cronbach's alpha should exceed 0.70 as suggested by Nunnally (1978) and Hair et al. (2009). Table 3 provides the Cronbach's alphas for scale items used in this study.

Scales	Number of items	Sample size	Cronbach's alpha
Service Quality	5	234	0.934
Satisfaction	5	234	0.941
Trust	5	234	0.911
Loyalty	5	234	0.909

**Table 3 Cronbach 's Alpha for Scale Items**

### Validity Analysis

Validity is the degree to which an instrument measures what it intends to measure, and the degree to which the "think" that the instrument measures have meaning. (Lawrence and Martin, 2001). In this study, three validity tests were used to measure the latent constructs and to ensure acceptability of the instrument (Hennig-Thurau et al, 2001; Morgan and Hunt, 1994). These include content validity, convergent validity and discriminant validity.

Content validity is the degree to which the content of a test or questionnaire covers the extent and depth of the topics it is intended to cover. Content validity, discriminant validity and unidimensionality can be investigated by using factor analysis. Construct validity, including convergent validity and discriminant validity, assess the degree to which a measurement is represented and logically concerned.

Discriminant validity is defined as the evidence that different methods or tests developed to measure different traits, indeed, measure different constructs (Zhu, 2000). Discriminant validity is a criterion imposed on a measure of a construct requiring that it not correlate too highly with measures from which it is assumed to differ. Factor analysis was used to assess unidimensionality, convergent validity, and discriminant validity in this study.

Unidimensionality is defined as the existence of one construct underlying a set of items. Thus, unidimensionality is the degree to which items represent one and only one underlying latent variable. The concept of unidimensionality has long been recognized as one of the most basic assumptions in measurement theory. Lack of unidimensionality most often represents a misspecification and, unfortunately, a number of misspecifications of this kind typically occur with initial models. (Anderson and Gerbing, 1982).

### Confirmatory Factor Analysis

Confirmatory factor analysis (CFA) was conducted to assess the construct validity of the model. Convergent validity is confirmation of the existence of a construct determined by the correlations exhibited by independent measures of the construct. To assess convergent validity, the loading estimates and construct reliability were investigated. In SPSS AMOS 18, convergent validity can be assessed and tested using the measurement model by determining the significant t-value of each item's estimated pattern coefficient on its posited underlying construct factor. (Anderson and Gerbing, 1988).

Confirmatory factor analysis (CFA) was performed using SPSS AMOS 18 to measure the unidimensionality, convergent and discriminant validity. The CFA results provide overall fit indices ( $\chi^2 = 615.41$ ), chi-square degree of freedom = 234, RMSEA (root mean square error of approximation) = 0.082, GFI (goodness-of-fit) = 0.85, AGFI (adjusted goodness-of-fit) = 0.79, CFI (comparative fit index) = 0.96. RMR (root mean square residual) = 0.061 and NNFI (non-normed fit index) = 0.96. Table 4 presents the results of the CFA analysis, while Table 5 shows the fit statistics results.

Construct	Path	Coefficient	SE	t-value	R <sup>2</sup>
Service Quality	Service Qualityà SEQ1	0.047	0.0048	13.14	0.71
	Service Qualityà SEQ2	0.063	0.0038	18.40	0.68
	Service Qualityà SEQ3	0.055	0.0029	14.69	0.61
	Service Qualityà SEQ4	0.061	0.0044	10.66	0.81
	Service Qualityà SEQ5	0.048	0.0033	17.41	0.69

Satisfaction	Satisfactionà SAT1	0.055	0.0037	16.61	0.68
	Satisfactionà SAT2	0.061	0.0037	15.77	0.77
	Satisfactionà SAT3	0.060	0.0041	15.32	0.80
	Satisfactionà SAT4	0.052	0.0033	14.62	0.75
	Satisfactionà SAT5	0.064	0.0042	16.39	0.68
Trust	Trustà TRU1	0.048	0.0033	15.36	0.78
	Trustà TRU2	0.064	0.0037	14.16	0.61
	Trustà TRU3	0.061	0.0039	15.45	0.69
	Trustà TRU4	0.055	0.0033	16.14	0.72
	Trustà TRU5	0.059	0.0035	16.54	0.77
Loyalty	Loyaltyà LOY1	0.059	0.0037	17.94	0.82
	Loyaltyà LOY2	0.064	0.0033	16.24	0.68
	Loyaltyà LOY3	0.057	0.0039	18.29	0.80
	Loyaltyà LOY4	0.066	0.0033	15.74	0.77
	Loyaltyà LOY5	0.063	0.0031	15.64	0.73

**Table 4: Confirmatory Factor Analysis (CFA) results for the study**

Description	P	RMSEA	GFI	AGFI	NNFI	CFI
Model	0.0021	0.082	0.85	0.79	0.96	0.96
Service Quality	0.0001	0.137	0.91	0.91	0.94	0.92
Satisfaction	0.0024	0.107	0.95	0.82	0.96	0.90
Trust	0.0000	0.143	0.90	0.83	0.91	0.97
Loyalty	0.0021	0.042	0.94	0.94	0.91	0.93

**Table 5 Fit Statistics Results**

As it can be seen from table 4, the  $R^2$  values, which explain the relative variance of the dependent variable, are satisfactory (larger than 0.60) (Joreskog and Sorbom, 1999). So, all manifest variables are valid for further analysis through Structural Equations Modeling (SEM).

Goodness-of-fit of the final model indicated "reasonable or good fit" or RMSEA = 0.082. Brown and Cudeck (1993) suggested that root mean square error of approximation (RMSEA) between 0.05 and 0.08 provide reasonable error of approximation. Hair et al. (2009) suggested  $0.05 < RMSEA < 0.08$  is for "good fit".

In this study, CFI (comparative fit index) = 0.96 denoting a good fit. Hu and Bentler (1999) suggested that a rule of thumb for the CFI and the incremental indexes is that values greater than roughly 0.90 may indicate reasonably good fit of the researcher's model.

The GFI was the first standardized fit index (Joreskog and Sorbom, 1999). GFI = 1.0 indicates perfect model fit. Therefore, a GFI = 0.85 demonstrates reasonable fit in this study. The AGFI of 0.79 indicated an extension of the GFI.

The NNFI (non-normed fit index) or Tucker-Lewis Index has been recommended by Bentler and Bonett (1980). Hair et al. (2009) recommended a value of 0.90 or better for good fit. Thus, an NNFI = 0.96 for this study implies good fit.

From the above goodness-of-fit evaluation, confirmatory factor analysis for the final measurement model reasonably supported the model's fit.

### Unidimensionality

Unidimensionality is defined as the existence of one construct underlying a set of items. Thus, unidimensionality is the degree to which items represent one and only one underlying latent variable. The concept of unidimensionality has long been recognized as one of the most basic assumptions in measurement theory. Lack of unidimensionality most often represents misspecification. Unfortunately, a number of misspecification errors of this kind typically occur with initial models. (Anderson and Gerbing, 1982)

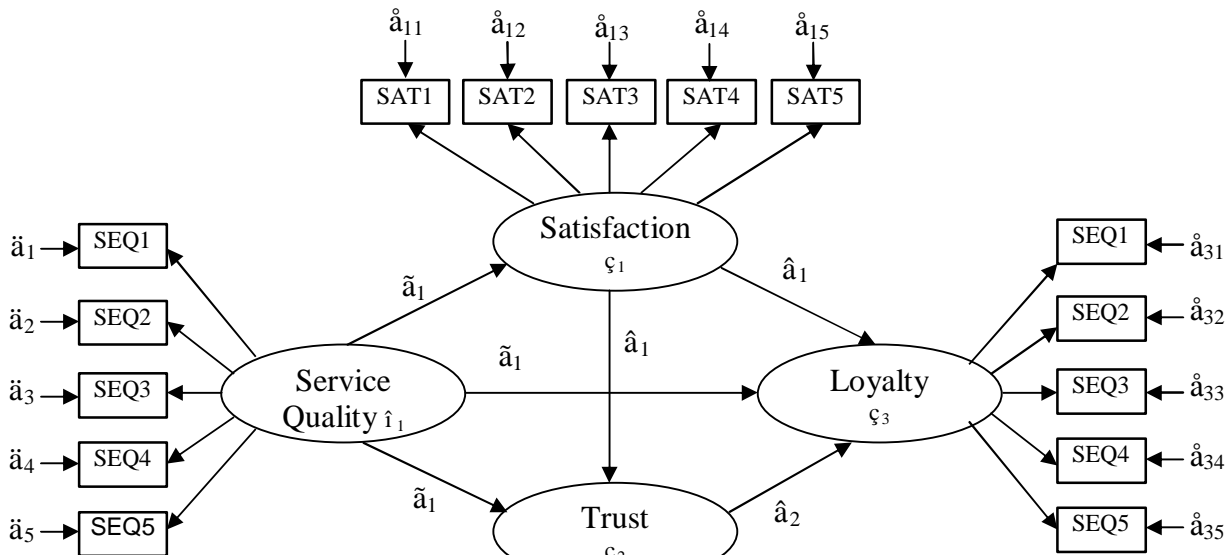
Unidimensionality was examined here by incorporating the four unidimensional scales into a single factor analysis. Garver and Mentzer (1999) stated that recent developments and research strongly suggest that confirmatory factor analysis (CFA) is a more rigorous and precise test for unidimensionality as compared to traditional techniques, such as exploratory factor analysis. Therefore, confirmatory factor analysis was used to identify unidimensionality in this study.

Garver and Mentzer (1999) also suggested that the criteria for assessing construct unidimensionality in CFA are: 1) the overall measurement model fit, and 2) components of the measurement model fit. The overall measurement model fit or goodness-of-fit indexes of the final model have been analyzed in the previous section indicated "reasonable fit" ( $\chi^2 = 615.41$ ), chi-square degree of freedom = 234, RMSEA = 0.82, GFI = 0.85, AGFI = 0.79, CFI = 0.96 and NNFI = 0.96.

Components of the measurement model fit were analyzed by examining the standardized residuals. When the standardized shared residuals variance is above 2.58 - corresponding to the critical  $p < 0.01$  threshold - one or both of the measurement items may not be unidimensional. (Gerbing and Anderson, 1988; Segar, 1997). In this study, all the standardized residuals of the model were below the critical value of 2.58, so the model could be judged to be unidimensional.

**Convergent validity**

Convergent validity can be empirically assessed by reviewing the  $t$ -tests for the factor loadings. If all factor loadings for the indicators measuring the same construct are statistically significant (greater than twice their standard error), this can be viewed as evidence supporting the convergent validity of those indicators. (Anderson and Gerbing, 1988) As shown in Table 4, all  $t$ -tests were significant showing that all indicators are effectively measuring the same construct, or have high convergent validity.



**Fig. 2 The Structural Equation Modeling of the Study**

**Discriminant validity**

Discriminant validity represents the extent to which measures of a given construct differ from measures of other constructs in the same model, or the extent to which measures designed to assess different constructs are, in fact, distinct from one another. Discriminant validity exists when the proportion of variance extracted in each construct (Average Variance Extracted - AVE) exceeds the square of the coefficient representing its correlation with other constructs (Fornell and Larcker, 1981). As it can be seen from Table 6, the average communalities measures of each construct are greater than the variance shared with other constructs, demonstrating that the discriminant validity of all scales is adequate. In addition, all AVE exceed 0.50, indicating solid the construct validity. Overall, the measurement results are satisfactory and suggest that it is appropriate to proceed with the evaluation of the structural model.

	Service Quality	Satisfaction	Trust	Loyalty	AVE
Service Quality	1.00				0.87
Satisfaction	0.64	1.00			0.73
Trust	0.58	0.49	1.00		0.84
Loyalty	0.61	0.55	0.51	1.00	0.81

The p-value are all less than 0.01.

**Table 6 Correlation coefficients between latent variables of the model and the Average Variance Extracted values**

#### 4. Hypotheses Testing Results

The hypothesized relationships in the model are examined using structural equation modeling (SEM). The hypothesized structural equation modeling was tested using SPSS AMOS 18. Results are shown on Table 7. All the hypotheses were supported.

Path	Hypotheses	Coefficient estimate	Standard Error	t-value	p-value
Service Quality => Satisfaction	H1	0.57	0.08	5.38	<0.001
Service Quality => Trust	H2	0.37	0.07	8.49	<0.001
Service Quality => Loyalty	H3	0.23	0.06	3.68	<0.001
Satisfaction => Trust	H4	0.31	0.07	3.22	<0.005
Satisfaction => Loyalty	H5	0.66	0.06	11.02	<0.001
Trust => Loyalty	H6	0.29	0.07	4.64	<0.005

**Table 7 Structural equation results for the**

#### hypothesized model

**H1: Service Quality positively influences Satisfaction** ( $\hat{\alpha}_{11}=0.57$ ;  $p<0.001$ ). This supports the findings of Rosen and Surprenant, 1998; Olsen, 2002; Oliver, 1997; Gustafsson et al., 2005; Cronin and Taylor, 1992; Brady and Robertson, 2001, who found that service quality has a significant impact on satisfaction.

**H2: Service Quality positively influences Trust** ( $\hat{\alpha}_{12}=0.37$ ;  $p<0.001$ ). This result confirms the belief that the higher the service quality customers receive from a service provider, the higher the trust he/she exert towards this service provider. This supports Gounaris and Venetis (2002), who found that service quality impacted trust in long term relationships. It is expected that if others research this in the future they should obtain similar results.

**H3: Service Quality positively influences Loyalty** ( $\hat{\alpha}_{13}=0.23$ ;  $p<0.001$ ). This finding comply with the research conducted by (Boulding et al., 1993; Cronin and Taylor, 1992), who found that higher levels of service Quality led to higher levels of customers loyalty.

**H4: Satisfaction positively influences Trust** ( $\hat{\alpha}_{12}=0.31$ ;  $p<0.005$ ). This finding supports the previous research on the mediating role that satisfaction plays in the Service Quality – Trust relationship conducted by Caruana (2002) and Fullerton and Taylor (2002).

**H5: Satisfaction positively influences Loyalty** ( $\hat{\alpha}_{13}=0.66$ ;  $p<0.001$ ), complying with the results of many other studies (e.g., Allen, 2004; Anderson and Srinivasan, 2003; Bloemer and Kasper, 1995; Luarn and Lin, 2003; Singh and Sirdeshmukh, 2000).

**H6: Trust positively influences Loyalty** ( $\hat{\alpha}_{23}=0.29$ ;  $p<0.005$ ). Results from the test of hypothesis 6 confirm the belief that the higher the level of trust the greater the loyalty intentions of young retail customers. The results support those found in previous studies. (e.g., Chow and Holden, 1997; Macintosh and Lockshin, 1997; Hennig-Thurau et al., 2002; McCole and Palmer, 2002) (Moorman, Deshpande, and Zaltman, 1993; Morgan and Hunt, 1994).

#### 5. Conclusions

While several authors have emphasized the multidimensional nature of service quality and the relationships between customer satisfaction, customer trust, and customer loyalty, this research sought to establish the bridges between service quality, customer satisfaction, customer trust, and customer loyalty in a retail context.

Empirical tests of the model, using a sample of retail customers, were conducted to support the proposed hypotheses.

This research contributes to the progress of formulating and measuring the constructs of service quality, satisfaction, trust and loyalty. Similarly, the items measuring these constructs in the retailing setting were tested and refined. The reliable and valid instrument confirmed in this research can be used by further studies detecting the relationships among these constructs in an extended context.

The findings also provide several managerial implications. The fundamental premise of the proposed model was that retailers should understand comprehensively the critical factors necessary to achieve high service quality that will significantly impact on customers' trust, satisfaction and loyalty, and use them as diagnostic information. By recognizing and analyzing these diagnostic indicators, retailers will be better able to formulate and implement their strategic plans. According to Hansen and Bush (1999), a great success will result from a strategy that concentrates on one targeted dimension of service quality, rather than from one in which the retail firm improves marginally on all of the dimensions. The interpretation of the research model has the potential to help retailers better understand how customers assess the quality of service and how their service campaigns influence the customers satisfaction, trust and loyalty in different extent. Learning the uncovered relationships between service quality and customer satisfaction, trust, and loyalty, retailers can effectively allocate their resources and develop a rational plan to improve their service quality under specific business circumstances.

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## LITERATURE REVIEW ON CLOUD COMPUTING AND MODELING OF BUSINESS ECOSYSTEM IN ALBANIA

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### **Abstract:**

*Modern economical theorists and other social scientists resort to mainly systems of mathematical equations which are stochastic systems of nonlinear differential equations. The problem with this approach is that the value of describing the “economic” events is not always justified by the effort put in developing these systems which are generally outdated until they mature. We can describe the situation as “The economy changes faster than the theory” The computational methods described in this paper aim to provide an alternative way to explain economical phenomena without attempting to find an ultimate rule leaving room for future evolution and adaptation to unforeseen conditions.*

**Key words:** *economic phenomenon, mathematical equations.*

**JEL Classification:** C20.

### • **Introduction**

Modern economical theorists and other social scientists resort to mainly systems of mathematical equations which are Stochastic systems of nonlinear differential equations. The problem with this approach is that the value of describing the “economic” events is not always justified by the effort put in developing these systems which are generally outdated until they mature. We can describe the situation as “The economy changes faster than the theory” The computational methods described in this paper aim to provide an alternative way to explain economical phenomena without attempting to find an ultimate rule leaving room for future evolution and adaptation to unforeseen conditions.

The most important rapid change in the field of Economics is the change of paradigm in Information and Communication Technologies. If we focus more on the subject we observe that the definitions and delivery, consumption, deployment of all services within this context are changing. Business models, business environment as well as market conditions are also affected. Of all the changes taking place at the field of computers and information technologies, one phrase is increasing its importance and dominance. This is “Cloud Computing”. This phrase originates from the cloud symbol used in flow charts and diagrams to symbolize the wide area network. The principle behind the cloud is that any computer connected to the network is connected to the same pool of computing power, applications, and files. The term “Cloud Computing” is defined by US National Institute for Standards and Technology (NIST) in their 2011 DRAFT Cloud Computing Synopsis and Recommendations as “Cloud computing is a model for enabling convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction. This cloud model promotes availability and is composed of five essential characteristics, three service models, and four deployment models” [1]

Methodology used in this paper is mainly literature review for collection of data from National and International sources and classify them to be useful as input for a programming and agent based modelling environment for which only the outlines are given.

Actual implementation of the model by creating the initial software on provided infrastructure is left for further studies. In fact the user generated software model requires no other effort, but each study to improve and develop will be part of this self-organizing and self-developing network (the word “self” is used in the sense that the network is an entity independent of its constituents)

### • **Literature review**

Using mathematical systems to understand economy goes back to the 17th century when German Universities started studying public administration data calling the new field as “Statistics”. However development of explicit and abstract models to apply mathematical tools appeared first in Johann Heinrich Von Thünen’s book named: The Isolated State. As a farmer and an amateur economist, Von Thünen proposed a model to describe the use of agricultural land development of cities assuming city is located centrally within an Isolated State which is self-sufficient and has no external influences, surrounded by an unoccupied wilderness. Also completely flat land without wide rivers and mountains to interrupt as well as consistent soil quality and climate conditions are assumed. He hypothesized that patterns of rings around the city would develop, with dairying and intensive farming being the first ring around the city, timber and firewood production in the second ring, extensive field crops for grains and bread in the third, and animal farming in the fourth. Of course before the invention of refrigeration, industry, efficient fuel sources and electricity, Thunen’s predictions were different from the actual city formations but his model is still considered as an important model in Economics and Geography which illustrates the balance between the cost of land and transportation.[2]

Later in 20th century Mathematicians like John von Neumann and John F. Nash contributed to the Economic Theory by their studies on a newly theorized field of mathematics called “Game Theory” [3] Although some developments occurred before it, the field of game theory came into being with the 1944 book Theory of Games and Economic Behavior by John von Neumann and Oskar Morgenstern. [4] Von Neumann is widely considered as the father of computers, due to his proposed Von Neumann architecture.

Von Neumann was also working on a theoretical machine capable of producing a copy of itself, but due to technical difficulties in 1940s he was having very limited progress. His friend Stanislaw Ulam improved the concept by replacing the actual machine by a collection of cells in a grid on paper. Intrigued by this idea Von Neumann drew it to create the first “Cellular Automaton” and thus become the father of “Agent Based Modeling” since Cellular automata were the first examples of state machines which are defined as abstract machines with behaviour composed of states, transitions and actions which are essential to the definition of agent based models.

One of the most important papers on the application of artificial agents to study Economic Theory belongs to John H. Holland and John H. Miller, in their 1991 paper the authors discussed how “artificial adaptive agents”, as they call them, can be defined and be tested in a wide variety of artificial worlds. In their work, Holland and Miller, defined Genetic Algorithms and Classifier Systems as basic components of agent based model of a complex adaptive system.

This has been widely accepted and used in 1990s, for modeling of cognition, team working, logistics, consumer behavior, workforce management, and portfolio management. They have also been used to analyze traffic congestion. However these applications of this new form of modeling method have been for specific cases for a limited period of time which limit their validity by specific model and duration.

For the academic world to assess the scientific value of these researches we had to wait for 21st century. Especially in the last decade we have seen a rapid increase in the number and extent of studies.

In a 2003 paper Leigh Tesfatsion from Department of Economics, Iowa State University has studied the concept of Agent-Based Computational Economics (ACE), describing how economic studies can be modeled using multi-agent systems (another term used as a synonym for agent based modeling) According to Tesfatsion, computational economy evolves over time as its constituent agents repeatedly interact with each other and learn from these interactions. These local interactions give rise to macroeconomic regularities and the result is a complex system of recurrent causal chains connecting agent behaviors, interaction networks, and social welfare outcomes. The agents of the system are parallel models for which evolutionary forces resulting from rule based interactions replace the rational decisions of real life entities. The key concern for Agent Base Modeling is that it’s not possible to calculate the extent to which these rule based evolutionary forces might substitute for the rationality assumed in standard economic theories [5]

In their 2006 study Holcombe, Coakley and Smallwood attempted to develop a general framework for agent based modeling of Complex Systems. They have pointed out the importance of a common communication language and built a collection of tools in Extensible Markup Language (XML) which allow efficient simulation and visualization of complex systems in biology and medicine. [6].

In a more recent paper on normative agent based systems, Christopher D. Hollander and Annie S. Wu (2011) has proposed that social norms as the slow changing (if not static) rules for configuring multi-agent systems for simulation of Social and Economic Behaviour. They provide an introduction to and present a holistic viewpoint of the state of normative computing (computational solutions that employ ideas based on social norms.) by:

- introducing social norms and their application to agent-based systems;
- identify and describe a normative process abstracted from the existing research;
- discuss future directions for research in normative multi-agent computing.

“Cloud Computing” as a model of service delivery and consumption has been increasingly researched and analyzed as part of ICT field, but as the weight of information and ICT in the social life increases this field has started to become part of the Economic field of study. In this paper Cloud Computing is proposed as a strategic choice for Albania and defined as the main resource (and deliverable) for the model proposed for the country.

As part of the definition by NIST Draft Synopsis and Recommendations [1], the essential characteristics, service models and deployment models for Cloud Computing are given as below:

Essential Characteristics include:

- On-demand self-service: user can unilaterally provision and configure the service without need for human intervention from the service provider
- Broad network access: Capabilities are available over the network through the use of thin or thick clients (i.e. by using laptops, PDAs etc.)
- Resource pooling: computing resources are pooled to serve multiple consumers using a multi-tenant model, with different physical and virtual resources dynamically assigned and reassigned according to consumer demand.
- Rapid elasticity: Capabilities can be rapidly and elastically provisioned, in some cases automatically, to quickly scale up and rapidly released to quickly scale down
- Measured Service: Cloud systems automatically control and optimize resource use by leveraging a metering capability

Service Models include:

- Cloud Software as a Service: Software Services are delivered through applications running on a Cloud Infrastructure with the essential characteristics given above
- Cloud Platform as a Service: Cloud service provider (CSP) provides capability to consumer to run applications and services on the Cloud. Infrastructure is managed by CSP but Software and applications managed by consumer
- Cloud Infrastructure as a Service: Both Infrastructure and Platforms are managed by consumer; CSP only provides the physical, scalable infrastructure composed of ICT resources with essential characteristics given above.

Finally Deployment Models include:

- Private Cloud : Cloud infrastructure is solely for one organization, may be managed by the organization or third party, may be on or off premises
- Community Cloud: Limited to several organizations forming a community, again may be managed by one or more organizations within community or 3rd party
- Public cloud: The cloud infrastructure is made available to the general public or a large industry group and is owned by an organization selling cloud services.
- Hybrid Cloud: The cloud infrastructure is a composition of two or more clouds (private, community, or public) that remain unique entities but are bound together by standardized or proprietary technology

Although different definitions and classifications appear, these definitions are valid in most of the literature. The question of “why Cloud Computing is important for Albania?” can be answered through a set of review and observations.

From ITU report on ICT Development Index published in 2009 (covering years between 2002-2007) Albania ranks 85<sup>th</sup> in ICT Development Index, 78<sup>th</sup> in ICT use and skills sub-indices. Also the country is in top ten countries in gains in the skills sub-index. [7]

The popularity of mobile and broadband communication is increasing according to the Authority of Electronic Communication and Postage (AKEP) sources. In June 16, 2010 Report No. 54188-AL by World Bank, Albania is counted as one of the few countries with net positive growth in last 10 years in Europe [8]

As can be seen from this data the country is ranking below average in ICT penetration but this rank is increasing. For the maintenance of economic growth, ICT capital investments should be kept limited to infrastructure and carrier network, where as human capital and service capabilities should be promoted. In this paper a simulation platform and environment is proposed for this purpose.

- **ICT based business development model for Albania**

The approach used in this paper is to use Agent Based Modeling to model the actual society in parallel in a simulation environment with the environmental conditions and rules continuously determined by the system agents. Agents responsible from regulation of these resources have special rules determined by the sponsors of the network, others like the designers of the network (including the author of this paper) look for the resources provided by the sponsors or supplied by the supplier agents who compete for the resources produced according to the rules of the system or provided directly from the environment.

Agent-based Computational Economics (ACE) is defined as computational study of economies, modeled as evolving systems of interacting “Agents” starting from initial conditions specified by the modeler. Computational economy evolves over time as its agents repeatedly interact with each other and learn from these interactions. ACE is therefore a bottom-up approach to the study of economic systems [5]

The main elements of our model can be listed as “individuals”, “businesses”, “institutions”, which are further categorized as information and communication technology (ICT) professionals, ICT consumers, ICT businesses, other businesses, governmental bodies.

Subcategories of other businesses are limited to manufacturing, tourism, health, mining, energy and trade. The KPIs (Key Performance Indicators) related to the economy include the number of businesses, Gross Domestic Product, Individual incomes of ICT professionals and ICT consumers, return on assets (ROA) of ICT Businesses and non-ICT ones. This model has been used to devise scenarios for calculating the number of new or existing players in the ecosystem.

The following algorithm can be used to initialize the platform to continue increasing its reference database as well as providing information to be used by parties involved to improve the efficiency of their actual business or tasks.

- Determine rules for the given specific elements
- Register generic elements as an artificial agents with predetermined rules
- Start the classifier system with bucket brigade algorithm (BBA) for the rule classification
- Implement the rule discovery algorithm (RDA) to generate and test new rules
- Publicly announce the status of rules and virtual profit (loss) conditions of elements.
- Associate real entities with artificial adaptive agents to form the “information bridge” between the actual economy and virtual economy
- Share the predictions and reports with involved parties as benefit of their participation in the public simulation

In bucket brigade algorithm, each rule is a producer in the complex economy. Each rule buys input messages and sells output messages. When a satisfied rule succeeds in competition to post its message it pays the rules that supplied the input messages satisfying the condition part. This amount is subtracted from the Rule R’s Strength. In the next cycle if other rules are satisfied by R’s message and win the competition in turn then R receives their payment and R’s strength is increased accordingly. Some rules also act directly on the environment in a way that produces direct pay off from the environment to the system. Their strength is increased in proportion to that pay off.

As a result of BBA, a rules strength increases over time only if it earns profit on average. This happens only if rule produces direct pay off, or belongs to one or more causal chains leading to that pay off. Under appropriate conditions rule strengths in BBA converges to a useful measure of rules’ contributions to the system performance. [9]

For rule discovery, a slightly modified genetic algorithm is proposed. For generic rules in competition the actual parties involved including the individuals and companies registered the Rule sets are collected to be applied to the agent associated with the real entity. Any rule set defined by real entities are taken as input for the rule discovery algorithm.

Under the combined effects of BBA and RDA, rules become coupled in complex networks. Clusters and hierarchies of rules emerge. Over time, these substructures serve as building blocks for still more complex substructures [9]

- **Conclusions**

Although Albania sees ICT as the leading industry to carry the country to the future, a 2008 study on National Strategy states the condition of ICT strategy as follows: "The process in its totality shows signs of lack of harmonization and sustainability." [10] Emerging fast, Albania needs IT resources and software needed for the vital sectors of tourism, trade, mining and logistics. Same sectors also require Human Capital for ICT services. Internet penetration is low (~30% in 2011 according to Authority of Electronic Communication and Postage - AKEP sources) but usage of social networking is greater than the internet penetration which indicates lack of purchase power which will be resolved as the economy grows. From this data it can be predicted that Cloud computing is a solution to the lack of IT infrastructure and human capital. To promote ICT service and Albanian economic growth the model given above can be used as part of the Government ICT Strategy. Actual implementation of the model by developing the initial software and platform is left for further study. The modelling methodology in this paper can be used to implement a simulation based ICT Service Platform by Electronic Communication and Postage Authority (AKEP) in collaboration with other related institutions to increase efficiency of technical education and improve corporate usage of ICT technologies in future studies to map regulatory framework of similar countries and markets.

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**SECTION VIII: TAXATION, FISCAL SOVEREIGNTY &  
FISCAL DECENTRALIZATION**

**CORPORATE TAX REFORM IN REPUBLIC OF MACEDONIA**

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***Abstract:***

*The Direct Tax System in the Republic of Macedonia has always been subject of continuous reforms and additional improvements in order to achieve primary tax policy goals for simplicity and efficiency, especially in the period after the country became a candidate for membership in The European Union. The efficiency principle usually demands a tax structure with lower statutory tax rates and therefore, lower effective corporate tax burden that will not distort the investment decision. On the other hand, the simplicity principle requires a structure with less tax items and tax brackets, as well as lower administrative and compliance costs. From this perspective, tax authorities in Republic of Macedonia have made great efforts to restructure and redesign The Corporate Income Tax System and ultimately produced some simple and interesting solutions. Therefore, the goal of this article is to describe the Corporate Income Tax System in the RM as well as the recent reform trends that included: introducing flat tax rates in direct taxing, implementing the Tax on Gross Revenues for small enterprises, restructuring the Corporate Tax Incentive System etc. Except the description, the intention is to evaluate the effect of these tax code derogations by using some of the reliable effective tax burden measures such as the marginal effective tax rates – METR, and its components. The basic research method used in this article is the descriptive method. The rest of the methodology is consisted of: the comparative method, the empirical method, and the method of the METR. After reviewing the article, readers will have an illustration of the concept of the Macedonian Corporate Tax System and its recent trends and solutions that made it more effective over time. Therefore, it is highly recommended for researchers in the field of comparative tax studies, tax officials, investors as well as any other interested parties.*

**Key words:** tax rate, tax base, tax entities, tax burden, dividends, capital gains, etc.

**JEL Classification:** H25.

### **1. General considerations**

The tax reform can be described as a dynamic process of continuous improvement of the structures of the national tax systems in order to fulfill the general economic and tax policy goals. Each tax reform is generally consisted of some mutual and essential elements such as: the historical element (what were the economic conditions at the beginning of the reform), the cause element (what were the main drivers of the reform), characteristics (what were the distinctive features of the reform), and the success element (was it able to accomplish the primary policy goals). The experience confirms that some of the most powerful tax reform drivers from a domestic and international point of view are the general tax policy principals such as efficiency and simplicity.

The efficiency principle usually demands a tax structure with lower statutory tax rates and lower effective corporate tax burden that will not distort the investment decision. It is very difficult to define tax distortion because of its complex nature therefore it is desirable to be explained with reference to a neutral tax system. Theoretically, a neutral tax system generates equal tax burden across the economic agents, without any tendencies to change the relative prices between factors of production.

However, the overall implications of these distortions depend on the response of economic agents: a given tax system will have large distortionary effects on the economy (i.e. high deadweight losses or excess burden) when the elasticities of substitution are high and small distortionary effects when the elasticity of substitution is low.<sup>274</sup> There is strong evidence that all taxes are potentially distortive, but the majority of the experts agree that corporate tax has an exceptionally strong impact on the relative price of the capital, and therefore on the corporate firm's finance and investment decisions.

The corporate tax system can affect the company's behavior in a number of ways. First, it influences the choice of the sources of finance. Empirical studies confirm that high corporate tax rates could increase the cost of equity-financed investment because of the treatment of the interest payments as a deductible item on the tax base. Consequently, that will reduce the total amount of equity-financed investment of the firm. Also, there is evidence that certain types of taxation create a preference to more frequent use of retained earnings as a source of finance instead of equity (e.g. preferential tax treatment of capital gains over dividends; or taxation of capital gains upon realization). Secondly, if the corporate tax system generates excessively high tax burden, then it can depress the overall investment activities in the domestic economy. In international context, corporations might trigger tax planning activities to shift taxable income from affiliates in high tax countries to affiliates in low tax countries. Next, corporate tax can seriously affect market dynamics on mergers and acquisitions as well as the legal organizational form chosen by the firm. Except these, there are many other examples for corporate tax influence on the company's behavior.

Another important factor that contributes for the corporate tax reform is the enormous complexity of contemporary tax systems. It results in high operating cost of the tax system. According to Sandford<sup>275</sup>, operating costs represent an important concept for evaluation of the effectiveness of the tax system to collect sufficient amount of tax revenues. The larger amount of tax revenues per unit of operating cost are collected, the more the tax system is effective. The operating costs are consisted of the administrative costs (the costs that are generated by the tax administration to serve the national tax system) and the compliance costs that are usually of inherent nature (the costs above the actual tax liabilities generated by the tax entities in order to pay the taxes). Because the intention is to reduce the complexity of the tax system, every tax reform has to include certain measures that would improve its overall simplicity such as: simplifying the tax structure, lowering the statutory tax rates, implementing flat tax rates, lowering the number and the intensity of the tax incentive measures, cutting the number of deductible items etc. This can be realized through an extensive process of simplifying the national tax code, for example, according to the concept of "restructure, renumber, rewrite".<sup>276</sup> Actually, in most of the cases, tax simplicity may be complementary with tax efficiency and the biggest challenge of every corporate tax reform is to jointly accomplish the general tax policy goals.

## 2. The Corporate Tax System in Republic of Macedonia

Basic priority of the Corporate Income Tax (CIT) reform in the Republic of Macedonia (RM) is to maintain a tax structure that would enable a relatively simple and easy administration and at the same time would provide a comparatively lower corporate effective tax burden. Elementary, the development programs had to create more stable and much safer investment environment through improvement of the transparency of the tax system, as well as through elimination of the level of the corruption within the tax administration. Then, the CIT system had to be revised in every aspect of its basic elements. According to the latest National Corporate Income Tax Code<sup>277</sup>, the elements of the CIT structure in the RM are as they follow:

**Tax rate.** The basic characteristic future of The Direct Tax System in the RM is the application of proportional tax rates on CIT base as well as on Personal Income Tax (PIT) base.<sup>278</sup> This means that the RM has implemented a flat tax rate within its Direct Tax structure. Accordingly, the statutory (or the nominal) tax rate is 10% on taxable income for legal entities (companies and corporations), as well as on taxable income for individual entities.

<sup>274</sup> Leibfritz W., Thornton J., Bibbie A.: "Taxation and economic performance" An OECD study, OECD, 1997, p. 91.

<sup>275</sup> Sandford C.: "Why tax systems differ – A comparative study of the political economy of taxation" Fiscal Publications, Fersfield, 2000.

<sup>276</sup> This principle was firstly introduced by some of the leading reforming countries such as Australia and Great Britain. According to it, "restructure" refers to rebuilding the structure of the tax code with fewer tax rules, "renumber" refers to implementing numerical system with less numbers, and "rewrite" refers to cleaning from the unnecessary terms and simplifying the writing style of the tax code: Howe G.: "Tax law simplification in United Kingdom", Further key issues in tax reform, Old coach house, Fersfield, 1998.

<sup>277</sup> Here we describe the elements of the National Corporate Income Tax Code that is temporarily in force from 01. 01. 2012. In order to explain the evolution of the elements we refer to the National Corporate Income Tax Code in the period from 1993-2012.

<sup>278</sup> We use the same practice for the elements of National Personal Income Tax Code.



The concept of the flat tax rate in direct taxation was firstly introduced in 2007 when the tax rate of 12% was implemented in January, and then from the beginning of 2008 until now, the rate was reduced at 10%. This step was a clear proof of the major change in the overall tax policy for radical improvement on the tax structure in the RM. Before 2007, the tax structure was consisted of proportional tax rate on corporate income and progressive tax rates on personal income. The CIT rate at the beginning of the independence period was 30% and it was in force until the end of 1995. In the period 1996-2007 the rate was lowered to 15%:

(Table 1).

CIT rates in the RM in the period 1993-2012

Period	Statutory CIT rate
1993 – 1995	30%
1996 – 2006	15%
2007	12%
2008 – 2011...	10%

Source: The National Corporate Income Tax Code of the RM.

On the other hand, the PIT structure in the period of 1993-2001 was progressive and included 3 marginal income brackets and 3 different progressive statutory tax rates (23%, 27% and 35%). Then, in 2001 there were implemented new tax code rules that reduced its overall level of progression. Firstly, there was a reduction in the number of the income brackets from 3 to 2, and secondly, the tax authorities decreased the nominal tax rates (15% and 18% additionally). Shortly after, the level of the progressivity was once again increased due to the implementation of the new tax codes in 2004 (3 income brackets with tax rates of 15%, 18% and 24% additionally), that lasted until the end of 2006, when the flat tax rate was primarily introduced.

From the evolution of the tax rate parameters, it is obvious to see the determination of the government for reform improvements, especially in a form of extensive tax rate cuts, not only to the CIT, but to the PIT as well.

**Tax entities and tax administration.** Tax entities (or tax payers) of CIT are resident legal business entities according to the National Trade Companies Code, that can take different forms of business organizations such as limited liability companies or corporations. Also, permanent affiliates and subsidiaries of foreign corporations are considered as tax entities formally, for the profit realized on the territory of the RM. The taxation year is identical with the calendar year, and companies must submit their annual corporate income tax return due to February 28<sup>th</sup> of the following year. All entities operating in Macedonia must make 12 advance payments of corporate profit tax by the 15<sup>th</sup> day following the end of each month. If, at the end of the taxation year, it is determined that the total of the advance payments exceeds the tax due for the year, the excess may be credited against future tax obligations or alternatively refunded.

**Tax base.** The generally accepted concept is that resident companies should be taxed on their worldwide income (i.a. the gross income realized from their regular business activities in domestic and foreign countries). Since April 2011, the tax base is defined as a sum of the taxable expenses (or payments subject to income tax) and the underestimated revenues. The first category, and that is “taxable expenses” refers to those expenses that are not excluded from taxation which actually form the tax base. By definition, it is considered that taxable expenses are not primarily connected with the firm’s regular business activities and therefore are subject to income tax. These tax items are clearly notified in the latest version of the National Corporate Income Tax Code.<sup>279</sup> The second category, “underestimated revenues,” refers to the transactions between connected legal and individual entities and they include 4 basic items.<sup>280</sup> The difference between the gross earnings book value and the tax on taxable expenses and underestimated revenues is subject of additional tax only in the case of distribution of the earnings (in a form of dividends or other forms of income distribution), when a withholding tax of 10% is applied. If the difference is negative, then a loss after taxes is generated, and in that case tax entities have a legal right to carry it forward in the next 5 (five) years.

**Measures against erosion of the tax base.** There are 2 basic measures involved in protecting the tax base from tax planning activities and income shifting: the *thin capitalization rules* and the *transfer pricing rules*. These measures were not fully developed in the previous versions of the tax code. According to the latest version, the thin capitalization rules regulate the treatment of interest payments for the purpose of taxation. Generally, interest payment on loans borrowed for the purpose of the regular finance activities are treated as a nontaxable expense, and therefore are not included in the tax base. On the other hand, interest payments that are not part of the regular business activities are considered as a taxable item and consequently, are included within the tax base. More precisely, the group of taxable interest payments is consisted of the following items: 1. interest expenses on delayed payments; 2. interest payments on loans from connected legal entities that are not considered as banks or other financial institutions, above the normal market interest rate;

<sup>279</sup> The National Corporate Income Tax Code of the RM, article 11, and article 12.

<sup>280</sup> See below in the next section.

and 3. interest payments on loans from nonresident stockholders that hold minimum of 25% of the corporate equity, if the loan exceeds 3 times above the capital participation of the individual stockholder (as debt-to-equity ratio of 3:1). Rules that regulate the transfer of the profit between connected entities are based on the principle of the arm's length prices. According to this principle, only the transfer prices that are comparable to the competitive domestic and foreign market prices are recognized for the purpose of taxation. Any difference between the transfer prices and the competitive market prices must be included within the tax base. As we can see from this article, these 4 measures are actually identical with the group of items known as "underestimated revenues" that take part of the tax base and also extend its dimension.

**Treatment of capital income.** Basically, if there is a decision for distribution of the profit after the calculation of the CIT (or the tax on taxable expenses and underestimated revenues), then corporations are obligated to withhold the tax on capital income. According to the tax rules, every form of income distribution from a domestic legal entity to any other domestic legal entity is free from taxation (zero rate withholding tax on the transfer of the profit). Resident legal entities are obligated to apply withholding tax on capital income only in the case of distribution of the profit to foreign legal and individual entities and domestic individual entities. The most common forms of income distribution that are subject of the withholding tax on capital income are dividends, interests, income from authorial rights, royalties from patents and know-how, fees for management, consulting, financial, research and development services, rent and payments under leases of immovable property, payments for telecommunication services and insurance premiums. Specifically, dividends are subject of the withholding tax on dividends. Here, the tax base is equal to the difference between the gross earnings book value and the tax on taxable expenses and underestimated revenues plus the amount of the undistributed accumulated earnings (if the management carries out decision for their distribution in a form of dividends). Also, if the company pays interest to the relevant entities, then it must withhold the tax on interest income due to the transfer. In these cases, the applied tax rate is 10%, as well as in any other case of income distribution.

If transfer is made in favor of foreign residential entities, then the tax rate will be determined according to the tax treaties for avoidance of double taxation signed between the correspondent countries.<sup>281</sup>

**Treatment of capital gains.** Capital gains derived by resident companies and permanent establishments of nonresident companies are considered part of their regular gross earnings and they are exempt from tax until they are distributed. Individual stockholders must pay the capital gains tax only upon realization of the stocks. Tax base is identical with 70% of the difference between the share's sales price and its acquired cost price (30% deduction on the tax base). As it is already noted, the tax rate is proportional and equals 10% on the base.

According to the tax code, the withholding tax rates on capital income (from interest, dividends and capital gains) in the previous period were 23% in the period 1993-2001, 15% in the period 2001-2006, 12% in 2007 and 10% in the period from 2008 till now.

**Foreign tax reliefs.** The residential tax entities who already paid their corporate income tax liabilities from the profit realized on the territories of the other foreign countries can qualify for the foreign tax relief. Actually, it's a tax credit that gives relief on the tax liability of the qualified domestic entities in a value that is not higher of the national CIT rate. The purpose of this measure is to accomplish an effective relief from double taxation.

**Depreciation and inventories.** These two categories of expenses are defined as nontaxable expenses and do not enter into the tax base, because they come from the regular business activities. Code rules give open space for the Government to specify the details of the depreciation. Accordingly, the Government of the RM (or more precisely, the Ministry of Finance) has adopted The Act for the methods of depreciation on the assets in the RM and basically, it's the primary regulatory frame in this area. Although the general tax code recognizes all of the standard depreciation methods (straight-line method and declining balance-method) and gives an opportunity for the specific functional method, The Act strictly restricts the choice to the straight-line method as the only relevant depreciation method. The rules of The Act requires that tangible and intangible assets must be capitalized according to their acquired cost price and they are subject of depreciation according to The National Nomenclature of depreciation (see table 2). In accordance with The Generally Accepted Accounting Principles, inventories are valued at cost.

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<sup>281</sup> About the withholding tax rates on capital income between the RM and some of the foreign countries see: Ernst&Young "The E&Y 2010 Worldwide Corporate Tax Guide", Ernst&Young, April, 2010, p. 622.

(Table 2).  
The National Nomenclature of depreciation

No.	Group of assets	Annual deprec. rate
<b>1.</b>	<b>Buildings:</b>	
1.1.	High structure buildings.....	2,5
1.2.	Low structure buildings.....	3
1.3.	Buildings with wooden construction.....	5
1.4.	Other buildings.....	10
<b>2.</b>	<b>Equipment:</b>	
2.1.	Machinery.....	5
2.2.	Additional equipment.....	10
2.3.	Furniture.....	20
2.4.	Computer hardware.....	25
2.5.	Other equipment.....	10
<b>3.</b>	<b>Fruit and wine orchards, grain mills and other.....</b>	<b>10</b>
<b>4.</b>	<b>Herds.....</b>	<b>20</b>
<b>5.</b>	<b>Long term intangible assets.....</b>	<b>20</b>
<b>6.</b>	<b>Other assets.....</b>	<b>10</b>

Source: The Act for the methods of depreciation on the assets in the RM.

**Tax on Gross Revenues (TGR).** A specific feature of CIT code of the RM is the existence of the so called Tax on Gross Revenues that was specially developed for the small enterprises. Trade companies that are classified as a micro and small enterprises according to The National Trade Companies Code are legal tax entities for the TGR instead for the CIT. According to the tax code, there are 2 types of small trade companies: 1. trade companies that are totally exempt from the obligation to pay the TGR; and 2. trade companies that could make a choice between the regular CIT and the TGR. The first category includes the enterprises with gross annual turnover of 3.000.000 denars or less (approximately 50.000 euro) The second category includes all trade companies (except the ones involved in banking, finance, insurance, gambling and entertaining businesses) with gross annual turnover between 3.000.000 and 6.000.000 denars (approximately 50.000 to 100.000 euro). If one model of taxation is chosen, then the companies are forbidden to change it for the next 3 years. The tax rate of the TGR is 1% on the annual gross revenues. Companies must submit their annual TGR balance due to 31<sup>st</sup> of May of the following year while payment of tax liabilities must be completed due to 30<sup>th</sup> of June.

Although the reason for promotion of the TGR was purely simplification of the tax procedure, a justified criticism has occurred among the experts and the business community. Accordingly, in the period when it was firstly introduced (2006) until the end of 2011, the code had not predicted the possibility for tax exemption for the smallest enterprises nor the option for the model of taxation, and therefore, the obligation for the TGR for every company was mandatory without any exception. Because the TGR is calculated on the annual gross revenues, regardless the amount of the annual gross expenses, enterprises were obliged for the TGR even in case of realization of a negative financial results. So, it was interpreted that the smallest companies of the entrepreneurship sector were discriminated against in comparison with the bigger companies and from that point of view the concept of the TGR was a step further from the general tax policy principals. But from the beginning of this year, this anomaly was corrected together with the implementation of the measures stated above.

**The Tax Incentive System.** The Corporate Tax Incentive system in the RM has gone under a substantial reduction of the number and the intensity of the available tax incentive measures. As a result of the drop of the number and the variety of the tax incentive instruments, there has been a trend of significant broadening of the national CIT base, which is in accordance with the general international tendencies. The primary aim was to minimize the risk of possible excess loss on the potential budget revenue account. For that reason, tax authorities had to make a transition from a policy based on narrow tax base and numerous targeted tax incentives to a policy based on wide tax base with small number of general tax incentives. This transition in the tax incentives policy area is also in accordance with the general tax policy principles for simplicity. More precisely, tax entities are faced with less tax measures and have a clearer path for qualification of the instruments. On the other hand, the tax administration procedure is faster, easier and the process of determination of the tax base is more precise. In order to illustrate this process we present below table 3. This table compares the available tax instruments in 2012, and the instruments that were available in the previous period.

(Table 3).

*Tax incentive measures in the RM*

<b>Tax Incentives in the RM</b>		
<b>Instrument:</b>	<b>1995-2012</b>	<b>2012</b>
Tax holiday (CIT exemption)	X	-
Partial profit exemption	X	-
Preferential CIT rate	-	-
Accelerated depreciation	X	-
Tax allowance	X	-
Reinvested allowance	X	-
Tax credit	X	X
Tax exemption on undistributed earnings	X	X
Preferential tax zones	X	X

Source: National Corporate Income Tax Code; OECD: "Tax policy assessment and design in support of direct investment", An OECD study of countries in SEE, OECD, April, 2003, p. 178.

The two possible direct outcomes from this reform are: 1. the increasing level of the marginal corporate tax burden; and 2. the increasing amount of collected public revenues from direct taxes (especially from CIT).<sup>282</sup> There are some indicators that the presented policy has contributed for slight, but continuous increment of the corporate METR, despite the determination of the government to decrease the statutory tax rates. The data shows that the METR was -5,42% in the period from 2000-2005, 11,52% in 2006, 9,12% in 2007 and 11,77% in the period 2008-2011.<sup>283</sup> Regardless the higher marginal tax burden, it should be noticed that the effect was not negative to the domestic efficiency, because the level of investment grew continuously from year to year. According to the State Statistical Institute of the RM, the level of domestic investment grew for nearly 2,5 times in 2008 compared to 2001 and nearly 2,4 times in 2010 compared to 2001.<sup>284</sup> Also, in the period of the last decade, the RM has managed to improve the overall performance to collect tax revenues. The relevant data from the Ministry of finance indicates that revenues from direct taxes in 2008 had grown for 1,7 times compared to 2001. Within their structure in 2008, revenues from PIT had been increased for 1,2 times compared to 2001 and the revenues from CIT manifested a record increment of nearly 3,3 times compared to 2002 (from 2.624 million to 8.579 million denars).<sup>285</sup> Concerning the relationship between the CIT and the METR, this growth rate can't be insignificant and we can conclude that the increased level of the marginal corporate tax burden has a positive effect on the level of collected public revenues.<sup>286</sup> Generally, we may conclude that the effect of the extension of the CIT base has been much stronger from the effect of the reduction of the CIT rate. Observed from that perspective, the CIT reform in the RM has effectively managed to achieve a formal balance between the fundamental tax policy principals.

### 3. Tax efficiency considerations

The most relevant parameters for determination of the potential efficiency effects are: the CIT rate, the capital income tax rates, and the character of the CIT system. From the previous sections we already determined the CIT rate as parameter (t). The capital income tax rate parameters are the withholding tax rates on capital income (from interest, dividends and capital gains) and they will be determined additionally. The character of the CIT system (parameter  $\epsilon$ ) is the level of the integration between corporate and personal income taxation. If the tax system is characterized as a classical CIT system ( $\epsilon = 1$ ), then it means that there is no integration between corporate and personal taxation. In that case, the CIT is paid on the corporate profit and the PIT on dividends is paid upon distribution of the profit. When the system is characterized as an integrated CIT system, then ( $\epsilon > 1$ ), and in that case the CIT is paid on the corporate profit, but upon the distribution of the dividends a tax credit or tax allowance is granted on the stockholder's PIT liability.

<sup>282</sup> Although indirect taxes (especially VAT) contribute the largest amount of tax revenues, they are not included in this analysis because they are not part of the CIT system, nor their effect is connected with the methodology of METR.

<sup>283</sup> These are the author's calculations of the relevant METR according to the methodology of King and Fulerton (1984); Assumptions: real interest rate 5%, inflation 2% and economic depreciation of the assets is 11,85%.

<sup>284</sup> State Statistical Institute of the RM.

<sup>285</sup> Ministry of Finance of the RM.

<sup>286</sup> It should be noted that this conclusion is relevant only in stable macroeconomic environment since from 2008 there had been a drop on the CIT revenues due to the international economic crises.

Therefore the value of  $\epsilon$  is higher than 1 for the value of the tax credit (c) or  $\epsilon = 1/(1 - c)$ . There is also a special case of so called “full integration” tax system where the amount of distributed gross dividends is deductible from the corporate profit base and in that case the value of the parameter  $\epsilon$  is transformed to  $\epsilon = 1/(1 - t)$ .

Tax efficiency effects depend on the level of the marginal corporate tax burden and the relevant methodology used for its calculation is METR.<sup>287</sup> The coefficient of METR is defined as:

$$\text{METR} = (p - s) / p \dots \dots \dots (1);$$

where p represents the investor’s (or the company’s) rate of return before taxes and s represent the saver’s rate of return after taxes. The parameter p can be evaluated through the expression:

$$\delta = [(1 - A) (\delta + \ddot{a} - \delta) / (1 - t)] - \ddot{a} \dots \dots \dots (2);$$

where A is the tax incentives net-present value,  $p^{288}$  is cost of the capital (or the discount rate),  $\ddot{a}$  is the rate of economic depreciation, and  $\delta$  is the inflation rate. On the other hand, the parameter s can be calculated as:

$$s = (1 - m) (r + \delta) - \delta \dots \dots \dots (3);$$

where r is the real interest rate, m is the personal income tax rate on interest income and  $\delta$  is the inflation rate.

The term from the expression (p - s) is also called “tax wedge” and it is an expression of the difference between the preference to invest and the preference to save. This term (the total tax wedge) can be divided into 2 parts: a) the investment tax wedge and b) the savings tax wedge.<sup>289</sup> The second term is measured as (r - s) and it represents the effective tax burden on the saver’s income. The first term which is crucial for our analysis is measured as a difference between the investor’s rate of return before taxes and the real interest rate (p - r) and it’s an expression for the effective tax burden on the investor’s (or company’s) capital income. More precisely, if the effective tax burden is positive (p > r), then the tax system depresses the investment activities. If the effective tax burden is equal to 0 (p = r), then the tax system is neutral to the investment decision. And if the effective tax burden is negative (p < r), then the tax system supports the investment.

There is only one more thing to define before the analysis, and that is the relation between the discount rate (cost of the capital) and the interest rate. In perfect economies without presence of taxes the cost of the capital is identical with the real interest rate (p = r) and the economic agents are completely indifferent between the investment decision and the decision to save (p = s). The existence of the national tax system diverges the difference between the cost of the capital and the interest rate and therefore creates a positive tax wedge (p > s). In this case the key factor for the investment decision becomes the discount rate, because it can have different values according to the different sources of finance (debt, new share issues, or retained earnings).

**Calculating the effects of taxation on investment.** If we take into account all these considerations, we might evaluate the effects from the evolution of the tax structure through the methodology of METR. For that purpose we assume that the tax incentives net-present value is 0 (A = 0), there is no inflation in the economy ( $\delta = 0$ ) and the rate of economic depreciation is equal to 0 ( $\ddot{a} = 0$ ). In that case the expression (2) transforms into:

$$\delta = \delta / (1 - t) \dots \dots \dots (4);$$

and the effect from the tax structure on the domestic efficiency (the level of domestic investment) can be expressed through the coefficient of the investment tax wedge:

$$p - r \dots \dots \dots (5);$$

**Debt.** The discount rate by the methodology of METR, in case of investment financed with debt, under the assumptions stated above is measured with the expression:

$$p = r (1 - t) \dots \dots \dots (6);$$

If we insert term (6) into term (4) then the value of the investors rate of return p will be transformed into:  $p = r (1 - t) / (1 - t) = r$ ; and the investment tax wedge into:  $p - r = r - r = 0$ .

This means that the tax system is neutral to the investment decision in every case of investment financed with debt. If we take this conclusion into consideration, then the evolution of the tax structure in the RM didn’t have any effect on the level of debt financed investment.

**New share issues.** If the investor covers the investment with new share issues, than he must earn rate of return at least equal to the cost of the capital. If we consider the proposed assumptions, than the discount rate in this case will be measured through the expression:

$$p = r / \epsilon \dots \dots \dots (7);$$

<sup>287</sup> I choose the pioneering METR methodology according to the authors Mervin A. King and Don Fulerton because of its explicit theoretical foundations. See: King M. A., Fulerton D: “The taxation of income from capital: A comparative study of the United States, the United Kingdom, Sweden and Germany,” National Bureau of economic Research, University of Chicago Press, 1984.

<sup>288</sup> It is advisable to make difference between p (the investor’s rate of return) and italic p (the discount rate).

<sup>289</sup> Leibfritz W., Thornton J., Bibbie A.: “Taxation and economic performance,” An OECD study, OECD, 1997, p. 95, 96, 97.

As we already noted, the value of  $\delta$  may have different value depending on the character of the corporate tax system. Therefore, in the case of investment financed with new share issues, we might consider every possible option of  $\delta$ .

*Classical corporate tax system ( $\delta = 1$ ).* In the option of a classical CIT system the value of the parameter  $\delta$  is 1. So, it is obvious that term for the discount rate (7) turns into:

$$p = r \dots \dots \dots (8);$$

If we insert term (8) into term (4), the value of the investors rate of return  $p$  will become:  $\delta = r / (1 - t)$ ; and the value of the investment tax wedge:  $p - r = rt / (1 - t)$ ;

From this equation we can draw a conclusion that countries with classical CIT system generate positive tax burden on the investment income, so the tax system might limit the overall investment activities financed with new share issues in the country.

*Full integration system ( $\delta = 1/(1 - t)$ ).* Let us analyze the effect of the other extreme option - the implementation of the full integration system. In that option the value of the coefficient  $\delta$  is  $1/(1 - t)$  and the cost of the capital becomes:  $\delta = r / [1 / (1 - t)]$  or more exactly:

$$p = r (1 - t) \dots \dots \dots (9);$$

By inserting term (9) into term (4), the value of the investors rate of return  $p$  will become:  $p = r (1 - t) / (1 - t) = r$ ; and the investment tax wedge:  $\delta - r = r - r = 0$ .

This means that a fully integrated CIT system generates a neutral effect on the investment decision and, in that case, is totally identical with the option in which investments are financed with debt. Also, this can be interpreted as that the application of this system creates equal tax treatment between debt and equity and eliminates the possibility of tax distortion.

*Integrated tax system ( $\delta > 1$ ).* Between the both extreme options is the integrated tax system where the value of  $\delta$  is higher than 1. Therefore, the cost of the capital becomes:

$$p = r / \delta \dots \dots \dots (10);$$

If we insert term (10) into term (4) the investors rate of return will become:  $p = (r / \delta) / (1 - t)$ ; and the investment tax wedge:  $\delta - r = (r / \delta) / (1 - t) - r$ ; or more exactly:  $p - r = r [1 - \delta(1 - t)] / \delta(1 - t)$ .

The term  $\delta(1 - t)$  (11); from the expression above indicates the irreversible dependency between the tax burden and  $\delta$ . It was determined that  $\delta$  has a value of  $1/(1 - c)$  where  $c$  is the value of the tax credit granted to the stockholders. If we consider this into term (11), then the term will transform into  $(1 - t) / (1 - c)$ . Assuming that there is no tax credit (classical tax system  $c = 0$ ), then term (11) will become  $(1 - t)$  and the investment tax wedge will generate the exact value as the option of the classical CIT system. On the other hand if we assume that  $c = t$  (full integration tax system) then term (11) will have a value of 1 and the investment tax wedge will automatically generate a value of 0. From this we may conclude that the higher the  $\delta$  coefficient, the lower the investment tax burden is.

If we analyze the evolution of the tax structure of the RM, we may say that the CIT system was a classical one until the end of 1996. In the period of 1996 - 2006, the RM had implemented an integrated CIT system with an imputation rate (or tax credit) of 50% on the base. This measure reduced the effective tax rate on dividend income for 50% as well. In 2007, this measure was abolished and the classical form of taxation was reintroduced and was never changed again. So, the tax burden on investment financed with equity was positive during the relevant period *ceteris paribus*. Only in the period of integration the positive burden was lowered by some extent but the treatment of equity was never equalized with debt.

**Retained earnings.** In the case when investors cover the investment with retained earnings, if we consider the proposed assumptions, than the discount rate is measured through the expression:

$$\delta = r [(1 - m) / (1 - z)] \dots \dots \dots (12);$$

If we consider term (12) for the investors rate of return  $p$  and if we calculate the investment tax wedge, then:

$$p - r = r [t + z(1 - t) - m] / (1 - z)(1 - t) \dots \dots \dots (13);$$

where  $z$  represents the effective tax rate on accrued capital gains, and the rest of the symbols have the same meaning.

The term  $t + z(1 - t)$  (14), from the expression above, is the combined corporate tax bill and the personal capital gains tax liability resulting from an extra unit of corporate profits which is retained in the corporation.<sup>290</sup> It is clearly seen from the expression that if this combined liability exceeds  $m$  (or the personal tax liability on interest income) then the tax burden will be positive. If the combined tax liability is lower than  $m$ , then the tax burden will be negative (positive effects on the investment decision). Only in a situation where the combined tax liability is equal to the tax liability on interest income the corporate system will be neutral to investment.

*“Comprehensive” personal income tax rate ( $z = m$ ).* Empirical studies determine that usually, the tax burden on investment financed with retained earnings is much lower than the tax burden on investment covered with equity.

<sup>290</sup> Leibfritz W., Thornton J., Bibbie A.: “Taxation and economic performance” An OECD study, OECD, 1997, p. 98.

This will discriminate new companies that require larger proportion of equity to finance their business activities compared to the old mature companies that more commonly use retained earnings as a source of finance. In order to level “the playground rules” authorities may implement a “comprehensive” personal income tax rate within the classical CIT system. This means that the effective tax rate on capital gains is identical with the tax rate on interest income ( $z = m$ ).

If we incorporate this assumption in term (12), then the discount rate will be calculated as:  $\delta = r [(1 - z) / (1 - z)] = r$ ; the investors rate of return will transform into:  $\delta = r / (1 - t)$ ; and the investment tax wedge:  $p - r = rt / (1 - t)$ .

This means that the tax treatment of retained earnings becomes identical with the treatment of equity.

*Zero effective capital gains tax rate ( $z = 0$ ).* Some countries often imply zero tax rates on capital gains income, which, of course, will have certain repercussions on taxation. If this assumption is incorporated in term (12), then the discount rate will be measured as:  $p = r (1 - m) / (1 - 0)$ ; or more precisely:  $p = r (1 - m)$ . If we calculate investor’s rate of return it will become:  $p = r (1 - m) / (1 - t)$ ; and the investment tax wedge:  $p - r = r (t - m) / (1 - t)$ .

The term  $(t - m)$  (14); clearly shows that the implementation of zero capital gains tax rate creates an effective tax burden that will primarily depend on the relation between the CIT rate  $t$  and the PIT rate on interest income  $m$ . From that aspect, if  $t > m$ , then the effective tax burden is positive; if  $t = m$  than the tax burden is 0; and if  $t < m$ , we will have a situation with negative tax burden on investment income.

*Flat tax rate ( $t = m$ ).* First we must notice the difference between the effective tax rate on capital gains income  $z$  and the statutory tax rate on capital gains income  $z_s$ . The effective tax rate is usually lower than the statutory tax rate because the tax liability occurs only upon realization of the capital gain. There is a developed methodology for calculation of  $z^{291}$ , but it would be sufficient to present it. What is important is that if we reject the taxing rule for realization of the capital gains (or we suppose that the realization will never occur), then the effective tax rate  $z$  will generate value of zero ( $z = 0$ ). If all these assumptions are included within term (13), then the investment tax wedge with a flat tax rate structure will automatically transform into zero ( $p - r = 0$ ). This means that imposition of a flat tax rate structure generates a zero effective tax burden and a neutral effect on investment when it is financed with retained earnings.

If we use this analysis in context of the evolution of the tax structure of the RM, we may say that in the period of 1993-1996 the CIT produced positive tax burden on investment covered with retained earnings. Because the CIT rate  $t$  was higher than the PIT rate on interest income  $m$  ( $30\% > 23\%$ ), this situation probably produced negative effect on this sort of investment, just like term (14) indicated. Then, in 1996, the CIT rate  $t$  was reduced to 15%, while the PIT rate on interest income was still 23%. This created a situation where ( $t < m$ ) and according to term (14) the tax burden was negative and the tax system probably supported investment with retained earnings. This condition lasted until 2001 when the parameter  $m$  was reduced to 15%. From that year on, the parameter  $t$  was equal with the parameter  $m$  ( $t = m$ ) and this condition probably generated a zero effective tax burden and accordingly, a neutral effect on investment financed with retained earnings.

If we take into account the fact that there is a 30% deduction available on the capital gains tax base, then we can confirm that retained earnings are one of the most preferred sources of finance in the RM.

In general, from this analysis we may resume that the CIT system of the RM is reformed in a manner that improved its overall efficiency performances. The tax structure does not create any distortions on investment with debt and retained earnings, but there is some excess tax burden on investment with equity due to the existence of the classical form of corporate taxation. Of course, these conclusions are drawn under the assumptions stated above and therefore, represent a theoretical framework that can be different from the real “playground.” In reality, as we can see from the presented methodology of METR, the corporate tax burden as well as the investment decision can depend on a large number of variable parameters such as the capital structure, the inflation, the economic depreciation, the implemented tax incentive measures, etc., that can really produce different results if they are taken into consideration.

### Conclusions.

The tax reform can be described as a dynamic process of continuous improvement of the structures of the national tax systems in order to fulfill the general economic and tax policy goals. It has been confirmed that some of the most powerful tax reform drivers from a domestic and international point of view are the general tax policy principals. Basic priority of the Corporate Income Tax reform in the RM is to maintain a tax structure that would enable a relatively simple and easy administration and at the same time would provide a comparatively lower corporate effective tax burden.

<sup>291</sup> See: King Ì .À., Fulerton D: “The taxation of income from capital: A comparative study of the United States, the United Kingdom, Sweden and Germany,” National Bureau of economic Research, University of Chicago Press, 1984, p. 23.

Therefore, the tax system had to be revised in every aspect of its basic elements and this process produced some specific futures such as: the flat tax rate structure, The Tax on Gross Revenues and a Tax Incentive System with small variety of available instruments.

This transition in the tax policy area is also in accordance with the general tax policy principles for simplicity and efficiency. More exactly, the administration service is much faster and the tax payers spend less time and resources for the procedure. Also, there is evidence that the overall efficiency performances are generally satisfactory.

According to the analysis, the tax structure does not create any distortions on investment with debt and retained earnings, but there is some excess tax burden on investment with equity. Of course, these conclusions represent a theoretical framework and therefore, are limited only on the assumptions stated above.

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**FLAT TAX AND ITS AFFECT ON ALBANIAN'S FDI**

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**Abstract:**

*Over the last 15 years waves of flat tax reforms have been rippling across the transition economies of Eastern Europe. Resulting economic consequences, globalization and special interest activities have spurred debates among politicians and economists in the Germany, Eastern Europe, and even in Albania. This essay investigates the potential efficacy of flat tax reform in the Albania with public choice tools. In this paper I develop two testable hypotheses to study the effects of the flat-tax proposal. The sections below include: 1) impacts of tax reforms, 2) comparison of between Albania and South East Europe FDI inflows. Also, the article discusses the impact of the new fiscal policies adopted by Albania, by implementing the flat tax on foreign direct investment. From this point of view were analyzed developments flow and the stock of foreign direct investment, taking into account the performance indicators of the flow of FDI.*

**Keywords:** Fiscal Policy, Flat Tax, FDI inflows, Regression Model.

**JEL Classification:** H29.

**Introduction**

In recent years the flat-tax revolution became popular among the transition countries. In recent years, many countries have adopted the flat tax, as an alternative to well known progressive tax system. With the latest extension of the EU, are a growing number of states that have adopted the flat tax imposition or who intend to adopt. Beginning with Estonia in 1994, a growing number of nations have joined the flat tax club. There is now Serbia with 14% (2003), Romania 16% (2005), Macedonia 12% (2007), Montenegro 15% (2007).

Virtually all governments are keen to attract foreign direct investment (FDI). It can generate new jobs, bring in new technologies and, more generally, promote growth and employment. The resulting net increase in domestic income is shared with government through taxation of wages and profits of foreign-owned companies, and possibly other taxes on business (e.g. property tax). FDI may also positively affect domestic income through spillover effects such as the introduction of new technologies and the enhancement of human capital (skills). Given these potential benefits, policy makers continually re-examine their tax rules to ensure they are attractive to inbound investment. Tax policies may also support direct investment abroad, as outbound investment may provide efficient access to foreign markets and production scale economies, leading to increased net domestic income. At the same time, governments continually balance the desire to offer a competitive tax environment for FDI, with the need to ensure that an appropriate share of domestic tax is collected from multinationals. But while tax is recognized as being an important factor in decisions on where to invest, it is not the main determinant. FDI is attracted to countries offering: access to markets and profit opportunities; a predictable and non-discriminatory legal and regulatory framework; macroeconomic stability; skilled and responsive labor markets; and well-developed infrastructure. All of these factors will influence the long-term profitability of a project.

Anyway our study is based on especially on the impact that "tax form" has on FDI inflows. Starting from end of 2007 Albania has implemented a new fiscal policy, specially the launch of 10 % flat tax, ranking Albania between the countries with the lowest taxes in the region. The 10% flat tax is both for personal income tax and corporate income tax.

The government program of scaled tax cuts contributed not only to make the country a more attractive one for investments, but it did not endanger at all the fiscal consolidation. The introduction of the flat-rate-tax at the level of 10% means: reducing the corporate tax from 25% to 10%, personal income tax from 23% to 10%, and small business tax was cut back by 50%, social security contribution from 44% to 27.9%. By lowering fiscal charge by 50% for four major taxes such as personal income tax, corporate income tax, social contribution, and small business tax, Albania offer real incentives for foreign and domestic investors (Milo 2011).

Albania is ranked 18th among 141 countries according to UNCTAD's Inward FDI Performance Index for 2010, up sharply from the 68th place it occupied in 2005. This improved position reflects an investor-friendly business environment and opportunities opened up by the privatization of state-owned enterprises. FDI inflows increased from one quarter to one third of the value of gross domestic capital formation from 2009 (€717 million) to 2010 (€793 million). It fell back again to one quarter in 2011 (€742 million) which can still be considered as a good result in the absence of major privatization deals. Therefore, the flat tax system should continue to be aggressively advertised to potential foreign investors. FDI in Albania has mostly been attracted by the various privatization initiatives of the Government in sectors such as banking, energy, and telecommunications. Specifically, 24% of the FDI during the period 2004-2008 went to privatizations, eventually rising to 26% in 2009. In recent years, an important development targeting investors has been the establishment of the Law on Concessions which aims at creating a favorable framework for promoting and facilitating the implementation of privately financed concession projects in the development of infrastructure and public service areas in a wide range of sectors. Further, several structural reforms have been undertaken so as to simplify and lower start-up investment costs. In particular, in May 2009 the National Licensing Center was established mirroring the establishment of the National Registration Center in 2007. This Center is a sort of "one-stop-shop" for issuing licenses and permits reducing efforts for obtaining a license by local businesses to a minimal level.

### How sensitive is FDI to taxation?

Studies examining cross-border flows suggest that on average, FDI decreases by 3.7% following a 1% percentage point increase in the tax rate on FDI. But there is a wide range of estimates, with most studies finding decreases in the range of 0% to 5%.

However, it is not always clear that a tax reduction is required (or is able) to attract FDI. Where a higher corporate tax burden is matched by well-developed infrastructure, public services and other host country attributes attractive to business, including market size, trade (e.g. transportation) costs, tax competition from relatively low-tax countries not offering similar advantages may not seriously affect net profitability and investment location choice. A recent contribution to this work is provided by Hajkova *et al.* (2006), who investigate the impact of tax on FDI while controlling for a number of policy and non-policy factors, and find that not controlling for such factors may lead to serious overestimation of tax elasticity.

A literature review carried out for the current project by Mooij and Ederveen (2005) finds most studies reporting a negative relationship between taxation and FDI, but with a wide range of estimates of the tax elasticity of FDI. While certain empirical studies find a strong negative relationship between host country taxation and FDI, others do not (OECD 2007). In my study in fact the relationship between taxation and FDI (see below) is positive. In other words, one might expect a priori that the sensitivity of FDI to taxation would vary and depend on host country conditions and policies (including the level of corporate tax rates), types of industries/business activities covered, the time period examined, and other factors. Indeed, the literature review suggests that the influence of tax on FDI is complex and depends on a number of difficult to measure factors, with additional empirical work required to better understand the role of taxation amongst key factors influencing FDI location decisions.

Indeed, a number of large OECD countries with relatively high effective tax rates are very successful in attracting FDI. This points to the importance of market size and other host country attributes in attracting FDI and the presence of location-specific profits that governments are able to tax. Tax is but one element and cannot compensate for poor infrastructure, limited access to markets, or other weak investment conditions. Also, while attention often focuses on corporate income tax, the importance of other taxes must be recognized. (OECD 2008)

### Purpose of the Study

This study investigates potential factors impacting foreign direct investment performance in Albania. We are based especially to find a connection between the new fiscal policy implemented in Albania and Albanian FDI inflows. Also we tried to make some comparison of countries with same fiscal system (flat tax implemented) and their inflows of FDI.

Three research questions were formulated to help guide the present study:

- *Is there a significant impact of the flat tax on FDI inflows in Albania?*

- *Is there any difference between FDI inflows of South East Europe and Albania?*
- *Can we make a forecast based on the best forecasting methods about FDI inflows for 2012?*

This study hopes to present evidence determining the importance of implementation of flat tax in Albania. Did the flat tax increase the FDI inflows after its implementation in Albanian fiscal system? Also we made some comparison of countries with flat tax system (Western Balkan countries) if there was a difference between FDI inflows of South East Europe and Albania.

### Methodology

#### *Data Sources*

We are based on data provided from the Report in Foreign Direct Investment in Albania, 2011 and World Bank. A dummy variable and continues variables for the regression function were selected. Proportional tax and flat tax are considered as dummy variable. Other variables introduced at the material are time series such FDI inflows of Albania from 2005-2011 and FDI inflows of South East Europe during these years to make a comparison.

#### Data Analysis

The main purpose was to find out if there is a connection of FDI inflows before and after the implementation of flat tax in Albania. I used dummy variables (proportional tax = 0 and flat tax = 1) as predictor variable and FDI inflows as dependent variable.

The regression analysis was performed in one phase, because we are taking into consideration only one predictor. We use the SPSS statistic to run the regression function in order to see the impact of flat tax to the FDI inflows in Albania after its implementation. So I was based on time series of FDI inflows from 2005 until 2011 to create the dependent variable. Based on this data I created a dummy variable; from 2005-2008 (the period on which Albania had a proportional tax) I defined it with 0, and from 2008-2011 (the implementation of flat tax) defined as 1. FDI inflows data collected are in million Euros.

- *Is there a significant impact of the flat tax on FDI inflows in Albania?*

In fact it did as we notice from the regression function below:

$$Y = FDI \text{ inflows}$$

$$D_1 = \text{Dummy variable (0=proportional tax, 1=flat tax)}$$

First of all, we can conclude that at 0.05 level of significance the independent variable (dummy variable, tax form) is significant (p-value=0.003). From the result we see that there exist a strong positive relationship between the form tax and FDI inflows (coefficient of correlation is 0.94). Another important point is that tax form explains 85% of variation of FDI inflows while 15% is explained from the other variables. (See Appendix)

The intercept from regression is about 317.667 million-euro means that if the Dummy variable is 0 i.e. is a proportional tax; FDI inflows record a sum of 317.667 million euro. The coefficient of slope is about 411.583 million euro means that if Dummy variable is 1 i.e. is a flat tax; FDI inflows will increase with 411.583 million euro per each increase with one unit of the flat tax. (See appendix)

- *There is a significant difference between FDI inflows of South-East Europe and FDI inflows of Albania? Do FDI inflows of South-East Europe overcome the FDI inflows of Albania?*

To get an answer of those questions we raise a hypothesise about the difference between FDI inflows of South-East Europe and Albania. So we try to prove if the average FDI inflows of South-East Europe are greater than the average FDI inflows of Albania.

With a  $p\text{-value}=0.001/2=0.0005>0.05$  (means that is significant) we can reject and so we can conclude that at 0.05 level of significance the average FDI inflows of south-East Europe are greater than the average FDI inflows of Albania.

The difference exists between FDI inflows of South-East Europe and Albania over the years (2005-2011) through Randomized Block Anova is easily noticed by  $p\text{-value}=0.001$ . The Anova Test provide us information that does not exist a significant difference between FDI inflows of Albania and South-East Europe over the years ( $p\text{-value}=0.54$ ). (See Appendix)

- *Can we make a forecast based on the best forecasting methods about FDI inflows for 2012?*

From the data collected we can forecast about the FDI inflows for 2012. There are several methods of calculating it. Based on Mega stat program I tried to calculate the FDI inflows for 2012, through moving average and exponential smoothing. The three attempt resulted from moving average provide also with three different MAPE (calculated it manually) where:

With 2 periods, MAPE results 26%; With 3 period, MAPE results 27.7%; With 4 period, MAPE results 29%. Also forecasting with exponential smooth, with an alpha 0.3 and an initial value 713 million euro, MAPE results 37.2%.

After all these calculation the best method is forecasting with moving average of 2 periods which result with the lowest MAPE, so the forecast for 2012 will be 767.5 million euro FDI inflows.

### **Conclusions and Recommendations:**

The porpoise of this paper is to bring the advantages of implementation of flat tax to Albania fiscal policy. Virtually all governments are keen to attract foreign direct investment (FDI). It can generate new jobs, bring in new technologies and, more generally, promote growth and employment.

But while tax is recognized as being an important factor in decisions on where to invest, it is not the main determinant. FDI is attracted to countries offering: access to markets and profit opportunities; a predictable and non-discriminatory legal and regulatory framework; macroeconomic stability; skilled and responsive labor markets; and well-developed infrastructure. All of these factors will influence the long-term profitability of a project. Anyway my study is based on especially on the impact that “tax form” has on FDI inflows.

I am mainly based on the effect that flat tax has brought to FDI inflows in Albania. By creating a dummy variable for the progressive tax vs. flat tax (as predictor) through single regression model I try to notice the impact of ‘tax form’ on FDI inflows in Albania. I raised three research questions and through statistical program we conclude:

- That there is a strong positive relationship between these variables where “tax form,” explains 85.4% of variation of FDI Inflows.
- That there is a significant impact of flat tax to the Albania FDI inflows, by increasing it with 411 million Euros after its implementation (2008).
- That there is a significant difference between FDI inflows of Albania and South-East Europe, where the late inflows are greater than Albania. (Expressed in millions euro). From the other side the FDI inflows have not a significant difference over the years, so as for Albania, as for South East Europe in general there is no huge boost of FDI inflows.
- We made a forecast of FDI inflows of Albania for 2012, resulted in 767.5 million euro FDI inflows.
- The implementation of the flat tax should be taken into count if Albania really wants to boost her FDI inflows. It can generate new jobs, bring in new technologies and, more generally, promote growth and employment.

- Indeed, the literature review suggests that the influence of tax on FDI is complex and depends on a number of difficult to measure factors, with additional empirical work required to better understand the role of taxation amongst key factors influencing FDI location decisions.

### Appendix

#### Regression model

Model Summary									
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.924 <sup>a</sup>	.854	.825	99.579	.854	29.286	1	5	.003

a. Predictors: (Constant), tax form

#### Regression coefficient

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	317.667	57.492		5.525	.003
	tax form	411.583	76.054	.924	5.412	.003

a. *Dependent Variable: FDI*

*Paired means*

<i>Paired Samples Test</i>									
		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	South-East Europe – Albania	5604.571	2537.509	959.088	3257.767	7951.375	5.844	6	.001

*ANOVA table*

<i>Source</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>p-value</i>
Treatments	109,939,273.14	1	109,939,273.143	34.15	.0011
Blocks	17,722,617.71	6	2,953,769.619	0.92	.5403
Error	19,316,848.86	6	3,219,474.810		
Total	146,978,739.71	13			

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**PROGRESSIVE OR FLAT RATES ON TAXING PERSONAL INCOME?  
THE CASE OF ALBANIA**

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**Abstract:**

*The tax system has an important impact on determining the behavior of economic agents, market distortions, government revenues, the redistribution of income, etc. The performance of the tax system can be measured according to the efficiency like administrative procedures, tax rates, flexibility on changing conditions of the economy and equity like shifting tax incidence from wealthy to poor individuals, or from small businesses to big corporate. Nowadays it is held a strong debate about the tax rates comparing progressive with flat ones. The advocates of flat taxes give point to administrative simplicity and the broader base of taxation reducing evasion. The increase of inequality, the shift of tax burden from high level income to low level income and sometimes the level of government revenue raised are some of the weaknesses of this tax. However many countries in the world including Albania have adopted this kind of tax. But it doesn't have the same impact. Some of the countries have shown good experiences of flat tax and some other have unclear effects of this tax. The aim of this paper is to show the situation of the flat tax in Albania with all the improvement made, the problems and the challenges for the future based on efficiency and equity problem. The analysis is focused in some important point like simplicity of the tax procedures, fiscal burden and government revenues. At the end will be drawn some conclusion and recommendations.*

**Keywords:** *Progressive tax, flat tax, government revenue, fiscal burden, personal income tax, profit tax*

**JEL classification:** *H20, H23, H24.*

- **Theoretical consideration of flat tax application**

The term flat tax was proposed by Hall and Rabushka in 1985 as a genuine reform of taxation. This reform aims to change substantially the way the government decides to organize the collection of government revenues. According to this tax reform the income will be taxed only once with the same rate of taxation. The authors argue that income taxed only once can significantly simplify taxation system. Another important aspect of the flat tax is that income is taxed uniformly regardless of the level of the income of individuals. The only exception according to the proposal made by the Hall-Rabushka is the reduction of taxation of families and individuals with are below a certain minimum of income. Flat tax reform according to Hall-Rabushka is considered as a tax which increases consumption, because of the increase of consumption trend by reducing double taxation. The authors have reached the conclusion that this reform aim to increase the efficiency of the tax system through a tax system based on consumption without prejudice in this way the government revenues. As a result is expected a boost of savings and investment and therefore the accumulation of capital in the market. These are important factors for a sustainable economic growth.

The Placement of flat tax is divided into two moments by the economists. First moment has to do with setting the tax in the Baltic Republics. The characteristic of these tax rates is that they are higher than in other countries and where the placement of the flat tax has been part of a package of tax system reforms of these countries.

However, over time these rates are somewhat reduced compared to their start. The second wave of flat tax setting begins with Russia in 2000 and continues with a number of other countries. Their common characteristics are the tax rates between 10 - 19 percent. Placement of the flat tax in these countries has been accompanied by some auxiliary measures addressed mainly in the reduction of social security contributions. Placing a full flat tax structure would mean unifying the value added tax (VAT) with the same rate with personal income tax (PIT) and profit tax (PT). This form is applied only by Slovakia which has the same rate of 19 percent for all three taxes.

### 1.1 Some reasons why to use flat taxes

Application of the flat tax by more than eight countries in the past 5 years may seem like a matter of fashion, but in fact it was a necessity. Although there are many differences between the countries regarding the application of the flat tax - as compared to the rates used, followed reforms, the low level of management, economic development features, etc. – However there are also quite common features.

Why this tendency toward flat tax?

- This tax is applied generally by new governments as a signal to reach to a tax regime at market policies. In many cases, this signal is well received.
- Countries that have applied this tax suffer from problems of management, high evasion and corruption. While the placement of the flat tax simplifies the taxation system by eliminating some forms of arbitration, or special treatment of certain categories, such as Russia or Ukraine. This does not mean that since the introduction of this tax, the tax system is not complex anymore.
- Many of these countries have had a tax structure scalable and high tax rates which may have adversely affected the poor management.
- Especially countries that have applied flat tax after 2001 have made a reduction of social security contributions to alleviating this tax on lower income levels that do not pay such a rate.
- A number of these countries have almost the same rate for income tax and profit tax.

Theoretically flat taxes contribute positively to economic growth through increasing consumption, saving and investment. Flat tax encourages citizens to work, especially when wages are closely linked to working hours. So they work more because for each additional hour of work they have the same tax rate, unlike the progressive tax, where the increase of working hours can also increase the rate of tax. Avoiding double taxation, flat tax increase after tax income and this leads to increased consumption and aggregate demand as well as increase their investment financed through savings. Also simplifying administrative procedures and lower tax rates increase the absorption of foreign investment and capital accumulation. Administrative simplifications reduce the possibilities for fraud, tax evasion and corruption.

Despite the positive effects, the effect of the flat tax in economic growth is somewhat unclear. Flat tax may also negatively affect equality. As will be explained below in the paper the low and average wages pay more in absolute terms in the case of the flat tax than in the case of progressive taxation. This may be associated with a reduction in consumption and aggregate demand and negatively affect economic growth. Although the flat tax could increase the efficiency of the tax system for the reasons mentioned above, it can negatively affect vertical equality because of treating in the same manner different levels of income.

- **Flat tax adoption in Albania and other countries**

Is it fair that people who earn more money have to pay more taxes? In cases of progressive tax structure, there are different tax rates for different groups of income. Progressive tax system have a distributional effect on income or spending moving from low to high tax rates where the average tax rate is lower than marginal tax rate. Progressive taxes tend to lower the tax effect on individuals with low ability to pay, shifting it in a nonproportional way toward individuals with higher ability to pay.

To avoid this shifting of the fiscal burden toward businesses, long procedures which stimulate fiscal evasion and corruption and also to give a better climate to investments many countries of Eastern and South East Europe including Albania have adopted the flat tax regime. As it is mentioned before the Baltic Republics were the first countries who replaced the progressive tax system with the flat tax. They had high rates of this tax, but they reduced them with some point percent during time. The table below shows most of the countries with a flat tax regime.

**Table 1. Some of the countries which adoptet the flat tax regime**



Countries	Years	PIT before flat tax	PIT after flat tax	PT before flat tax	PT after flat tax	TAP 2007	TF 2007
Estonia	1994	16, 24, 33	26	35	26	22	22
Lituania	1994	18 – 33	33	29	29	27	15
Letonia	1997	10, 25	25	25	25	25	15
Russia	2001	10, 20, 30	13	30	37	13	24
Slovakia	2004	10 – 38	19	25	19	19	19
Ukraine	2004	10 – 40	13	30	25	15	25
Romania	2005	18 – 40	16	25	16	16	16
Albania	2007	1 – 20	10	20	20	10	20
Macedonia	2007	15 – 24	12	15	12	12	12
Montenegro	2007	15, 19, 23	10	15, 20, 9	9	10	9
Czech Rep.	2008	12 – 32	15	24	22	12 – 32	24
Bulgaria	2008	20 – 24	10	10	10	20 – 24	10

Source: Keen, Kim, Varsano (2006)

As it is seen from the table setting a single rate is applied in almost all cases to the personal income tax (PIT), corporate income tax (CIT) and in some cases, VAT is set at the same rate. Some of the countries which adopted the flat tax regime at the first years have done changes on tax rates after some years. Another case where there are differences between them is the way they treat income from capital which does not have the same rate of income from work.

If we refer to Albania, first negotiations about setting the flat tax starting in 2004, but its implementation was made in July 2007 for PIT and on January 1, 2008 for PT. Its structure is such that the level of 10 000 lek is not taxed and pay up to 30 000, taxed with 10 percent of the difference between the salary of the individual with threshold of 10 000 lek, while above this level fully 10 percent tax applies. Just as mentioned earlier administrative system in Albania has many problems related to tax administration and tax. Simplification and establishing a single rate lower than before will affect the increase of income through the expansion of the tax base and eliminate abuses in connection with the businesses to be declared as a small business

### 3. Flat tax impact vs. Progressive tax impact

One of the most discussed issues related to the flat tax is whether it reduces the progression or not. Setting up a single rate seem to avoid progression, but the fact that there is an escalation therefore a lower category of wages that does not pay taxes somewhat complicates the analysis. This refers to the marginal rate and the threshold set associated with wages that do not pay tax. There are some cases: If  $A_P$  (progressive threshold) <  $A_F$  (flat tax threshold) and marginal rate is located near the highest levels, the flat tax system turns out to be more progressive than the previous. This is presented in the diagram below. This is more aligned with the first wave of reforms, such as Lithuania.

Figure 1. Flat tax reform

Tax

Flat Tax,  $T_F$  Progressiv Tax  $T_P$

$A_P$      $A_F$     Income

If  $A_P$  (progressive threshold) <  $A_F$  (flat tax threshold) and the marginal rate is set between the high level and low marginal rates, the flat tax system turns out to be more progressive than the previous one, in this case the effect progressive flat tax in comparison with the previous system is not very clear. As it is shown graphically both lines representing tax structures have two common points.

Figure 2. Flat tax reform

Tax

Progresiv Tax,  $T_P$

Flat tax,  $T_F$

$A_P$   $A_F$

Income,  $Y$

If  $A_P$  (progressive threshold) >  $A_F$  (flat tax threshold) and the marginal rate is set between the high level and low marginal rates, the flat tax system turns out to be less progressive than the previous. The impact of the flat tax on the incentive to work is not very clear in principle. In the case of the flat tax reform with lower marginal rates seeks to stimulate efforts to work at higher levels of income by reducing marginal rates, but stops them by lowering the average tax rate. Such issues are extended even in other cases of wage distribution. In terms of simplicity, the flat tax has a positive effect, eliminating some arbitrary taxation, but that does not necessarily mean that the tax system is more complex, as in the case of Russia.

For some countries, the flat tax has led to the creation of a political package for the expansion of the taxable base, removing many exemptions and preferences (certain categories that were exempt from taxes), as is the case of Ukraine. This has led to revenue growth and improvement of horizontal equality.

Following this discussion, the figure below represents the absolute amount of tax to be paid for different levels of monthly wages, by comparing the two tax structures in the case of Albania. It is observed that the wages below 140 000 lek pay more in the case of flat tax than in the case of progressive tax and only wages above this level pay less taxes in case of flat tax. Specifically the biggest difference between the two taxes corresponds to the level of salaries from 45 000 lek to 85 000 lek which can be considered the average level of wages. So in our case this wage category is the one that holds more flat tax. This wage interval belongs to a wide category of individuals. So the tax burden is shifted from a small group with high wages (over 140 000 lek) to a bigger group.

**Figure 3. Flat tax payments compared to that progressive for different wage levels**

Source: Own calculation

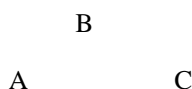
**3.1 Flat tax effect on government revenues**

Except the positive impact on work incentives, consumption and investment increase, another effect that should be taken in consideration is that of government revenues raised by flat tax.

To explain better the effects that cause flat tax to total tax revenues is necessary to focus on theoretical treatment of Laffer curve. This theory explains the relationship between the level of taxation and the income collected on the budget.

**Figure 4. Laffer Curve – the relation between tax rate and government revenue**

Revenue



Tax rate

Laffer curve suggests that revenues collected from taxes have immediate changes when the level of taxation changes. In the graph above point B is called an optimal point. This point means that the government revenue collected is at the maximum level due to the rate of the tax. Any reduction of tax rates below B-level would lead to reduction in government revenue.

If the tax rate is above point B, (for example point C in the graph) then every reduction from C to B will be accompanied by a growth in government revenues, and the norms of tax cuts from B towards A will be accompanied by reduction in tax revenues. According to this theory in cases of low rates near 0, an increase on tax rate will have a strong increase on government revenue. The same positive effect happens by a cut of high tax rates. This theory can also give the chance to the government to choose different ways for raising tax revenues. The governments can apply high tax rates for narrow segment of population or can apply a low level of tax for a broader group of peoples.

In practice if flat tax do not broaden the base of taxpayers it can cause serious problems to government revenues. In cases of high debt and budget deficits this may harm even more. The situation of government revenues collected by the flat tax (both PIT and PT) during the last decade is shown on the figure below. If we compare the tax revenues collected from the personal income tax before 2007 with the period after we can conclude that there is an increase on the revenue raised from the flat tax on 2008 compared to the previous period. However on the next years 2009 – 2010 the situation remained on the same position.

**Figure 5. The trend of personal income and profit tax and the overall tax revenues (in % GDP)**

Source: Ministry of Finance

The profit tax revenues decreased after the adoption of the flat tax. This is an indicator that this tax didn't reduce the fiscal evasion significantly among the businesses.

As it can be seen, during 2010, tax revenues, in terms of GDP, in the budget have been lower than a year ago. A possible reason is the 10 percent rate applied to personal income tax and profit tax in our country that is among the lowest in the countries that have applied this tax. Another feature is the slow economic growth after 2008 in most of the countries. If we refer to the tax structure revenue, nearly 50 percent of the revenues come from the value added tax, which is part of the indirect taxation. The direct taxation (PIT and PT) take only 15 – 18 percent of the revenues.

Is the substitution of flat tax with a progressive tax a studied reform? The answer to this question is very difficult and can be given only after doing a study on the effects and groups that will be affected by the change in tax structure. Despite the economic costs of a tax reform are political costs that in one way or another place for them. However, we can say that a tax reform is needed to draw government revenues from stagnation which have stalled.

### CONCLUSIONS.

The taxation system has an impact on the behavior of economic agents, in the efficiency of markets and in many macroeconomic variables that affect economic growth, and therefore tax structures are in continual reform. One of the reforms to be discussed is the replacement of the flat tax progressive tax. One of the countries that have applied this reform is also Albania.

From this simple analysis of the flat tax reform for the period 2007 -2010 arrived at the conclusion that the reasons why the top of this reform were:

First, this was an attempt of the government to increase the budget revenues through expanding the tax base and lowering the tax rate.

Second, it affects the growth of capital stock in the country by attracting foreign capital.

Third, the application of this tax was seen as a way to reduce the scale of the informal economy and reduce tax evasion.

This reform was intended to facilitate fiscal burden of the individuals with low incomes. Three years after the introduction of this reform we can say according to figures that part of the population with low income and middle are the ones that pay more tax than individuals with higher incomes. Another problem that is also noticed is the low level of government revenues derived from this tax, which is not near the forecast level. Now Albania is at one point that the government must take in consideration an adjustment of the flat tax or a reform that could raise more government revenues and increase the scale of formal economy.

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## THE SOVEREIGN DEBT CRISIS IN THE EURO AREA: CAUSES AND EFFECTS

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### **Abstract:**

*The present report focuses on the reasons for and the consequences of the Euro area sovereign debt crisis. Structural imbalances between the core and the periphery of the Euro area and the lack of fiscal integration are the main reasons for the crisis. After the creation of the EA its peripheral members borrowed large sums of money, mainly from foreign private lenders, and gradually aggravated their public finance stability indicators. The lenders' loss of faith in the solvency of these states stopped the cheap foreign financing and grew into a government debt crisis. The crisis drew attention to the asymmetries between the heart and the periphery of the Economic and Monetary Union (EMU), which can be seen in the different levels and dynamics of key macroeconomic indicators such as consumption, saving and investment. The debt crisis is not just a problem of EA peripheral member countries (Greece, Ireland, Portugal, Italy, and Spain) and cannot be resolved solely by fiscal austerity measures in these countries. The EA government debt crisis has systemic character and requires strategic solutions such as fiscal integration of EA member states (or at least increased coordination of their fiscal policies) and the establishment of a new governance structure of the EMU.*

**Key words:** Euro area, sovereign debt crisis

**JEL Classification Code:** E44, F34

### **1. The roots of the EA government debt crisis**

The unprecedented global economic crisis of 2008 and the recession after it have led to a worldwide deterioration of fiscal deficit and public debt ratios to GDP. This deterioration is due mainly to a fall in budget revenues because of decreasing incomes, profits, sales and consumption. In 2010 developed economies averaged fiscal deficit of 8.3% of GDP and public debt ratio of 97% of GDP. In 2006 the public debt to GDP ratio for advanced countries was 75% [2]. Optimal public debt levels for the group of developed states vary from 60% to 90% of GDP. A vicious debt spiral may be created if GDP growth falls below debt service expenses [3].

The sovereign debt crisis started in the beginning of 2010 when the return on Greek government bonds sharply rose because the market had doubts about the ability of Greece to meet its obligations. Soon interest rates became intolerably high for Ireland and Portugal as well and the three states were made to seek assistance from International Monetary Fund (IMF) and the European Union (EU) to compensate for the lost confidence of private lenders.

One of the main reasons for the debt crisis is the great disparity between the center and the outskirts of the EMU, which manifests in the different levels and trends of important macroeconomic indicators like per-capita income, consumption, saving and investment. Before the crisis the peripheral states tried to catch up with the center in their development through cheap foreign loans. The asymmetries between the center and the outskirts of the EMU are most obvious in saving and consumption. After the introduction of the Euro the peripheral countries took advantage of low interest rates, made loans and increased their consumption expenditures. For ten years (1997-2007) real consumption expenditures have grown by 55% in Ireland and by approximately 35% in Greece and Spain [1]. On the other hand, the share of consumption in Germany has been steady since 2001 which, combined with the high rate of saving, gives the country lots of money to lend abroad. The picture of imbalances is completed by investment trends.

The share of investment expenditure in GDP has slightly declined in Greece, remained constant in Portugal and risen in Ireland and Spain [1]. However, in the latter two countries the increase of investment share has been due to the boom in residential construction but not to a rise of productive capacity that can contribute to economic growth.

In brief, foreign loans have been used in Greece and Portugal to increase consumption and in Ireland and Spain to build residences. In all the four countries the increase of their foreign debt after the adoption of the Euro has been accompanied by a low rate of saving. The received foreign loans have not been used to increase productive capacity, to generate economic growth and decrease the debt burden. The imprudent use of foreign loans has made their service by the peripheral countries problematic.

In spite of this imprudent behavior of the troubled countries in borrowing and spending, the debt crisis is not only their problem but a systemic crisis of the whole EMU. If the crisis is not systemically solved it may affect all the EA.

The government debt crisis has political and institutional foundations because it is related to the political project of monetary integration and creation of the EMU. Finding a way out of the crisis requires new institutional framework of the EA and new decisions in the areas of monetary and fiscal policies.

The monetary union has intensified financial integration but has also deepened the imbalances and the asymmetries between the core and the outskirts of the EA. The main cause of the crisis is a structural defect of the EMU that lies in its very foundation: the implementation of a common monetary policy without fiscal integration (or at least fiscal harmonization).

## **2. Consequences from the government debt crisis**

The EA sovereign debt crisis has moved European integration to a critical stage. If the EA collapses or some member states leave it this will mean disintegration and bring the integration process decades back. The only exit is to build a more united and more integrated monetary union via fiscal integration or stronger coordination of fiscal policies of EA member states.

The debt crisis has raised the cost of the loans for the troubled countries, which have to adapt to the new situation of decreased foreign capital inflow. The monetary union membership has deprived Greece, Ireland, Portugal, Italy, and Spain of the opportunity to depreciate their currencies and substitute the decreased loans from abroad for higher export revenues.

The fiscal austerity measures in the troubled countries and the financial support they receive by the European money funds and the IMF are short-term, temporary actions which by themselves are not sufficient to solve a strategic problem of structural and systemic character.

The efforts to counteract the crisis in the troubled countries have concentrated mainly on the rapid and sharp decline of fiscal deficits. Though, the crisis and its consequences can be overcome solely by structural reforms for raising the competitiveness of the economies of affected countries, especially in tradable industries. Such structural adaptation can prove difficult under the conditions of decreased capital inflows from abroad, lack of autonomous exchange rate policy and fall in income and savings. Now the main challenge is to maintain steady economic growth and cut domestic expenditures at the same time.

Under a common currency a favorable scenario for adaptation to the crisis requires an increase in competitiveness of tradable industries. In order to be successful this increase must be accompanied by auspicious international economic conditions such as a rise in demand globally and in the core of the EA. An unfavorable adaptation scenario could occur under a decline in wages and a slowdown in consumption and investment in troubled countries. The limited opportunities to implement anti-cyclical fiscal policy in a monetary union might create a macroeconomic environment of deflation, high interest rates, huge fiscal deficits and banking crisis. In such an environment it is difficult to regain the trust of foreign lenders and investors.

The debt crisis solution requires the active participation of the EA core countries, which have to demonstrate solidarity with the periphery and political will for fiscal integration (or at least increased fiscal policy coordination of EA member states). European institutions need to be careful in selecting and implementing crisis exit strategies since under an economic slowdown liquidity problems can become solvency issues and spread all over the EA through the so called "contagion effects". So far policymakers have been unable to stop contagion and offer long-term measures for promoting competitiveness and economic growth.

Crucial to the crisis outcome will be the EU institutional response which has found expression in the creation of new tools to prevent financial crises: the European Financial Stabilization Mechanism (EFSM), the European Financial Stabilization Facility (EFSF) and the European Stability Mechanism (ESM).

The EFSM can render financial support to all EU member states, while the EFSF and the ESM are designed to provide funds for EA member states in distress.

The EFSF is a temporary special-purpose unit established to raise funds from financial markets and to deliver financial resources to troubled EA member states at interest rates lower than the market ones. The EFSF has been criticized about its similarities to other special-purpose vehicles such as the Collateralized Debt Obligations (CDOs) and the Structured Investment Vehicles (SIVs) that were in the center of the US mortgage crisis.

It should be emphasized that money funds can correct short-term money failures but not long-term structural problems. Money funds ought to be used with caution because the financial support they provide may have crowding-out effect on private lending and private lenders may become subordinate to the priority of money funds to act as lenders of last resort (LOLR).

(The role of the LOLR is to provide financial assistance in emergency situations. LOLRs are central banks at national level and the IMF on a global scale. The ESM will start acting as a LOLR in the EA in the summer of 2013.)

Money funds provide financial support on the condition that the states in distress implement certain programs for macroeconomic and financial stabilization. This should guarantee that troubled countries will really and truly do what is necessary to stabilize their economies and finance. The ESM will act as an international LOLR and will provide financial resources to EA member states when markets refuse to do so, at interest rates lower than the market ones. This will benefit not only the troubled countries but also its lenders. The ESM requires private sector involvement in the financing of problematic countries. The nature and the extent of this involvement depend on the implemented programs for financial and macroeconomic stability. The requirement of private sector participation in the financial support for troubled countries should guarantee the rational investment of granted funds and the elimination of possible crowding-out effects on private investment and lending.

### 3. The crisis impact on Bulgaria

The global economic crisis, the subsequent recession and the EA government debt crisis have delayed the processes of real and nominal convergence for several years. Before the global crisis Bulgaria was expected to adopt the Euro about 2015. Considering the delay in the integration process it is more likely that Bulgaria will join the EA at the end of this decade. The most probable scenario for the Euro introduction for Bulgaria is to maintain the currency board arrangement (CBA) and to observe the new crisis-imposed EU requirements. Bulgaria is a small open economy with limited resources in a CBA, in an EU membership and in a future EMU membership. This specificity demands macroeconomic policy consistent with new global and EU realities. Bulgarian macroeconomic indicators should be kept around the EA average in order to guarantee a fluent continuation of the process of nominal and real convergence. Bulgarian governments implement fiscal policies more restrictive than the European standards require. These policies could damage the growth potential of Bulgarian economy. Although Bulgaria has marked a faint GDP growth each quarter since early 2010, this economic recovery is deceptive because the main driving forces of economic growth – consumption and investment, decline. Only net exports are positive due to the increase in exports of raw materials. With a deficit financial account, with falling consumption and investment expenditures the growth prospects of Bulgarian economy cannot be good.

### Conclusions

The sovereign debt crisis in the Euro area went deeper and grew into a crisis of growth, which is proved by the forecasts of a negative growth in the Euro area for 2012. The development of the crisis has demonstrated that it is not merely a short-term crisis of liquidity but a result of deep structural and institutional problems at national and community level. The crisis can not be solved by simply pouring money into the economies of the states in distress but by implementing institutional and structural reforms at the level of Euro area and in the Euro area member states.

The competences of the Euro area institutions should be redefined, fiscal policies of Euro area member states should be strictly coordinated and new financial stability tools should be created to lend money only if the troubled countries implement national programs for macroeconomic and financial stabilization.

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## TOWARDS THE APPROXIMATION OF DIRECT TAXATION MODELS OF COMPANIES' INCOMES TAXES

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### **Abstract:**

*The inexistence of the harmonisation of the effective principles and the real non-homogeneity of the national's tax systems make the direct taxation a real factor of the competition for the companies. The companies, through specific planning and relocations, seek to exploit the current incompatibility of the national's tax systems in the field of direct taxation. In fact, this situation doesn't intend that the European tax harmonization in the field of direct taxation it is necessary to be pursued, but it means that an excessive incompatibility between the national's tax systems produces negative effects creating as result current distortions in the internal market and, in most cases, incompatibilities with the European order for which the Member States of the European Union need to apply a national tax policy in line with the European Union tax policy. Taking into consideration this issue, the proposed paper aims to analyze the question of the harmonization of national direct taxation systems in relation of the companies' incomes taxes with the European Union discipline taking into account that the task of the European Union is to supervise the Member States in way to ensure the correct application of the rules established by the European Union Treaty. In view of these purposes and final objective to respond improvement action in the field of direct taxation of companies' incomes, to verify if exist or not yet an European tax model for the direct taxation of the companies' incomes and to remove the distortions to internal market, the expected results of the research, being based on the analysis of the European Union discipline, will be the approximation and the coordination, in the context of the subsidiary principle, of national direct tax systems with the European Union discipline in order to ensure the community principles and the fundamental freedoms.*

**Key words:** companies' incomes taxes, approximation, cross-border activities, discrimination.

**JEL Classification:** K33.

### **1. Introduction.**

The companies, having as purpose to make more competitive their actions within internal market, use overall the incongruence and the fiscal incompatibility choosing between different national tax orders the tax system that offers the possibility to exploit the “*tax paradise*”.

In order to reach at a right conclusion for the role that plays the tax factor to the competition between the companies, it is relevant to individualize the entire process carried out by the European Union against the national tax provisions from which emerge the issues of distortions to the internal market, the harmful tax competition and also to guarantee the fundamental principles established by the Treaty of the European Union as well as the Court of Justice of the European Union, issues that highlight the relevance of the approximation of national direct taxation systems with the European discipline.

The choice of the companies to be located within internal market as well as inland the territory of the Third States directly affects the tax requirements of that territory.

This means that the companies located through a permanent establishment or a company branch in an area known as “*tax paradise*” feel certain fiscal facilities; the reason for which the Member States have established certain rules related to the Code of the Conduct approved by the Ecofin Counsel of 1 December 1997 whereas some national tax systems are protected in unilateral way<sup>292</sup>.

<sup>292</sup> One of this case is that of the Italian order which in the year 2002 has introduced the new discipline of Controlled Foreign Companies.



## I. Towards an internal market without tax obstacles for the companies.

The reform of the European Union in the field of direct taxation of companies' incomes it is crucial for achieving the Lisbon-strategic goal "...to become the most competitive and dynamic knowledge-based economy in the world..."<sup>293</sup>.

The taxation of companies can play an important role in achieving this objective and creating a level-playing field for businesses in the European Union. Related to this subject, the European Commission have prepared a comprehensive study that highlights the necessity to adopt company incomes direct taxation strategy in the European Union to the new economic framework and to achieve a more efficient internal market without tax obstacles<sup>294</sup> as well as the current application of company incomes direct taxation discipline in the internal market creates inefficiencies and prevents operators from exploiting its full benefits that imply the loss of European Union welfare, undermine the competitiveness of European Union businesses creating obstacles to cross-border economic activities in the internal market.

### 1.1. The initiatives of European Union in the field of the company taxation: from Neumark report to Communication (2001) 260 of European Commission.

The company taxation, since the founding of the European Communities, has received particular attention as an important element for the completion of the internal market. The realization of this objective has become subject of several studies such as the *Neumark Report* of 1962<sup>295</sup>, the *Segre Report* of 1966<sup>296</sup> and the *Tempel Report* of 1970<sup>297</sup> and also of a considerable number of legislative projects.

As result, derives a number of measures for the harmonization of the types of corporate incomes taxes and also of their tax bases. In 1975, the Commission had put forward new proposed directives that drawn in the years 1984-1985 result to be for more focussed on loss-compensation. In the year 1988, the Commission proposed a new draft directive whose purpose was the harmonisation of incomes company tax bases, a proposal that wasn't approved due the reluctance of most European Union Member States.

The failure of these various initiatives, rightly of subsidiary principle, generated in 1990 a new development in the field of the company tax discipline subject of the Communication [SEC 90/601] of the European Commission which suggested the consultation process with European Union Member States for the approximation of the company tax systems within the European Union for all the future actions. On this basis, based on the proposals of the European Commission which originated in the late of the years 1960-s, finally, in July 1990 are adopted three measures, two directives and one convention<sup>298</sup>.

In 1994, the Commission withdrew a first proposal aimed at abolishing withholding taxes levied on cross-border interest and royalty payments between associated companies of different Member States.

The approach of 1990 is developed in the years 1996-1997 with the Communication of Commission COM 97/495. The "*tax package*" and notably the Code of Conduct on Tax Competition in the field of corporate taxation open new scenarios to discussion.

<sup>293</sup> This objective, firstly, was established from the European Council in Lisbon in March 2000 and reiterated by the Stockholm European Council of March 2001 (Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, COM (2001), 582 final, Brussels, 23.10.2001).

<sup>294</sup> Communication "Tax Policy in the European Union", COM (2001) 260.

<sup>295</sup> The Neumark Report (EC, 1962) proposed the creation of an economic area without "artificial" barriers. It highlighted the need to reduce economic distortions resulting from different tax systems. For more see: HÖLZLER, (1976), *Harmonization of company taxation systems*, Intereconomics Review of European Economic Policy, Vol. 11, n. 1, Germany.

<sup>296</sup> The Segre Report found that the national markets in Europe discriminated in favor of domestic borrowers, especially, national governments, as against foreign, primarily through regulations governing the investments of funds of savings bank and insurance companies. For more see: ARNER, *Financial Stability, Economic Growth and the Role of Law*, 2007, p. 330, Cambridge.

<sup>297</sup> The van den Tempel Report (Commission of the European Communities 1970) recommended the classical corporation tax as the best form of the taxation. For more see: VANISTENDAEL (1992), *The Ruding Committee Report: a personal view*, [Fiscal Studies](#), Vol. 13, n. 2, pp. 85-95, London.

<sup>298</sup> *Merger Directive 90/434/CEE, Parent-Subsidiary Directive 90/435/CEE, Arbitration Convention 90/436/CEE* (Communication from the Commission to the Council, to European Parliament and to Economic and Social Committee, *Toward an Internal Market without tax obstacles – A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities*, [COM (2001) 582], Brussels 23.10.2001, page 4).

In 1999/2000, the Council, with the objective to integrate the ongoing work relating the tax package, requires the Commission a comprehensive study of corporate tax regime that is finally finalized with the adoption of the Directive 2003/49/EC, finally approved during the Ecofin Council in the 3 June 2003, relating the applicable regime on the interest and royalties of companies. With the Communication of the 23 October 2001, the Commission has proposed, in relation to tax obstacles of the internal market, a twin-track strategy which provides a series of short-term measures and also a comprehensive strategy of medium term that will provide the multinational companies the possibility to take advantage by an European tax system for the consolidation of the tax base for the companies with community dimensions.

*1.2. The new strategy of the European Commission for the abrogation or reduction of the company tax obstacles to cross-border economic activity in the internal market.*

The Commission services study<sup>299</sup> has identified a number of fields in which company tax comprise or lead to obstacles to cross-border trade, establishment and investment or hamper cross-border economic activity in the internal market. The additional tax or compliance burdens associated with doing business in more than one Member States caused by these obstacles undermine the international competitiveness of European companies and waste resources.

In particular, the obstacles are related to: the allocation of the profits on an arms' length basis by separate accounting on a transaction by transaction basis that gives, *inter alia*, to numerous problems in the fiscal treatment of infra-group transfer pricing, notably in the form of high compliance cost and potential double taxation; cross-border flows of income between associated companies are often subject to additional tax, in particular, withholding taxes on *bona-fide* intra-group payments of dividends, interests and royalties contain a risk of double-taxation and are not in line with the internal market idea; major limits on cross-border loss relief which may lead to double-taxation; cross-border restructuring operations give rise to substantial tax charges, the reason for which the Merger Directive (90/434) provides for the deferral of corporate tax on such operations but its scope is too narrow and its implementation in Member States is very difficult, consequently, as result of capital gains taxes and transfer taxes on cross-border restructuring operations are often prohibitively high, the companies are forced to leave economically sub-optimal structures untouched; the specific problems relating to double taxation conventions in the EU.

Most of these problems stem from the fact that companies in the EU need to comply with the different sets of rules of Member States taking into account that these companies increasingly target the EU as one market, this conflict with economically efficient business plan and structures. The multiplicity of tax laws, conventions and practices entails substantial compliance costs and represents in itself a barrier to cross-border economic activity.

To abrogate or reduce the above-mentioned company tax obstacles, the study identifies the targeted measures, concretely: the Commission will, in concert with the Member States, must propose to develop guidance on important European Court of Justice rulings and to co-ordinate their implementation; the Commission will give priority to tabling the necessary amendments to the existing proposals for extension of the Merger Directive and the Parent-Subsidiary Directive; the Commission will withdraw its old proposal for a directive concerning cross-border loss-offset and to examine the Danish joint taxation system<sup>300</sup>; the examination of the issues which can be addressed without legislative initiatives to develop and exchange best practice on Advance Pricing Agreements and documentation requirements as well as the Convention must be improved and turned into an instrument of European Union law; a common approach to double taxation treaty issues will help to overcome the current complexities; the perspective of an European Union version of the OECD model convention against the double taxation of the incomes; the need to adopt certain provision of double taxation conventions based on the OECD model to comply with the Treaty principles, an attempt that will constitute the first step towards the possible elaboration of an EU model tax treaty.

*1.3. The consolidated corporate tax base: a positive measure for the company tax systems in the EU?*

The above targeted solutions would go some way towards remedying the tax obstacles. However, even if all of them were implemented, they would not address the underlying problem of dealing with up to different tax systems. Only providing multinational companies with a consolidated corporate tax base for their EU wide activities will significantly produce the follows results: the reduction of the compliance costs resulting from the need to deal with different tax systems within the internal market; do away within the EU with transfer pricing problems;

<sup>299</sup> Executive Summary of the Commission Services Study on "Company Taxation in the Internal Market", SEC (2001) 1681.

<sup>300</sup> In certain cases, Danish joint taxation system enables Danish parent companies and in addition to their branches also foreign subsidiaries to be taxed jointly in Denmark, thereby enabling the parent to take into account losses incurred by foreign subsidiaries. This would attempt to achieve a greater symmetry between the taxation of profits and the offset of losses.

to allow for the offsetting and comprehensive consolidation of profits and losses of an EU basis; simplify many international restructuring operations; the reduction of certain complexities arising from the co-existence of the classical and exemption approaches to international taxation; to avoid many situations of double taxation and remove many discriminatory situations and restrictions.

## II. The role of the European Court of Justice to guarantee the right of establishment of companies and the freedom of movement of capitals in the fiscal context.

The global behaviour to the European taxation seems to be founded at a detailed and explicit interpretative activity of the Court of Justice of European Union. Distinguished for its dynamic and evolutes interpretative sense of the European order, the Court of Justice of European Union has subjected the direct taxation also to the fundamental freedoms of establishment of companies and movement of capitals, establishing the basis for an intervention of European legislator in the field of the harmonization of direct taxation, nevertheless its qualification to the exclusive competence of the Member States.

The behaviour of the Court of Justice of European Union has permitted to super the formal difficulty to the tax issue addressed to the explicit competence of the European Union, individualizing to the Treaty of European Union the basis of an European direct taxation. Highlighting that the Member States are obligated to exercise their competence in conformity with the European law, the Court of Justice of European Union has enlarged the field of application of direct taxation related to the principle of non discrimination in the matter of the freedom of establishment of companies and movement of the capitals. To the interdiction of the discrimination the Court of Justice of European Union has readdressed also the interdiction of any discrimination dissimulated or realized to the damage of the non residents subjects.

These developments evidence the gradual but decisive activity for the construction of an European direct taxation to the opera of the Court of Justice of European Union, to the response of the distortions effects derived by the presence of discriminatory national provisions.

### 2.1. The principles established by the European Court of Justice to guarantee the right of establishment of companies and the freedom of movement of capitals in the fiscal context.

The harmonization realized in the field of companies taxation it is, in fact, result of the application of provisions contained to the article 115 of the European Union Treaty related to the approximation of the legislations (*ex. article 94 of CEE Treaty*)<sup>301</sup> that request the unanimity for the acts of the Counsel and for which the field of direct taxation remains as an exclusive competence of the Member States. However, also in this field the Member States must observe the principles and the interdictions established to protect the general purposes of the European Union. Among the instruments that permit the realization it is identified *in primis* the establishment of the internal market characterized by the elimination, between the Member States, of the interdiction to free movement of the goods, persons, services and capitals<sup>302</sup>. The principles of the equality to the fiscal treatment and the interdiction of the discrimination, among the others, assume then an importance at the perspective of the valuation of the conformity of the domestic legislations with the European purposes.

The extensive interpretation adopted by the European Court of Justice for the interdiction of discriminatory restrictions sanctioned to the European Union Treaty and of the most general of the non discrimination principle in the base of the nationality has permitted the application to the question of fiscal nature of so-called "*fundamental freedoms*".

<sup>301</sup> "The Counsel, establishing with unanimity to the proposal of the Commission and consultation of the European Parliament and of the Economic and Social Committee, establishes directives addressed to the approximation of the legislative provisions and administrative of the Member States that have a direct influence to the establishment or function of the internal market".

<sup>302</sup> «The Community has the mansion to promote at the whole of the Community, between the establishment of a common market and of an economic and monetary union and among the application of common policies and actions as sanctioned to the articles 3 and 4, an harmonized development, equilibrated and sustainable of economic activities, a high level of occupation and social protection, the equality between the men's and woman's, a sustainable enlargement, a high degree of the competition and convergence of economic results, a high level of the protection of the ambient and the improvement of the quality of this last, the improvement of the level and quality of the life, the economic and social cohesion and the solidarity among the Member States».

Then, to the European Court has ascertained the delicate mansion to exercise the action of the intermediary in way to equilibrate the purposes of the European Union Treaty and the tax subsidiary principle protected from the Member States of European Union.

To general terms, the principle of the non discrimination imposes that analogue situations must not be treated at the same way except the case when that treatment isn't justified objectively<sup>303</sup>. In fact, the tax provisions only in specific cases produce directly a distinction in the base of the nationality.

A different treatment founded to the residence or to the legal office of the company can constitute a dissimulated discrimination in the base of the nationality. Essentially, the European Court of Justice has clarified that the principle of the equity prohibits not only the overt discrimination founded to the nationality but also the covert discrimination, nevertheless founded to others criteria's of distinction, in fact arrive to the same result<sup>304</sup>.

In addition, can be a covert discrimination if the related provision it is entirely susceptible to influence at the discriminated category more than doesn't result with that of not discriminated and if there exist the subsequent danger that the first it is subjected to a specific situation not favourable<sup>305</sup>.

However, the Court, subsequently, has integrated and become more organic its reasonable interpretation establishing that doesn't exist discrimination in the case where the presumed discriminatory provisions are justified as result of objective considerations independently from the nationality of the interested persons when those are in proportion with the legal objective to follow from national legislation.

The jurisprudence of the European Court of Justice in the field of the interdictions and restrictions of fundamental freedoms permits to evidence certain principles related to the possible cases of justification of the treatment disparity among the resident and not resident subjects. However, must evidence that the European Union Treaty prevue a series of derogations related to the fundamental freedoms and to the principles of non discrimination founded to some important national interests as the reasons of public order, public security and public sanity.

The fundamental reason of the justification derived from the pronouncements of the European Court of Justice is related to the so-called "*principle of the coherence of tax systems*" called to a multiple sentences of the Court and effectively to the condition guarantee the direct applicability of the principle of equal treatment. In fact, the principle of subsidiary of the Member States to the direct taxation, except the application of the European law, brings to the necessity to guarantee the integrity and the coherence of the domestic tax systems, eventually also between the introduction of the provisions that prevue a different treatment for the situations that reasonable are different<sup>306</sup>.

Except the coherence of the tax regime, exist others possible cases of justification of restrictions to the freedoms of establishment related to the necessity to guarantee the efficacy of the tax controls, to eliminate the difficulties of administrative order, to the necessity to eliminate the reduction of the taxable income and also to contrast the fiscal evasion and the fiscal elusion.

## 2.2. The sentence BGM Verkooijen (C-35/98) and the freedom of movement of capital: conclusions to the future perspectives.

Differently to other fundamental freedoms prevue to the European Union Treaty, to the freedom of movement of capitals is recognised a direct effect, one of the purposes that the Member States should realized to guarantee the final purpose: the function of internal market. The liberalization of the movement of capitals it is entirely realized only with the adoption of the directive 88/361/CEE of 24 June 1988<sup>307</sup>, entered in force in 1 July 1990 that has prevue the abrogation of the restrictions to the movement of capitals in the European field.

In the basis of the conflict was request to the Dutch Tax Administration the exemption of Mr. Verkooijen to the taxation in way to obtain the possibility to be exempted from the final tax that he must pay to the taxable income at the moment of the distribution of the dividends from a Belgium society. These dividends were subject of the taxation in source in Belgium of 25% rate tax.

<sup>303</sup> Sentence Sermide v Cassa Conguaglio Zucchero and Others, 13 December 1984, C-106/83, Raccolta 1984, point 28. This classic phrase it is utilized at a series of decisions of the European Court of Justice. V. UCKMAR, *Corso di Diritto Tributario Internazionale*, Italy 2006.

<sup>304</sup> Sentence Sotgiu, 12 February 1974, C-152/73, Raccolta 1974, point 11 "the rules regarding the equality of treatment between nationals and non nationals forbid not only overt discrimination by reason of nationality but also all covert forms of discrimination which by the application of other criteria of differentiation, lead to the same results".

<sup>305</sup> About this question it is recommended to consult the Sentence O'Flynn v Adjudication Officer, 23 May 1996, C-237/94, Raccolta 1994, point 20.

<sup>306</sup> Sentence Bachmann c/Kingdom of Belgium, 28 January 1992, C-204-90, Raccolta, 1992, page 249.

<sup>307</sup> GUCE, L. 178 of 8.08.1988, page 5 ss.

The tax administration doesn't accepted the application to the dividends distributed from the Belgium society haven't detrained the Dutch tax to the dividends, a necessary requirement in application of the Dutch legislation to obtain the exemption requested.

Against the decision of the first grade where it is presented the request of Mr. Verkooijen, the Dutch Tax Administration presented a request to the High Court Hoge Raad that has suspended the judgement asking to the European Court of Justice to recognize if the Dutch provision it is compatible with the provision contained to the directive 88/361/CEE of 24 June 1988.

The European Court of Justice has valuated that the domestic legislation of a Member State doesn't subordinate the concession of an exemption from the tax income, to the which are subjects the dividends distributed to individuals persons that are in possession of the incomes, to the condition that these dividends are pay from the societies that has the legal office to this Member State, discriminating in this way the dividends pay from societies residents to an other State of European Union<sup>308</sup>.

In fact, this sentence it is noted for its relevant importance because enlarged for the first time to the freedom of movement of capital the principles established in the field of others fundamental principles. In particularly, this sentence brings relevant implications for the Member States in the field of direct taxation of dividends. The interdiction of any discrimination founded to the residence imposes to the Member States the requirement to approximate their domestic legislation to the European law due the different tax treatment, verified in a major part of Member States, based to place of establishment of the society that distribute the dividends.

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<sup>308</sup> M. DASSESSE. J. MALHERBE, P. MALHERBE, *Fiscalité européenne : impôts directs*, Paris 2005-2006.

**MACROECONOMIC ASPECTS OF PROPORTIONAL TAXATION OF CENTRAL AND EASTERN EUROPE**

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**Abstract:**

*Macroeconomic aspects of proportional taxation of Central and Eastern Europe. Over the last decade, most countries in Central and Eastern Europe have adopted proportional taxation as a measure to stimulate economic activity. The lack of conclusive empirical evidence, impaired social justice and the need to stimulate the economy, especially in a crisis moments, raise the issue of more clearly define the benefits of applying proportional taxation. The working paper aims to quantitatively test the underlying assumption in stimulating economic effects of administration of the tax. The object of empirical study is proportional taxation of the CEE countries (Bulgaria, Montenegro, Macedonia, Romania, Serbia, Slovakia, Albania, Russia and Georgia) and its impact on basic macroeconomic indicators such as GDP, employment, inflation, government debt and foreign direct investment. In order to conduct the econometric study of searched dependencies will apply an econometric methodology based on vector autoregressive model (VAR).*

**Key words:** Gross Domestic Product, Proportional Tax, Employment, Investment, Inflation

**JEL:** E62; H21;H24.

Over the last decade, most countries in Central and Eastern Europe have adopted proportional taxation as a measure to stimulate economic activity. The lack of conclusive empirical evidence, impaired social justice and the need to stimulate the economy, especially in a crisis moments, raise the issue of more clearly define the benefits of applying proportional taxation. The working paper aims to quantitatively test the underlying assumption in stimulating economic effects of administration of the tax.

The object of empirical study is proportional taxation of the CEE countries (Bulgaria, Montenegro, Macedonia, Romania, Serbia, Slovakia, Albania, Russia and Georgia) and its impact on basic macroeconomic indicators such as GDP, employment, inflation, government debt and foreign direct investment. In order to conduct the econometric study of searched dependencies will apply an econometric methodology based on vector autoregressive model (VAR).

Proportional taxation is speeding up more and more in the countries from Central and Eastern Europe. As a way of putting a tax on personal income, a number of countries have accepted the system of proportional taxation in order to increase their economic activity. The flat tax originates in the Baltic States. Estonia and Lithuania are the first contemporary countries that introduced the system of putting a flat tax on individual income in 1994. Thus they laid the "foundations" and other countries followed their example: Russia in 2001, Serbia in 2003, Slovakia in 2004, Georgia in 2005, Rumania in 2005, Albania in 2007, Macedonia in 2007, Montenegro in 2007, Bulgaria in 2008, the Czech Republic in 2008.

The incredible success that Estonia achieved according to some economists<sup>309</sup>, (**Mart Laar**) was an example for an increasing number of countries. Despite the incredible success in the countries from Central and Eastern Europe for many developed countries proportional income taxation is still a heresy. There is no well-developed economy that puts a tax on the income of its people with a flat rate.

<sup>309</sup> Ran, R. Estonia - a small country that could ", Institute for Market Economics, 2011.

Much of the econometric research doesn't give a simple answer that proportional taxation itself doesn't lead to increase in economic growth. The lack of a cause-and-effect relationship between this kind of taxation and the higher economic activity turns flat rate into one of the most discussed topics in the economic literature<sup>310</sup>.

The controversial results from the macroeconomic indicators of applying the proportional taxation on income are the reason why many economists are dealing with the efficiency of this system.

Observing the high economic growth of the Baltic countries after accepting the proportional taxation is found in Greenberg's research (**Greenberg, D**)<sup>311</sup>. According to the author the real effect of the flat tax on the economic growth remains ambiguous. The high economic activity is influenced by factors such as economic state, level of open economy, geographic position, and relations with the EU. Due to these similarities analysis can be made on the efficiency of the flat tax and the influence on the main macroeconomic indicators such as: tax revenue gained from individual income, GDP growth, employment. The analysis on the corresponding indicators aims to show if proportional taxation is a powerful means for economic growth and an effective regulator with redistributive effect. Despite the high correlation between the economic growth of the Baltic states and the applying of the flat tax Greenberg's economic analysis proves the lack of a positive influence on the increase of economic activity due to flat rate. Every country, apart from Ukraine, that has introduced proportional taxation has also introduced fiscal reforms in order to compensate for the lack of money.

The higher employment and the better income are not empirically proven, that the increase is due to the flat tax. According to the research on taxpayers it is too small and the main argument for accepting proportional taxation in the economies in transition is its simplicity. One of its advantages is that it places all taxpayers in one system where people can pay taxes easily and the government can manage them easily. This is the only reason for applying the flat tax in other countries as well. Thus, the first countries that have accepted the system of flat tax (Estonia, Lithuania, and Latvia) showed better results but the next countries (Russia, Serbia, Slovakia) introduced similar kind of taxation but didn't have similar success. The author comes to the conclusion that there is no evidence that the flat tax itself doesn't lead to growth, higher employment and higher tax income.

Actually the analysis on the Baltic States doesn't show that income taxation by proportional tax in some cases can have positive influence on some macroeconomic aspects. For example in Latvia there is a significant decrease in the part of the gray economy.

That's why even though there is no final empirical evidence that the flat tax enables economic growth, simplicity of applying and taxation may increase some economic indicators during the earlier years of transition. Despite this there is no convincing evidence that flat tax is a suitable model for growth.

The results from proportional taxation after its acceptance in Russia a panel survey with statistics database has been made by **Ivanova, A. Keen, M. Klemm, A.**<sup>312</sup> The reform of the income tax is considered to be extremely influential since for the first time such big economics accepts proportional taxation in order to tax the individual income of its people.

According to the International Monetary Fund the research on the use of the flat tax in Russia can be referred to as fundamental, the contributions and the contributions could served as an example also for the other countries that have accepted the system of flat tax.

The aim of the research is to show the influence on the economic activity of certain macroeconomic indicators. Variables such as GDP, employment, increase in income, personal income tax have been examined and the examined period is before and after the acceptance of proportional taxation of the years between 1994 and 2003.

The results from the reform that was carried out in Russia come to several specific conclusions with the help of the econometric research. During the period of proportional taxation there was a significant increase in personal income. But this itself was not caused by the low taxes, but by a number of other factors such as increase in the price of energy sources. The research rejects the idea that flat tax contributes to the actual increase in income.

According to the authors the analyzed results of the proportional taxation don't show clear results that low taxes contribute significantly to the increase in personal income. There is no specific evidence that the change in taxation has a highly stimulating effect on the changes connected with employment. All this is directly related to the elasticity of offering more well-paid labor.

According to the authors the increased budget income from the proportional taxation has a proportional relationship with the increased income, which is not due to the reform.

Russian experience in income tax a flat tax is widely echoed in academia. Essentially the reform itself didn't lead t the expected economic effects.

Positive resonance, however, can be found when the decrease in the tax rate encourages leaving the shadow economy.

<sup>310</sup> Ganchev.G. "Finance as a system: evolution, theory, policy," 2010.

<sup>311</sup> Greenberg, D. „The Flat Tax: An Examination of the Baltic States”

<sup>312</sup> Ivanova, A. Keen, M. and Klemm, A. IMF Working Paper „The Russian Flat Tax Reform” 2005.

Based on the analyzed statistic data a conclusion can be drawn that proportional taxation can hardly have a stimulating effect on the macroeconomic indicators.

Studies of these effects in the flat tax concerning the low economic growth have been found and confirmed by econometric models in other studies. Works in this field were done by Kochi, J. (Kochi, Y.) for Albania and Petkov, K. (Petkov, K.) for Bulgaria, and the two empirical studies examined the possibility of a flat tax for economic growth. The works confirm the thesis that the [proportional taxation is not able to generate positive economic growth. The authors study the two countries with the lowest tax rates applying proportional taxation and its impact on the economic growth. For example Kochi confirms that the flat tax introduced in the last decade in most countries in the region did not significantly improve the economic efficiency, the direct foreign investment, the employment and tax revenues.

A study concerning the economic efficiency and the inequality that occurred after the application of the flat tax are in empirical research in Romania. **Voinea, L. Mihaescu, F.**<sup>313</sup> conduct a research by calculating the impact of the introduced in 2005proportional income taxation. The variables that the authors use as their evidence are: economic growth, GDP and tax revenue. With a view to this thesis, they come to the conclusion on the basis of econometric estimates that implementation of the proportional tax system in Romania proved to be an ineffective reform for the country. Thus the main reasons are the low individual income taxation and the rising social inequality after the reform. The increasing social inequality is estimated by a Gini index, the results of which show the redistributive effect of the flat tax, and the shift in funds from low-income to high-income groups is clearly distinguished.

According to them the poor economic condition, the reduced purchasing ability of the population and the deepening crisis with domestic demand can be increased only if immediate actions on the method of income tax are taken. Romania is one of the countries whose worse income is the reason for a considerable increase in the external debt. The end of the crisis can be reached with a change in income tax by switching to a progressive income tax. According to the authors the in-built automatic stabilizers of the progressive taxation can have a positive influence on the deteriorated income, the increasing social inequality and the low purchasing ability, measures recommended by the International Monetary Fund. Thus, Romania became the first country that will adopt tax rate as a means of taxation in 2013 and will replace the current system of flat tax.

#### **Empirical study**

The empirical study includes data on the growth rate of gross domestic product, employment, public debt, inflation, foreign direct investment, savings and tax revenues of the countries of Central and Eastern Europe- Bulgaria, Montenegro, Macedonia, Romania, Serbia, Slovakia, Albania, Russia and Georgia and covers the period from 2002 to 2010.

The econometric model analysis Vector Autoregressive Model (VAR) with the following standard form:

$$y_t = A_1 y_{t-1} + \dots + A_p y_{t-p} + Bx_t + \varepsilon_t$$

Where

$y_t$  - vector of endogenous variables

$x_t$  - vector of exogenous variables

$A_1 \dots A_p$  and  $B$  - are matrices of coefficients

$\varepsilon_t$  - vector of innovations

Used in VAR analysis variables are identified by different codes depending on the studied variable and lag horizon. Presented in Table 1 Indications used in data provided by econometric models and made in the analyzes based on them.

<sup>313</sup> VOINEA, L. MIHAESKU, F. „The Impact of The Flat Tax Reform on Inequality” – The Case of Romania 2009.



Table1

<sup>1</sup>	<i>Index</i>	<i>Variable</i>
1.	GDP	Growth rate of <b>Gross Domestic Product (GDP)</b>
2.	GDP(-n)	Growth rate of <b>(GDP)</b> with lag t-n
3.	EMP	Growth rate of <b>Employment</b>
4.	EMP (-n)	Growth rate of <b>Employment</b> with lag t-n
5.	GDEB	Growth rate of <b>Government Debt</b>
6.	GDEB (-n)	Growth rate of <b>Government Debt</b> with lag t-n
7.	INF	Growth rate of <b>Inflation</b>
8.	INF(-n)	Growth rate of <b>Inflation</b> with lag t-n
9.	INV	Growth rate of <b>Foreign Direct Investment</b>
10.	INV (-n)	Growth rate of <b>Foreign Direct Investment</b> with lag t-n
11.	SAV	Growth rate of <b>Savings</b>
12.	SAV (-n)	Growth rate of <b>Savings</b> with lag t-n
13.	TAX	Growth rate of <b>Tax Revenues</b>
14.	TAX (-n)	Growth rate of <b>Tax Revenues</b> with lag t-n

Searching for specific economic channels through which the proportional taxation influences the economic activity of investigated countries, we direct our research to determine the direct influence on the dynamics of GDP, EMP and INV from the point of view of the dynamics of TAX. It is important to find out if there is synchronicity and dependence during the investigated period between dynamics of the incomes of the applying of proportional taxation and the macroeconomic indexes of economic activity mentioned above. Thanks to the used methodology of econometrics based on VAR we can measure the direct influence of every investigated macroeconomic quantity on the others through/via its statistic significance and weight in regressive equation of the given variable.

Examining the results of the whole period of investigation (2002-2010) we concentrate our interest on the variables giving the most correct idea of the levels of economic activity, namely GDP, EMP and INV – variables which must be the most sensitive to the transition of the tax system to the proportional taxation in accordance with the theory of applying of this taxation. The including of the rest variables shown in the VAR models aims to represent a wider picture of interaction of the investigated macroeconomic variables, but because of the aims of the current investigation and in order a higher concentration of this research to be reached, we focus on the basic ones with changeable expression of the macroeconomic activity, namely GDP, EMP and INV. The applied econometric research through VAR models of the analyzed variables is made in lag horizons to 2 lags.

#### **About Gross Domestic Product-GDP**

Analyzing the first and basic macroeconomic variable, namely GDP, we must say that the used VAR models do not show any presence of statistic connection between the dynamics of TAX and this of GDP. The only important one is made indirectly with the help of EMP and this is one lag backward – TAX (-1) to EMP to GDP. Having in mind the sing of statistically significant coefficients we can point out that the connection between TAX (-1) and EMP is inversely proportional, and this one between EMP and GDP is directly proportional. Generalizing the results we can conclude that the dynamics of GDP the same of the tax incomes from the proportional taxation doesn't have any direct influence but only indirect with the help of EMP but this connection is inversely proportional. This result poses a problem which of the investigated variables influence on GDP. Statistically important values toward GDP we find in dynamics of EMP and the savings in both lags of investigation, also in the dynamics of investment in lag **t-2**. It is expected to have such results as long as these indexes are examined by macroeconomic theory as basic determinants of GDP and its dynamics. It is obvious that in three variables – EMP, SAV and INV – statistically significant coefficients to lags **t-1** and **t-2** are negative. This fact is in contrast with the positive sign of the factors in lag **t**. This observation can be explained with the need of time for this mix of variables to start functioning in economics and to provoke the necessary dynamics of GDP. To confirm this we shall point out that at the moment **t** variables EMP and SAV have statistically significant coefficients toward GDP with positive sign showing one-way synchronicity in the rates of changing of GDP, EMP and SAV.

#### **About employment - EMP**

Examining the statistically significant determinants of the dynamics of EMP we must point out the absence of dynamics of tax incomes in lag **t**. Such kind of dependence exists only in lag **t-1** and it is with negative sign of the coefficient (-1.27E-12). So, we must conclude that at the moment **t** dynamics of tax incomes is not connected with the dynamics of EMP.

There is such a connection only in lag  $t-1$  but it shows the presence of inversely proportional connection. With statistically significant determinants of EMP we can put on the place the strong significance of the dynamics of GDP (6.57E-13) and we must say that the influence of GDP toward EMP is much higher than the influence toward GDP – the value of coefficients is 6.57E-13 against 2.80E-13. We must point out that the dynamics of EMP may follow the tendencies in its own dynamics. It is shown by the statistically significant and with positive sign coefficient of EMP (-1) against EMP, namely 1.54E-12. The dynamics of INV influences EMP but here the statistically significant coefficient is with negative value.

We must mention the influence of GDEB on the dynamics of EMP. There are statistically significant coefficient in GDEB (4.84E-13) and GDEB (-1)(-6.58E-13). These values let us conclude that at the moment  $t$  influence of the dynamics of GDEB is relatively significant, the value of the coefficient is the second one from all the determinants of EMP and relatively closer to this of GDP. This influence, however, is quickly consumed in moment  $t$  and in moment  $t-1$  it is already with negative sign and bigger absolute value. So, we can conclude that the dynamics of GDEB against EMP has stronger influence in moment  $t$  but it can't follow longer tendencies. The presence of statistically significant coefficients of GDEB in both lags with relatively high values show the active usage of GDEB as instrument of influence on EMP.

#### **About Investments - INV**

The analysis of determinants of the dynamics of the Direct Foreign Investments shows the presence of two basic factors demonstrating relatively longer influence, namely the dynamics of GDEB and EMP. Examining the influence of GDEB we must say that there are statistically significant values for the three lags of investigation -  $t$  (2.38E-13),  $t-1$  (-3.82E-13) and  $t-2$  (1.78E-13). In that way we can mark the presence of relatively longer influence of GDEB on the levels of investments. Having in mind that both of the lags have positive values of coefficients and only one in negative we could accept that there is clearly shown and one-way synchronicity in the dynamics of GDEB and this of investment. The negative value to lag  $t-1$  can be explained with the stronger influence of GDEB to lag  $t$  which leads to a compensating reaction to lag  $t-1$  with negative sign of coefficient, but all in all the dynamics of GDEB in a long-term plan follow the common tendency about which the positive sign of the coefficient to lag  $t-2$  testifies.

The next in demonstration to the examined lags, but with highest absolute values of coefficients of determinants toward INV is the variable EMP. The demonstration of this variable is registered by the statistically significant values to lag  $t$  (-5.18E-13) and  $t-1$  (5.37E-13), and judging by the absolute values of these coefficients we can conclude that about dynamics of Direct Foreign Investments the most important variable is the dynamics of EMP. The presence of positive value in moment  $t-1$  and followed by negative in moment  $t$  but relatively close absolute values of coefficients it can be expected by the need of time for initial establishment and developing of investments followed by hiring of personnel and this process is mentioned in the dynamics of levels of EMP. The presence of such a relationship can be judged by VAR model of EMP where INV have relatively high value of coefficient of determination in moment  $t$  and it is with negative sign. About relatively strong relationship between EMP and INV we can judge and coefficient of GDP against dynamics of INV, it is 2.38E-13 about lag  $t$  and -3.82E-13 about lag  $t-1$ .

#### **Conclusions**

1. There is no presence of synchronicity and determination between dynamics of GDP and Tax Incomes in the conditions of applying of proportional taxation. As determinants of GDP are registered Employment, Savings and Direct Foreign Investments, as the most – relatively long and significant is the dependence between Employment and Savings.
2. In lag  $t$  the dynamics of Tax Incomes is not involved and it doesn't define the dynamics of Employment, such kind of relationship is noticed only in lag  $t-1$  but it registers the presence of inversely proportional relationship. About the dynamics of Employment the main determinant is GDP followed by the dynamics of Government Debt, as the influence of the last variable is relatively longer.
3. The dependence between dynamics of Direct Foreign Investments and Tax Incomes in conditions of applying of proportional taxation is not registered. About the dynamics of Direct Foreign Investments the most important is the influence of the Government Debt is relatively longer, but this of Employment is much stronger.

#### **Table2**

##### **Statistical results of the estimation of the equation (1)**

Vector Autoregression Estimates

Sample (adjusted): 2002 2010

Included observations: 51 after adjustments

Standard errors in ( ) & t-statistics in [ ]

	GDP	EMP	GDEB	INF	INV	SAV	TAX
GDP(-1)	-7.61E-14 (2.7E-14) [-2.79676]	2.92E-13 (2.2E-13) [ 1.32690]	-2.70E-13 (1.0E-13) [-2.60815]	-1.57E-13 (4.2E-14) [-3.77208]	8.06E-14 (8.3E-14) [ 0.97591]	-1.20E-14 (1.1E-13) [-0.10931]	-3.40E-14 (2.2E-14) [-1.54638]
GDP(-2)	-1.02E-14 (2.5E-14) [-0.41384]	-7.16E-14 (2.0E-13) [-0.35827]	-1.98E-13 (9.4E-14) [-2.10292]	-2.60E-14 (3.8E-14) [-0.68478]	-9.31E-15 (7.5E-14) [-0.12407]	-3.69E-14 (1.0E-13) [-0.36853]	2.31E-14 (2.0E-14) [ 1.15708]
EMP(-1)	-1.69E-13 (4.2E-14) [-3.97958]	1.54E-12 (3.4E-13) [ 4.49849]	4.18E-13 (1.6E-13) [ 2.59284]	-1.53E-13 (6.5E-14) [-2.35642]	5.37E-13 (1.3E-13) [ 4.17314]	8.89E-13 (1.7E-13) [ 5.17718]	-1.47E-13 (3.4E-14) [-4.27949]
EMP(-2)	-7.49E-14 (3.9E-14) [-1.93037]	3.14E-14 (3.1E-13) [ 0.10010]	-7.57E-13 (1.5E-13) [-5.13082]	-2.13E-13 (6.0E-14) [-3.58348]	-3.86E-14 (1.2E-13) [-0.32794]	-4.00E-13 (1.6E-13) [-2.54779]	3.72E-15 (3.1E-14) [ 0.11888]
GDEB(-1)	2.14E-14 (3.9E-14) [ 0.54167]	-6.58E-13 (3.2E-13) [-2.06299]	-2.21E-13 (1.5E-13) [-1.47393]	-6.78E-14 (6.1E-14) [-1.12041]	-3.82E-13 (1.2E-13) [-3.19002]	-1.44E-13 (1.6E-13) [-0.89981]	-2.12E-14 (3.2E-14) [-0.66567]
GDEB(-2)	6.52E-15 (2.4E-14) [ 0.27364]	2.09E-13 (1.9E-13) [ 1.08545]	1.08E-13 (9.1E-14) [ 1.19350]	6.54E-14 (3.7E-14) [ 1.79151]	1.78E-13 (7.2E-14) [ 2.45769]	6.40E-14 (9.6E-14) [ 0.66414]	3.39E-14 (1.9E-14) [ 1.76127]
INF(-1)	1.71E-14 (1.8E-14) [ 0.94219]	-9.16E-15 (1.5E-13) [-0.06223]	7.75E-14 (6.9E-14) [ 1.12075]	3.69E-14 (2.8E-14) [ 1.32270]	-3.30E-14 (5.5E-14) [-0.59808]	-1.06E-14 (7.4E-14) [-0.14338]	-1.14E-16 (1.5E-14) [-0.00773]
INF(-2)	-1.00E-14 (1.6E-14) [-0.60858]	-4.52E-15 (1.3E-13) [-0.03396]	2.15E-14 (6.3E-14) [ 0.34372]	-1.63E-14 (2.5E-14) [-0.64400]	4.26E-14 (5.0E-14) [ 0.85196]	1.02E-13 (6.7E-14) [ 1.53523]	-4.41E-15 (1.3E-14) [-0.33215]
INV(-1)	-1.15E-14 (2.8E-14) [-0.40664]	4.17E-13 (2.3E-13) [ 1.81977]	3.17E-13 (1.1E-13) [ 2.93754]	4.47E-14 (4.3E-14) [ 1.02786]	1.28E-13 (8.6E-14) [ 1.48468]	3.75E-13 (1.1E-13) [ 3.26916]	-1.56E-14 (2.3E-14) [-0.68047]
INV(-2)	-6.36E-14 (2.7E-14) [-2.36564]	3.19E-13 (2.2E-13) [ 1.46844]	-2.52E-13 (1.0E-13) [-2.46636]	-1.25E-13 (4.1E-14) [-3.03339]	1.14E-13 (8.2E-14) [ 1.39296]	-1.15E-13 (1.1E-13) [-1.05911]	-1.03E-14 (2.2E-14) [-0.47463]
SAV(-1)	-4.00E-14 (1.9E-14) [-2.09482]	1.90E-13 (1.5E-13) [ 1.22770]	-1.23E-13 (7.3E-14) [-1.69672]	-5.30E-14 (2.9E-14) [-1.81124]	1.03E-13 (5.8E-14) [ 1.77041]	5.54E-14 (7.7E-14) [ 0.71632]	-4.82E-15 (1.5E-14) [-0.31252]
SAV(-2)	-6.44E-15 (2.1E-14) [-0.30577]	1.67E-13 (1.7E-13) [ 0.97857]	6.96E-14 (8.0E-14) [ 0.86964]	-1.62E-14 (3.2E-14) [-0.50206]	-2.18E-15 (6.4E-14) [-0.03409]	-3.15E-14 (8.5E-14) [-0.36929]	-2.40E-14 (1.7E-14) [-1.41279]
TAX(-1)	8.42E-14 (6.2E-14) [ 1.34827]	-1.27E-12 (5.1E-13) [-2.51361]	-5.60E-15 (2.4E-13) [-0.02357]	4.41E-14 (9.6E-14) [ 0.46039]	-3.75E-13 (1.9E-13) [-1.97729]	-3.77E-13 (2.5E-13) [-1.48992]	-1.69E-14 (5.0E-14) [-0.33439]
TAX(-2)	-2.71E-14 (5.0E-14) [-0.54075]	7.75E-13 (4.1E-13) [ 1.91342]	5.31E-14 (1.9E-13) [ 0.27881]	3.02E-14 (7.7E-14) [ 0.39333]	2.97E-13 (1.5E-13) [ 1.95093]	2.71E-13 (2.0E-13) [ 1.33753]	4.19E-14 (4.0E-14) [ 1.03509]
C	-1.03E-12 (9.3E-13)	2.42E-12 (7.5E-12)	-1.29E-12 (3.5E-12)	-1.31E-12 (1.4E-12)	-4.30E-12 (2.8E-12)	-2.23E-12 (3.8E-12)	-2.10E-12 (7.5E-13)

	[-1.10970]	[ 0.32118]	[-0.36413]	[-0.91545]	[-1.51931]	[-0.59217]	[-2.78892]
GDP	1.000000 (2.3E-14) [ 4.3e+13]	6.57E-13 (1.9E-13) [ 3.52297]	2.49E-14 (8.8E-14) [ 0.28389]	-7.95E-14 (3.5E-14) [-2.24665]	2.32E-13 (7.0E-14) [ 3.31558]	1.98E-13 (9.3E-14) [ 2.11583]	-3.69E-14 (1.9E-14) [-1.98369]
EMP	2.80E-13 (5.4E-14) [ 5.20791]	1.000000 (4.3E-13) [ 2.3e+12]	3.93E-13 (2.0E-13) [ 1.92520]	4.17E-13 (8.2E-14) [ 5.06165]	-5.18E-13 (1.6E-13) [-3.18007]	-4.81E-13 (2.2E-13) [-2.21325]	1.73E-13 (4.3E-14) [ 3.99442]
GDEB	-2.96E-14 (2.2E-14) [-1.34731]	4.84E-13 (1.8E-13) [ 2.72350]	1.000000 (8.4E-14) [ 1.2e+13]	-3.95E-15 (3.4E-14) [-0.11723]	2.38E-13 (6.7E-14) [ 3.56129]	8.83E-14 (8.9E-14) [ 0.99168]	-6.09E-15 (1.8E-14) [-0.34297]
INF	-5.70E-15 (1.7E-14) [-0.33340]	-1.33E-13 (1.4E-13) [-0.96148]	-1.01E-13 (6.5E-14) [-1.54830]	1.000000 (2.6E-14) [ 3.8e+13]	-1.05E-13 (5.2E-14) [-2.01433]	-1.16E-13 (6.9E-14) [-1.67036]	-2.14E-14 (1.4E-14) [-1.55388]
INV	5.01E-14 (2.9E-14) [ 1.74483]	-4.82E-13 (2.3E-13) [-2.07733]	-1.19E-13 (1.1E-13) [-1.09477]	4.02E-14 (4.4E-14) [ 0.91449]	1.000000 (8.7E-14) [ 1.1e+13]	-2.58E-13 (1.2E-13) [-2.21993]	1.90E-14 (2.3E-14) [ 0.82241]
SAV	3.71E-14 (1.8E-14) [ 2.06622]	-2.22E-13 (1.4E-13) [-1.53062]	5.17E-14 (6.8E-14) [ 0.75786]	6.02E-14 (2.7E-14) [ 2.19100]	-4.38E-14 (5.4E-14) [-0.80567]	1.000000 (7.3E-14) [ 1.4e+13]	3.67E-14 (1.4E-14) [ 2.53735]
TAX	-1.94E-14 (4.6E-14) [-0.41904]	6.21E-13 (3.7E-13) [ 1.65877]	1.29E-13 (1.8E-13) [ 0.73494]	0.000000 (7.1E-14) [ 0.00000]	2.07E-13 (1.4E-13) [ 1.47292]	2.07E-13 (1.9E-13) [ 1.10440]	1.000000 (3.7E-14) [ 2.7e+13]
R-squared	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000
Adj. R-squared	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000
Sum sq. resids	2.19E-24	1.43E-22	3.16E-23	5.14E-24	2.01E-23	3.58E-23	1.42E-24
S.E. equation	2.75E-13	2.22E-12	1.04E-12	4.21E-13	8.33E-13	1.11E-12	2.22E-13
F-statistic	1.49E+27	2.16E+25	3.75E+26	4.16E+26	1.20E+26	1.05E+26	2.01E+26
Log likelihood		1310.542					
Akaike AIC		-50.53104					
Schwarz SC		-49.69771					
Mean dependent	3.376471	60.07451	20.44118	6.412157	21.32863	20.20980	7.577451
S.D. dependent	6.880540	6.693843	13.10705	5.566769	5.913280	7.374151	2.039003
Determinant resid covariance (dof adj.)		1.1E-175					
Determinant resid covariance		2.1E-177					
Log likelihood		9867.726					
Akaike information criterion		-380.9304					
Schwarz criterion		-375.0971					

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## DECENTRALIZATION OF PUBLIC EXPENDITURE AND ECONOMY GROWTH: AN EVIDENCE FOR THE EUROPEAN UNION

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### *Abstract:*

*The goal of this paper is to analyze the impact of fiscal decentralization on economic growth in the European Union. The empirical investigation is based on regression analysis. The regression model includes the GDP growth rate as a dependent variable and fiscal decentralization indicators as independent variables. Results support the conventional understanding among scientists and politicians for a positive influence of fiscal decentralization on economic growth.*

**Key words:** *fiscal decentralization, local expenditures, local revenue, economic growth*

**JEL Classification:** *H77; R55; H71; H72; O40.*

### **1. Introduction**

The relationship between fiscal decentralization and economy growth as a subject of empirical work is a relatively new phenomenon in economic thought. Analyzers<sup>[6]</sup> note that while theoretical examinations started with the pioneer publications of Tiebout in 1956 [16], Musgrave in 1959 [9] and Oates in 1972 [10], empirical analysis regarding the role of economic growth on FD started at the end of the 1970s [7] [12] and estimations concerning the direct impact of FD on economic growth have only been conducted since the end of the 1990s (starting with the articles of Oates in 1995 [11] and Davoodi and Zou in 1998 [4]).

The first contributions to empirical analysis on this topic have been made by Oates in 1995 [11] and the author' collectives of Davoodi, Xie, and Zou in 1995 [5], Devarajan, Swaroop and Zou in 1996 [3], Davoodi and Zou in 1998 [4]. Next significant attempts for research are made in the studies of S. Yilmaz in 1999 [20], U. Thiessen in 2000 [17] [18] and 2003 [19], and the elaborated approach applied in the study of Akai, Nishimura and Sakata in 2004 [1]. The most recent analyses are done by Malik, Hassan and Hussain in 2006 [8] on provinces of Pakistan and Samimi, Lar, Haddad, Alizadeh in 2010 [13] on provinces of India.

The empirical methodology applied is based on regression analysis. The regression models are constructed through a linkage of measures for fiscal decentralization and choosing variables from a given endogenous model of economy growth. The wide accepted endogenous models are Barro's growth model [2] and the model of R. Solow [14]. Most of the studies use the first one.

However, the results of empirical work are still ambiguous and unreliable. The main reasons for such picture are 1) different models of decentralization across countries, 2) different income levels, 3) the low explanatory power of the regression models, 4) lots of omitted variables in the regressions, 5) the statistically insignificant regression coefficients and the different signs of these coefficients. Thus, we couldn't clearly conclude for the nature of the relationship between fiscal decentralization and economy growth.

The basic economic argument in favor of fiscal decentralization is based on two complementary assumptions: 1) decentralization will increase economic efficiency because local governments are better positioned than the national government to deliver public services as a result of information advantage; and 2) population mobility and competition among local governments for delivery of public services will ensure the matching of preferences of local communities and local governments[4].

There are objective limitations for the analytical work on this topic for the worldwide. Because of that we must have more modest expectations. The purpose of this paper is to analyze the impact of fiscal decentralization on economy growth in the European Union countries for the period 2000-2010. Thus, we could estimate the efficiency of the decentralization model in the EU-27. On other hand, there is a tendency for convergence of the allocation of GDP by state budget in these countries [15]. It additionally makes this group of countries very appropriate for analysis.

### **3. Empirical analysis of the impact of fiscal decentralization on economy growth**

## 2.1. Conceptual framework

The analytical framework of this study has been developed by Davoodi, Xie, and Zou [5], Devarajan, Swaroop and Zou [3], Davoodi and Zou [4]. It is adopted in the present analysis. These first analyses follow the endogenous growth model of Barro [2]. According to the model, the production function has two inputs: private capital and public spending. However, Davoodi and Zou [4] depart from the Barro model by assuming that public spending is carried out by three levels of government: federal, state, and local. Let  $k$  be private capital stock,  $g$  total government spending,  $f$  federal government spending,  $s$  state government spending, and  $l$  local government spending, all measured on a per capita basis:

$$g = f + s + l \quad (1)$$

The production function is Cobb - Douglas:

$$y = k^{\hat{a}} f^{\hat{a}} s^{\tilde{a}} l^{\hat{u}} \quad (2)$$

where  $y$  is per capita output,  $1 > \hat{a} > 0$ ;  $1 > \tilde{a} > 0$ ;  $1 > \hat{u} > 0$ ;  $\hat{a} + \tilde{a} + \hat{u} = 1$ .

The allocation of consolidated or total government spending  $g$  among different levels of government takes the following form:

$$f = \hat{e}_f g; \quad s = \hat{e}_s g; \quad l = \hat{e}_l g, \quad (3)$$

where  $\hat{e}_f + \hat{e}_s + \hat{e}_l = 1$  and  $0 < \hat{e}_i < 1$  for  $i = f, s, l$ . Thus, if  $\hat{e}_f$  is the share of federal government in total spending,  $\hat{e}_s$  the share of state government and  $\hat{e}_l$  the share of local government. Consolidated government spending  $g$  is financed by a flat income tax at rate  $t$ :

$$g = \hat{\theta} y \quad (4)$$

The representative agent's preferences are given by

$$U = \int_0^{\infty} \frac{c^{1-\hat{\sigma}} - 1}{1-\hat{\sigma}} e^{-\hat{\rho}t} dt \quad (5)$$

where  $c$  is per capita private consumption, and  $\hat{\rho}$  is the positive time discount rate.

The dynamic budget constraint of the representative agent is

$$\frac{dk}{dt} = (1-\tau)y - c = (1-\tau)k^{\alpha} f^{\beta} s^{\gamma} l^{\omega} - c \quad (6)$$

Davoodi and Zou [4] further assume a constant tax rate along the balanced growth path.

Given total government spending  $g$ , a constant tax rate  $t$ , and the shares of spending by different levels of governments ( $\hat{e}_i$ 's,  $i = f, s, l$ ) the representative agent's choice of consumption is determined by maximizing (5) subject to (6) and the government's budget allocation. Along the balanced growth path, the solution for the per capita growth rate of the economy is given by

$$\frac{dy/dt}{y} = \frac{1}{\hat{\sigma}} \left[ (1-\tau) \pi^{1-\alpha/\alpha} \alpha \theta_f^{\beta/\alpha} \theta_s^{\gamma/\alpha} \theta_l^{\omega/\alpha} - \hat{\rho} \right] \quad (7)$$

Equation (7) shows that the long-run growth rate of per capita output is a function of the tax rate and the shares of spending by different levels of government. It forms the basis for our empirical analysis of the relationship between fiscal decentralization and growth. Following the literature on fiscal federalism, we regard a country as more fiscally centralized if it has a higher value of the federal spending share  $\hat{e}_f$ .

It is important to note that, for a given share of total government spending in GDP, a reallocation of public spending among different levels of governments can lead to higher economic growth if the existing allocation is different from the growth-maximizing expenditure shares. To show this point, we maximize the growth rate in (7) by choosing  $\hat{e}_f$ ,  $\hat{e}_s$ , and  $\hat{e}_l$  subject to the constraint  $\hat{e}_f + \hat{e}_s + \hat{e}_l = 1$ . The growth-maximizing government budget shares are

$$\theta_f = \frac{\beta}{\beta + \gamma + \omega} \quad (8)$$

$$\theta_s = \frac{\gamma}{\beta + \gamma + \omega} \quad (9)$$

$$\theta_l = \frac{\omega}{\beta + \gamma + \omega} \quad (10)$$

Therefore, as long as the actual government budget shares are different from growth-maximizing shares, the growth rate can always be increased without altering the total budget's share in GDP.

## 2.2. Empirical methodology and data

The quantitative effects of fiscal decentralization on economy growth are estimated by the means of equation (11)' specification:

$$y_{it} = b_1 + b_2\hat{e}_{it} + b_3\hat{\alpha}_{it} + b_4X_{it} + b_5D_{it} + \hat{\alpha}_{it} \quad (11)$$

where  $y_{it}$  is growth rate of GDP for each country and year,  $\hat{e}_{it}$  is measure of fiscal decentralization - subnational share of total government expenditure,  $\hat{\alpha}_{it}$  - ratio of local government revenue to GDP,  $X_{it}$  - dummy variables - quantitative indicators - investments of private sector, inflation rate for each country and year, population growth for each country and year measured by percent,  $D_{it}$  - dummy variable - qualitative indicator - such variable in this case is the membership of concrete country in the Euro area. This variable receives a value "one" for years of membership and "zero" for all others.  $\hat{\alpha}_{it}$  expresses the error term of distribution. Source of data is Eurostat. The year data is used for the regression coefficients calculation. The estimation procedure is the Ordinary Least Squares method. The procedure is also applied on a three years average data panel.

## 2.3. Regression results

The regression results are presented in the Tables 1 and 2. Tables 3 and 4 show the tests for normal distribution of residuals across the models. Table 1 includes the regression results from the estimating procedure applied to a year data panel for the European Union.

The separate variants of the model specification are constructed by excluding of explanatory variables from equation (11). Thus, we get Models from 1 to 5.

**Table 1. Regression results for the EU-27 with year data for 2000 – 2010**

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
<b>(Constant)</b>	-3.076** (-2.548)	-3.806*** (-3.161223)	-3.745*** (-3.167)	-3.687*** (-3.118)	1.637*** (3.595)
<b>Subnational share of total government expenditure (%)</b>	0.221*** (3.416)	0.266*** (4.147)	0.263*** (4.159)	0.272*** (4.340)	0.393*** (6.587)
<b>Ratio of local government revenues to GDP (%)</b>	-0.433*** (-3.496)	-0.519*** (-4.225)	-0.515*** (-4.228)	-0.537*** (-4.454)	-0.784*** (-6.930)
<b>Investment rate(% of GDP)</b>	0.291*** (4.773)	0.289*** (4.667)	0.289*** (4.678)	0.298*** (4.848)	
<b>Inflation rate (%)</b>	0.040 (0.760)	0.066 (1.239)	0.061 (1.211)		
<b>Population growth rate (%)</b>	0.388 (1.246)	0.085 (0.283)			
<b>Euro area</b>	-1.448*** (-3.193)				
<b>R-squared</b>	0.235594	0.208728	0.208510	0.204538	0.140720
<b>Adjusted R-squared</b>	0.219779	0.195133	0.197668	0.196394	0.134875
<b>Durbin-Watson stat</b>	1.357452	1.303514	1.304572	1.311870	1.313129
<b>F-statistic</b>	14.89662	15.35249	19.23116	25.11321	24.07349
<b>Prob(F-statistic)</b>	0.000000	0.000000	0.000000	0.000000	0.000000
<b>Observations</b>	297	279	297	297	297

Source of data: Eurostat, Author's calculations

Note: t-test in parentheses

\*\*\* significant at 1%; \*\* significant at 5%; \* significant at 10%

The explanatory power of the model is not very high. Across the different specifications the values of adjusted R-squared vary from 0.219779 to 0.134875. The empirical values of F-statistics for each model are higher than its theoretical values. According to results from Durbin-Watson statistics for each model, there is a weak positive serial correlation. Therefore, the regressions are adequate and their results are reliable empirical evidence.

The regression coefficient estimated shows a reliable evidence for a positive impact of the subnational share of total government expenditure on economy growth in the European Union. The coefficient for each variant of specification is statistically significant at 1% level. It means that the probability for error of distribution is less 1%. This result is consistent with conventional expectations. The last three decades the EU has a clear policy for effective decentralization of state governance. The intentions building a working decentralization model have been incorporated in acts of the European Union law. The member states have adopted these fundamental acts and developed their principles. Thus, achievements of the EU law contribute to national efforts for an effectively decentralized public sector.

Positive sign of the regression coefficients means an increase in efficiency of the public expenditure. Efficiency gains are direct result from optimization of transfer of spending powers to the subnational authorities. Subnational shares of total government expenditure are close to maximizing growth shares. We could conclude that there is such organization of the expenditure carrying out, in which the level of provision of public goods is in accordance with the level of financing of their production. Thus, the local conditions and preferences are taken into account in the public goods provision.

The form of the relationship between subnational share of total government expenditure and economy growth in the European Union is linear. It means a strong influence of this measure for decentralization on economic development.

The impact of the local authorities' revenue is statistically significant at 1%. The relationship between the ratio of local government revenues to GDP and economy growth has a linear form.

Local authority's revenue negatively affects the economy growth in the EU-27. The sign of the regression coefficient is due to the depressing effect of taxation on the economic activity of business-agents. An increase in tax burden will lead to a decrease in the resources on hand in firms. Thus, the investment activity is depressed. These factors hamper the GDP growth.



**Table 2. Tests for normal residuals' distribution of the specifications from Table 1**

Variable	Model 1	Model 2	Model 3	Model 4	Model 4
Mean	1.58e-15	2.11e-15	1.03e-15	1.77e-15	7.12e-16
Median	0.601787	0.593007	0.619551	0.565537	0.667111
Maximum	6.112878	6.309334	6.295999	6.316324	7.572092
Minimum	-21.47219	-21.32170	-21.38633	-21.42629	-22.40860
Std. Dev.	3.380878	3.439777	3.440251	3.448872	3.584551
Skewness	-2.286466	-2.110300	-2.128447	-2.119050	-2.133714
Kurtosis	12.08655	10.95143	11.06280	10.98247	11.27960
Jarque-Bera	1280.530	1002.854	1028.732	1010.806	1073.689
Probability	0.000000	0.000000	0.000000	0.000000	0.000000

Source of data: Eurostat, Author's calculations

The results from the test for normal distribution of residuals in equation (11) for the EU in terms of year data are presented on Table 2. Hypothesis for normal distribution is confirmed for each model. Consequently, the Ordinary Least Squares method is the Best Linear Unbiased Estimator for the regression coefficients.

Table 3 presents the regression results for the EU estimated in terms of three years average data. The explanatory power of different models increases due to elimination of the negative impact of the trends in year data. The values of the adjusted R-squared vary from 0.338483 to 0.174322 across the specifications. The empirical values of F-statistics of the models are higher than their theoretical values. According to results from Durbin-Watson statistics for each model, hypotheses for autocorrelation are not confirmed.

Subnational share of total government expenditure again has a positive impact on economy growth. There are small differences in values of coefficients between the estimations in terms of year data and three years average data. While the results for most of the models are statistically significant at 1%, the level of significance for Model 1 is 5%. The empirical results also are reliable and unambiguous evidence.

The empirical evidence for a negative impact of local authorities' revenue is confirmed in terms of three year average data. Excluding Model 1, where the coefficient is statistically significant at 5%, the level of significance is 1%, i.e. the probability for error in distribution is less than one percent.

**Table3. Regression results for the EU-27 with average data for 2000 – 2010**

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
(Constant)	-5.470*** (-3.476)	-5.781*** (-3.691)	-5.309*** (-3.395)	-5.332*** (-3.366)	1.172* (1.862)
Subnational share of total government expenditure (%)	0.202** (2.213)	0.249*** (2.929)	0.221*** (2.610605)	0.244*** (2.873)	0.398*** (4.728)
Ratio of local government revenues to GDP (%)	-0.388** (-2.283)	-0.466*** (-2.884)	-0.422*** (-2.609)	-0.472*** (-2.922)	-0.782*** (-4.954)
Investment rate(% of GDP)	0.372*** (4.313)	0.337*** (4.058)	0.344*** (4.091)	0.370*** (4.413)	
Inflation rate (%)	0.164** (2.114)	0.186** (2.436)	0.143* (1.943)		
Population growth rate (%)	1.064** (2.302)	0.769** (1.853)			
Euro area	-1.016 (-1.421)				
R-squared	0.375578	0.363094	0.363094	0.317528	0.189755
Adjusted R-squared	0.338483	0.331873	0.331873	0.297842	0.174322
Durbin-Watson stat	1.817403	1.804151	1.804151	1.906860	2.201734
F-statistic	10.12492	11.62986	11.62986	16.12908	12.29521
Prob(F-statistic)	0.000000	0.000000	0.000000	0.000000	0.000016
Observations	108	108	108	108	108

Source of data: Eurostat, Author's calculations

Note: t-test in parentheses

\*\*\* significant at 1%; \*\* significant at 5%; \* significant at 10%

Table 4 shows the test for normal distribution of the residuals from unexplained deviation in the equation (11) in terms of three year average panel. The normality hypothesis is confirmed at 1% of probability for error in distribution. Hence, we could agree that the Ordinary Least Squares method is the best linear unbiased estimator of regression parameters.

**Table 4. Tests for normal residuals' distribution of the specifications from Table 3**

Variable	Model 1	Model 2	Model 3	Model 4	Model 4
Mean	-1.56e-15	-3.09e-15	-2.75e-16	-1.97e-15	4.81e-16
Median	0.302978	0.260837	0.314709	0.464756	0.580469
Maximum	5.642288	5.741910	5.096354	4.589225	4.918789
Minimum	-10.29890	-10.15420	-10.92625	-11.25750	-12.75874
Std. Dev.	2.555686	2.600123	2.643519	2.691527	2.932679
Skewness	-1.025623	-0.893545	-1.226927	-1.258902	-1.529858
Kurtosis	5.229412	4.726048	5.524078	5.516143	6.415253
Jarque-Bera	41.30049	27.77821	55.76569	57.01639	94.61616
Probability	0.000000	0.000001	0.000000	0.000000	0.000000

Source of data: Eurostat, Author's calculations

### 3. Conclusions.

The most important conclusions we could draw are regarding the influence of fiscal decentralization on economy growth. We have seen that decentralized public expenditure lead to increase in the efficiency not only of expenditure, but of the total public sector and economy. The transfer of spending powers to subnational authorities grows the GDP. According expectations, the increase in the local budget revenue would depress economic activity of private firms, which negatively affects the GDP growth rate.

In general, we could conclude that the model of fiscal decentralization in the EU is working and effective. It contributes to efficiency gains in public sector and catalyzes the economy growth in the member-states.

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**IMPLEMENTATION RULES FOR FISCAL DECENTRALISATION IN BULGARIA: A SURVEY**

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**Abstract:**

*The main purpose of this study is to examine the impact of the current world wide financial and economic crisis on financial decentralization process in Bulgaria and identify the answers of the central and local governments to the critical situation in the context of specific conditions of the national economy and the stage of financial decentralization reform. Analysis is focused on dynamics of the main macro economic indicators, based on fact figures for the period 1990–2011 and forecast for 2012, and its impact on the public finance. The most important actions, taken by the national government to consolidate the crisis are described and evaluated on the base of their effects on the local finance. A comparison is made between the loss of Bulgarian economy in the beginning of transition (1991-1993), during the financial crisis in 1996-1997, caused by credit crunch and series of bank bankruptcies, and the current financial and economic crisis. Finally, some conclusions and policy recommendations are outlined, intended to improve crisis management in Bulgaria both on the national and local level.*

**Key words:** financial decentralization, local finance, economic crisis

**JEL Classification:** H71, H77

**1. Introduction.**

The process of decentralizing public sector in Bulgaria started parallel to the transition from a planned, socialist type economy toward market based economy. During the last 20 years a remarkable progress has been achieved, although local government finance reform in Bulgaria proved to be a very long and difficult process. The main purpose of this paper is to provide a critical overview of the local government finance reform and analyze the process of strengthening financial decentralization in Bulgaria. It is structured in five sections. Section two introduces the specifics of country's government structure and presents the legal base of local self-government. Third section traces out the main stages in the evolution of financial decentralization. The role of different governmental tiers within the public sector of the country is analyzed on the base of the dynamics of public expenditures indicators. Development of the financial decentralization process is assessed through the relative importance of the local expenditures both in the consolidated public expenditures and the GDP. Special emphasis is placed upon the evolution of local budgets revenue structure over the period 1991-2012. The relative share of own-source revenues is analyzed as a precondition for expanding local financial autonomy. Fourth section illustrates the impact of economic crises on the local government finance. The last section concludes.

**2. Foundations of the Local Self-government in Bulgaria****2.1. Government Structure**

Government structure of Bulgaria is not very fragmented. Due to the five administrative reforms, which have been conducted during the second half of the 20<sup>th</sup> century, the number of the administrative-territorial units at different levels decreased. Presently, as a unitary state, with 7.4 million population<sup>314</sup> and territory of 111 000 sq. km, Bulgaria enjoys comparatively simple subordination scheme.

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<sup>314</sup> Last census on 01.02.2011, source: National Statistical Institute.  
<http://www.nsi.bg/Census2011/indexen.php>

Territorial structure of the country includes two regions on level NUTS I, 6 regions, defined as level NUTS II, 28 administrative districts corresponding to level NUTS III, and 264 municipalities, which represent the level LAU 1.<sup>315</sup>

Table 1 Administrative and Territorial Structure

Year	Administrative Territorial Units	Regions		Districts		Municipalities	
		Number	Average Population	Number	Average Population	Number	Average Population
1950		-	-	14	516 300	2 178	3 300
1961		-	-	28	261 000	979	8 000
1979		-	-	28	315 900	291	30 400
1987		-	-	9	997 400	273	32 900
1999		-	-	28	284 800	262	30 300
2006		6	1 280 000	28	280 000	264	29 900
2011		6	1 230 000	28	263 000	264	27 900

Source: National Statistical Institute

It is important to note, that regions are not administrative, but only statistical units, created according to the Regional Development Act (§ 4) and in compliance with the requirements of the European Union for allocation of regional development funds. The districts are deconcentrated administrative units of the central government, which coordinate national and local interests, but they neither enjoy financial autonomy, nor provide public services to the population. According to the Constitution (§136), the municipality - a legal entity is the only one tier of really autonomous subnational government in the country. It has the right of ownership and adopts independent municipal budget, which must be used in the interests of the local population. The bodies of local government - Municipal Council and Mayor - are elected directly by the local population for a 4-year mandate with the purpose to make and perform local government decisions. The last local elections held in 2011, elected respectively 264 mayors and 264 municipal councils with 5 145 municipal councilors. Men prevailed among the municipal councilor seat takers (71.6%).

## 2.2. Legal Grounds of Financial Decentralization

The basic principles of local self-government in Bulgaria are provided by the Constitution, adopted by the Parliament in 1991. In addition, there is a package of laws, shaping the legal grounds of decentralization. The Local Self-Government and Local Administration Act (1991) regulates organization and functions of local governments. The Act on Administrative and Territorial Structure of the Republic of Bulgaria (1995) determines the legal criteria and procedures for establishing, merging, splitting and liquidating administrative units. The Local Elections Act (1995) and the Referendum Act (1996) prescribe the rules for citizens' participation in political process at local level. The issues of acquiring and managing municipal property are solved by the Municipal Property Act (1996), while procedure and organization of the municipal budgeting process are formalized by the Municipal Budgets Act (1998).

Some important financial issues as type, base, and rate of local taxes and charges are specified by the Local Taxes and Fees Act (1997), whereas the procedure, conditions and limits of local debt service are determined by the Municipal Debt Act (2005). Thus, the most important legal pillars of the local self-government are stipulated, providing a stable base for expanding financial decentralization in Bulgaria. This is in consistence with the efforts of the EU countries for strengthening the legal base of government decentralization. [14]

## 3. Local Government Finance.

### 3.1. Evolution of Financial Decentralization.

Local government finance reform in Bulgaria proved to be a very long and difficult process. Decentralization of the public sector was conducted by the transition process, from centralized, socialist type economy to a market based economy, which started in 1990. Basically, the process of reforming local finance comprised of several distinct periods. During the first period, in the very beginning of transition (1991 – 1993) the highly centralized system was preserved.

<sup>315</sup> NUTS I, NUTS II and NUTS III are the abbreviations respectively of the level I, II and III of the Nomenclature of Territorial Statistical Units within the meaning of Regulation (EC) No 1059/2003 of the European Parliament and of the Council of 26 May 2003. LAU 1 is denotation for local administrative unit.

The independence of municipal budgets within the consolidated state budget was acknowledged in 1993, meaning that the State abandoned centralization of local budgetary surplus and financing of local deficit.

In addition, the intergovernmental fiscal relations were organized on the base of a newly introduced formula for distribution of the state subsidies to the municipal budgets.

The second period started in 1994, parallel to the process of gradually building the capacities of local authorities. The National Association of Municipalities in Republic of Bulgaria (NAMRB) and regional associations of municipalities emerged as main champions of financial decentralization. Several changes in intergovernmental relations were provoked, gradually eliminating mandatory priorities in the allocation of municipal expenditures. However, to the end of 2002, the intergovernmental fiscal relations remained centralized as far as the central government established a model of almost complete control over the municipal budgets. [16]

During the third period the real financial decentralization in Bulgaria evolved. It was initiated in 2003, based on the Cooperation Agreement, signed by the Council of Ministers and the NAMRB in 2002, whereby both parties agreed to decentralize local government and to increase financial independence of municipalities. Moreover, both the Financial Decentralization Concept and the program for its implementation were adopted. As a result, one of the main achievements in the scope of intergovernmental fiscal relations became a reality, namely the clear division between the local and central responsibilities for the public services. Provided for the first time by the annual State Budget Act for 2003 it was continued and improved during the following years. Additionally, this law provided a framework for regulating a new, simple and transparent model of assigning government subsidies. As a result subsidies allocation is based on a formula, which takes into account the expenditure needs and revenue capacity of local governments.

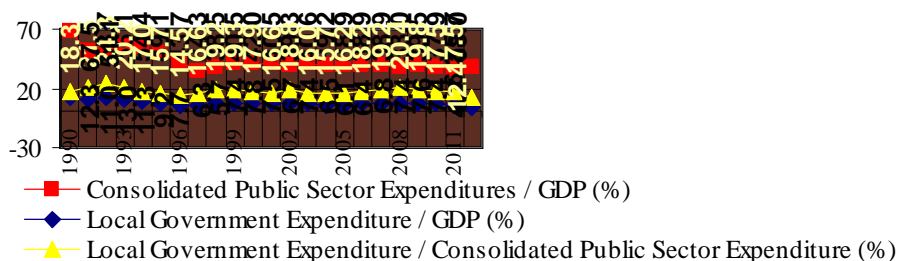
The lack of local tax autonomy has been a fundamental weakness of the revenue assignment system in Bulgaria during the transition period. Before the Constitutional amendments in the beginning of 2007 Bulgarian municipalities were prohibited from setting either rates or bases of local taxes. Property tax, motor vehicle tax, inheritance tax, donation tax, and tax on the real estate and movable property purchase, recognized as local taxes, were entirely regulated by the central governmental level. In this respect local taxes in Bulgaria have been considered as special transfers, based on the location of taxable property.

This is the reason why, 2007 can be pointed as a beginning of the fourth period, when two important legislative changes considerably influenced local taxation. Firstly, municipalities were given the authority to set local tax rates within certain legal limits. However, they are still disallowed to define local tax base and provide additional (or remove the existing) legal alleviations for certain taxpayers. Secondly, the patent tax was reassigned as a local tax. Basically, the patent tax is a net annual income tax, which is collected from the craftsmen and the owners of small enterprises, who offer hand-made products and a variety of services. The patent tax replaces the payment of personal income tax or corporate income tax, so it has the potential as an important part of local revenues and powerful instrument of the municipal tax policy.

### 3.2. Local Government Expenditure

During the transition period public sector expenditures have been very dynamic, in response to the fast-changing legal and financial environment. Due to the economic stagnation, financial instability, and vertical imbalance in the last decade of the 20<sup>th</sup> century, the relative importance of local governments within the governmental system decreased. Moreover, regardless of the financial stabilization and economic growth, achieved during the first years of the 21<sup>st</sup> century, the downward tendency has proved its persistency. The relative share of local budgets in GDP has been reduced to 7.5% in 2000 and 6.1% in 2004 by comparison with 12.3% in 1990. At the same time expenditures of the local governments, which formed 21.5% of the consolidated state budget in 1991, reached respectively 17.9% in 2000 and 15.7% in 2004.

Figure 1 Dynamics of the Public Expenditure Indicators



Source: Calculations based on the Ministry of Finance database,

Note: Data for 2012 are based on prognosis.

The reversion of this negative trend happened in 2005, due to the ongoing process of financial decentralization during the third period of local finance reform and increasing financial autonomy of local governments. The positive dynamics has been accelerated by the clear expenditure assignment, transparent intergovernmental transfer system, and local tax authority. In 2008 local governments appeared as an important part of the public sector in the country, accounting for 20.4% of total government spending. At the same time municipal budgets reached 7.6% of the GDP. In the period 2009-2011, as a result of the reflection of the worldwide economic crisis in Bulgaria, local government expenditures tend to decrease. In 2012 local government budgets are expected to reach to 12.4% of the consolidated budget and 4.7% of GDP.

### 3.3. Composition of Local Revenues

In the beginning of the transition period, local governments have suffered more than the central government from the decreased financial capacity of the public sector in the country. Because of the advantages of taxation at the central level and spending at the decentralized level, public sector in Bulgaria has often ended up with vertical and horizontal fiscal imbalance. Several problems had a decisive influence on the own-source local revenues, causing a significant decline of their relative share, especially during the 1990s.

First of all, the difficult interrelation of the local governments and the tax administration, which in 1991 became subordinated to the Ministry of Finance. As a result, the efforts of centrally dependent officers were aimed at collecting taxes from the larger taxpayers, causing delays of the local taxes and charges collection and even waste of local revenues. In a dynamic inflationary environment any postponement led to additional losses for the municipal budgets. The second serious problem was the outdated tax base for the property tax, which was also used for the calculation of inheritance tax, donation tax, and tax on the property purchase. These were the reasons why in the period 1991-1997 local taxes accounted for less than 3% of the local revenues.

Especially low was local tax revenue share in 1997 (0.5%), due to the hyperinflation, which additionally devaluated local tax base. Moreover, it was beyond the municipal competence to solve the problem. Although autonomous on paper, municipalities did not have any possibility to influence tax revenues. In addition, the inability of local governments to impose local charges and to set their rates freely, particularly in the inflationary situation, resulted in a growing gap between local revenue potential and the actual costs of local service provision. This was the reason why in 1990s own-source revenues accounted for only 12.8% of the total local revenues on the average.

Table 2 **Composition of Local Revenues (%)**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Own-source revenues	3.9	5.1	4.9	19.6	20.4	20.6	8.3	15.2	17.6	18.1	22.0
Including: Local taxes	0.7	0.9	1.2	2.3	2.5	2.9	0.5	5.0	4.8	4.9	5.2
Governmental transfers	96.1	94.9	95.1	77.1	77.7	77.5	91.4	83.9	80.3	81.9	77.6
Borrowing	n.a.	n.a.	n.a.	3.3	1.9	1.9	0.5	0.9	2.1	n.a.	0.4
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Own-source revenues	23.9	31.7	33.8	35.6	36.9	40.2	35.4	35.1	32.4	35.5	37.4
Including: Local taxes	7.0	9.6	9.3	9.5	10.7	13.4	13.4	13.6	11.6	13.1	14.5
Governmental transfers	75.7	67.9	65.9	64.0	61.3	58.7	60.3	63.2	67.4	64.4	62.6
Borrowing	0.4	0.4	0.3	0.4	1.8	1.1	4.3	1.7	0.2	0.1	0.0

**Source:** Calculations based on the Ministry of Finance database

**Note:** Data for 2012 are based on prognosis.

During the period 2000-2007 local own-source revenues have gradually increased, from 18.1% toward 40.2% of the total municipal revenues, provoked by the expanding financial decentralization. Since 2003 local governments have been given full discretion over local charges and service prices, which have quadrupled their importance in real and relative terms. In 2006 municipalities started to collect local tax revenues.

Especially high is the growth of local taxes in 2007 and the first half of 2008, due to the considerable revaluation of the property tax base on the one hand and the newly assigned tax competences on the other hand. At the same time, because of the expansion of the own-source revenues, intergovernmental transfer system has lost its dominant role in financing local governments in Bulgaria. However, having in mind the great difference between the fiscal capacity in several richest municipalities and the rest of the local governments in the country, for the present the strong intergovernmental transfer system still has no effective alternative.

Of great significance for the process of strengthening financial decentralization in Bulgaria were some macroeconomic and financial factors, such as constantly increasing economic activity, low levels of unemployment, moderate inflation rates, dynamically decreasing public debt, and consolidated budget surpluses exceeding 3% of the GDP. This process was broken in the autumn of 2008, due to a new and deep worldwide financial and economic crisis. Due to the severe financial discipline provided by the Currency Board, which preserved financial stability, Bulgaria faced the crisis consequences later and in a milder form than most of the countries all over the world. In 2009 crisis hit Bulgarian economy with all its might. Decreasing economic activity (GDP reduction of -5.1%) strongly affected public finance by reducing government revenues and increasing social pressure, mainly due to the fast growing unemployment rate. As a result a budget deficit of 4.7% of the GDP was reported in 2009. Although completely different from the expected 3% surplus, Bulgarian budgetary deficit is among the lowest in the European Union. In addition, bank system remained stable, inflation rate decreased to 2.8%, and public debt did not exceed 15.5% of the GDP.

At the local level economic crisis both sharply reduced local own-source revenues and – via budget constraints at the central level – increased the pressure on the grant system. As a result own-source revenues decreased to 35.4% of the total local revenues in 2008 and hardly reached 35.1% in 2009. In 2010 own-source revenues decreased vastly to 32.4% of the total local revenue. Especially low are the revenues from the tax on movable and immovable property purchase, mainly because of the collapse of the real estate market, reduction of the construction sector, and decrease of motor vehicles purchases. The increased share of the own-source revenue for 2011 (35.5%) is partly due to the reduction of the state transfers and partly due to the increase in the tax revenue. In attempts to consolidate the crisis, national government centralized public sector expenditures, as the role of the state increased.

#### 4. Local Finance in Times of Crisis

Current financial crisis is often defined as the worst worldwide economic crisis since the Great Depression. However, a brief review of the country's economic development showed that the current downturn is not the most severe crisis, faced by Bulgaria during the last 20 years, mainly due to the lessons for fiscal policy drawn from previous crises and the Currency Board, which preserved financial stability.

Since the beginning of transition from centralized to market based economy Bulgaria has survived during two extremely difficult periods. First of all, following the 1990 moratorium on external debt repayments, Bulgaria lost access to commercial external financing. During the period 1991 – 1993 the expansion of the private sector took place against the background of the steep decline in production and high unemployment associated with the transition. The cumulative decline in real GDP during this period reached almost 25%, mainly due to the drop in domestic demand and loss of the export markets. The restructuring of the economy resulted in enormous unemployment rate, which went up to 16% of the labor force and stabilized around that level. Price liberalization caused severe inflation in 1991 (303.2%). After the initial price shock the inflation rate steadily declined to 73.4% in 1993. However, the sharp changes in relative prices and costs, and the drop in imports led to additional decline in the output. Reflecting the economic conjuncture during the period, consolidated budgetary deficit reached 12.1% of the GDP and public debt was calculated to 180% of the GDP.

Table 3 Basic Economic Indicators, 1991 - 2012

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Annual GDP Growth (%)	-11,7	-7,3	-2,4	1,4	2,5	-9,4	-5,6	4,0	2,3	5,4	4,1
Unemployment Rates (%)	11,1	15,2	15,8	12,8	11,1	12,5	13,7	12,2	16,0	18,1	17,5
Inflation Rates (%)	303,2	92,0	73,4	121,3	64,1	121,6	1058,4	18,7	2,6	10,3	7,4
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Annual GDP Growth (%)	4,5	5,0	6,6	6,3	6,3	6,2	6,0	-5,1	0,4	1,7	2,9
Unemployment Rates (%)	15,6	13,7	12,0	10,1	9,0	6,9	5,6	9,1	10,2	11,2	11,2
Inflation Rates (%)	5,8	2,3	6,1	5,0	7,3	8,4	12,3	2,8	3,0	3,4	3,2

Source: Ministry of Finance, Bulgarian National Bank, National Statistic Institute, Employment Agency

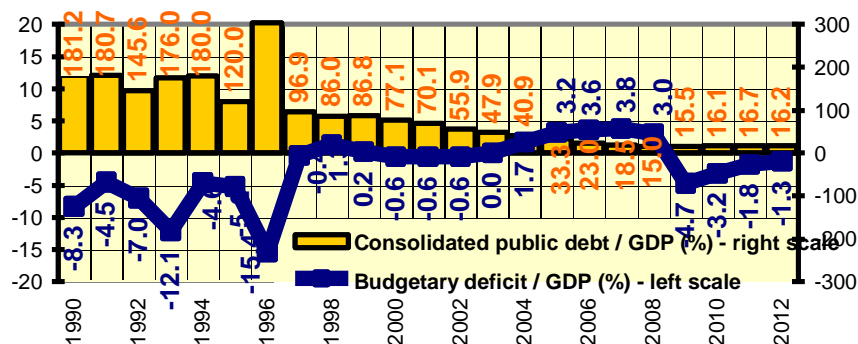
Note: Data for 2012 are based on prognosis



The second hard period was the financial crisis of 1996 – 1997. The two factors, which provoked the crisis, were bad loans on commercial banks' balance sheets and large government deficits. Until 1996, commercial credit in Bulgaria was expanded to a degree that was unprecedented relative to any other European transition economy. Government attempts to recapitalize the banks failed. The government replaced bad loans to enterprises with government bonds. Banks then made additional loans, so their balance sheets did not improve. The credit crunch was followed by series of bank bankruptcies. The economy slumped as a result of the collapse of the bank system.

At the same time the government bonds increased the level of government debt (303% of the GDP) and the interest obligations on this debt ballooned, creating enormous government deficit (-15.4% of the GDP). Hyperinflation of more than one thousand percent was registered in 1997, which totally deformed all the economic and financial relations.

Figure 2 Public Finance Indicators 1990 – 2012



Source: Ministry of Finance, Bulgarian National Bank, National Statistic Institute, Employment Agency

Note: Data for 2012 are based on prognosis.

As a last resort, the Currency Board was introduced on 01 July 1997, in order to restore the confidence in the national currency and bank system, to impose financial discipline and stabilize the economy. Generally speaking, Bulgarian Currency Board proved to be a great success. It established a fixed exchange rate and relied on automatic mechanisms to restore macroeconomic equilibrium, limiting severely the discretion of policymakers. From hyperinflationary levels during the first half of 1997, inflation fell to very low levels in the following years. The significant decrease of nominal interest rates made it possible for the government to reduce large government deficits. The economy started to grow, although more slowly that might be hoped during a recovery period.

The anti-crisis measures in response to the current worldwide crisis were taken comparatively late – in the second half of 2009, mainly due to the national elections in mid July. The efforts of the newly elected government were aimed at stabilizing public finance and diminishing budgetary deficit to the end of the year. The government actions were related both to the revenue and expenditure side of the state budget, mainly intended to increase the efficiency in the public sector. First of all, state administration was significantly reduced (by 15%), and salaries in the public sector were frozen for an indefinite period of time. As part of the measures intended to optimize administrative expenses, the Parliamentary Commission of Regional Policy and Local Self-government discussed the possibility of merging municipalities with few citizens. According to the Law on Administrative Territorial Structure of the Republic of Bulgaria (§8 (1) 1), municipalities must have population of at least 6000 in order to be administrative centers. Although local government in Bulgaria is not very fragmented, having in mind that the average municipality has 30 000 citizens, such a measure would affect 53 municipalities with population between 1242 and 5944. However, representatives of the central government declared that merger of municipalities could become a reality only after referendum.

Secondly, public sector investments were postponed for better times. Targeted capital investment subsidy, which used to be a significant source of financial resources for the local governments, has been reduced with 65.8%, from 205.5 million BGN<sup>316</sup> in 2009 to 117 million BGN in 2010, 90.2 million BGN in 2011 and 70.2 million BGN in 2012. Under the circumstances, most of the local governments rely on the European funds for investment financing. Moreover, the central government assumed the responsibility to pay on behalf of the local governments the required 5% project co-financing, in order to support local investments.

<sup>316</sup> BGN is the abbreviation on Bulgarian currency. According to the Currency Board provisions 1 EURO is equal to 1.95583 BGN.

Thirdly, tax collection efforts were strengthened. Bulgaria applies the lowest tax rates of the personal income tax and corporate income tax (both of them equal to 10%) among the EU countries, so the most popular anti-crisis fiscal measures (decreasing income taxes) are not applicable. (European Commission. 2009a) Instead, the National Revenue Agency launched large scale audits of legal entities and physical persons in order to improve tax collection. Moreover, local governments were given full legal rights of public executives, meaning in essence that they can levy distraint upon the bank accounts, salaries, and properties of the incorrect taxpayers. In order to expand local fiscal capacity, the maximum rates of the tax brackets were increased from 2‰ to 4.5‰ for the property tax and from 2.6% to 3.0% for the tax on the movable and immovable property purchase. In spite of these measures, public sector revenues dropped significantly, especially in the second half of 2009, mainly due to the decreasing economic activity.

At the same time consolidated public sector arrears increased nearly ten times, from 81.6 million BGN in the end of 2008 to 799.0 million BGN in the end of 2009. Local government arrears reached 196.8 millions BGN in the end of 2009 and 207.1 millions BGN in the end of 2011, which is the highest level since the start of financial decentralization reform. It is interesting to note that public sector arrears are more rapidly accumulated at the central level than the local level. During the period 2004 – 2008 local governments' arrears have formed more than 90% of the total public sector arrears. In the end of 2009 they represent only 24.6%. The increased amount of local arrears is partly due to the low local revenues. In 2009 only 60.2% of the expected local revenues were actually collected. On the other hand, pressed by the scarcity of financial resources, central government retained 10% of the state subsidies for the municipalities, which is in accordance with the regulations of the Annual State Budget Act 2009 (§17).

Table 4 Public Sector Arrears

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
1. Central Government Arrears (mio BGN)	54.8	2.2	4.8	4.6	2.8	8.0	602.2	237.2	169.4	146.9
2. Local Government Arrears (mio BGN)	74.3	42.3	47.9	51.4	54.2	73.6	196.8	194.3	207.1	179.2
3. Consolidated Arrears (mio BGN)	129.1	44.5	52.7	56.0	57.0	81.6	799.0	431.5	376.5	326.1
4. Local / Consolidated Arrears (%)	57.5	95.1	90.9	91.9	95.3	90.2	24.6	45.0	55.0	55.0
5. Local Deficit / Local Expenditures (%)	- 2.9	1.3	-5.1	2.4	-1.1	-4.2	-7.8	-1.8	-0.7	-0.3
6. Consolidated Deficit / Consolidated Expenditures (%)	0.0	4.3	8.0	9.6	8.9	7.9	-2.4	-10.6	-5.5	-10.4

Source: Ministry of Finance, Note: Data for 2012 are for Q1

It is interesting to note, that local governments in Bulgaria have generally not been sources of severe fiscal deficits in recent years, as a result of the adopted equalization scheme. According to the calculations smaller municipalities register lower indebtedness. The equalization scheme provides smaller local governments with more subsidies per capita and thus compensates them for the shortage of funds caused by low fiscal capacity. Because large and medium size municipalities traditionally rely more on the own-source revenues than on the governmental transfers, they have lost significant part of their revenues due to the economic downturn. However, the local deficit did not exceed 7.8% of the total municipal expenditure in 2009 and decreased to 1.8% in 2010 and 0.7% in 2011, so it does not represent a significant burden on the local budgets.

## 5. Conclusion.

During the period 1991-2012 Bulgaria has made remarkable progress in reforming and decentralizing local government finance. First of all, the most important pillars of the legal base of local self-government have been adopted, providing a stable background of financial decentralization.

Secondly, the importance of local governments has significantly increased, as a share respectively into the gross domestic product and consolidated public sector of the country. Thirdly, expenditure assignment and intergovernmental transfer system have been put on a clear and transparent basis. Fourthly, local governments have been given full control over some of the own-source revenues (local fees, service prices and revenues from municipal asset management) and limited control over the local tax levy. As a result local governments became powerful component of the public sector.

The process of financial decentralization in Bulgaria has been hampered by the worldwide economic and financial crisis. In spite of the anti-crisis measures, public sector revenues dropped significantly, especially in the second half of 2009, mainly due to the decreasing economic activity. The current crisis reached Bulgaria at comparatively mature stage of financial decentralization reform, but municipalities can do very little without active central government support and cannot substitute for it in regard of the basic anti-crisis measures.

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**FISCAL DECENTRALIZATION IN ALBANIA: PROBLEMS OF OVER-CENTRALIZATION**

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**Abstract:**

*Local government, is financed by a mixture of own revenues (primarily local taxes which are located within the limits established by law, and collected by local government), the division of collected revenues in the territory of the local units from national tax and grants transfer from central government. Local and regional governments have limited funds. Local revenue base is usually quite narrow; local-level governments are closely dependent on government transfers. These transfers require both administrative and economic costs, but are necessary in the majority of countries, particularly in transition and developing countries. The purpose of this paper is to analyze how deep the fiscal decentralization in Albania is. Political and administrative decentralization can have sense only if accompanied by fiscal decentralization. This is a necessary requirement for a successful decentralization. **Political decentralization** gives citizens the control over decision-making processes within the framework of rules established for institutional decentralization.*

***Administrative decentralization**, transfers the responsibility for planning, financing and management of public services from central government, to regional or local governments. **Fiscal decentralization** describes the system of local expenditures financed through local revenues, various types of transfers and government borrowing.*

*Parker<sup>317</sup> (1995) recognizes the impossibility of designing a single strategy for decentralization and the importance of a healthy combination of all three types of decentralization. In this paper will be treated the historical, economic and political circumstances that have affected the process of decentralization after 1990. Given that the basis for institutional positioning of Albania was established with the approval of the 1998 Constitution and other laws we will focus on the main decentralization reform efforts made in 1998 and 2000 and particularly the depth of administrative and fiscal dimensions.*

**Key words:** political / administrative / fiscal decentralization, local government, government transfers.

**JEL Classification:** H3.

1. **The historical circumstances, economical and political issues affecting the decentralization process after 1990.**

**The meaning of decentralization**

Decentralization has emerged as a need of delegating the responsibilities from central to local level, contributing to increased power efficiency, increasing the level of democracy, the distribution of responsibilities, bringing decision-making closer to the citizens. Decentralization does not give the same effects in all cases. The process of decentralization often affects the growth of bureaucracy, the increment of expenditures on bureaucratic apparatus and increases the possibilities of works delays and various abuses.

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<sup>317</sup> Parker Andrew. 1995. "Decentralization: The Way Forward for Rural Development.

- Western countries have applied decentralization because this process allows to reduce costs for public services;
- Developing countries, consider decentralization the most efficient form of governance;
- In post-communist countries, decentralization helps them to democratize and apply the market economy;
- Decentralization helps African countries to shift from monism to pluralism and to alleviate poverty;
- In Asian decentralized countries - is empowered civil society and the individual, local governments have replaced the traditional form of government.
- In Latin America, decentralization has led military dictatorships to be replaced by parliamentary democracies.

In relation to this process in the world today many questions have been raised: What is the boundary between what can and what can not be decentralized? What are the advantages of decentralized governance? How to increase the effectiveness and government transparency? What are the necessary reforms that requires the decentralization process? How to increase the participation of citizens in the development processes? How to increase the participation of citizens in decision-making? How to increase government accountability to citizens?

### **1.1. An assessment of the decentralization reform in Albania**

After nearly half a century of extremely centralized government, post-communist Albania entered the path of political decentralization and in 1992 held the first democratic elections in the country. Despite the importance of this initial political move towards increased democratic representation, administrative and fiscal autonomy remained very weak. The process of decentralization got a second boost in the late nineties, when it was formally ratified the European Charter of Local Self-Government, constituting its main principles in the new constitution, and the legal reform for local self-government was approved.

Local governments in Albania has started functioning for more than 15 years and after the decentralization reform in 2000 has managed to consolidate as an important part of the executive power both at regional and local level for effective and efficient exercise of its functions and public services. Since from 2000, the implementation of the decentralization process seemed closely related to the drafting of the relevant legislation to enable the transfer of responsibilities from central to local government. New organic laws "On the organization and functioning of local government" No. 8652 of the year 2000 and Law No. 8653 " On administrative-territorial division of the local government units in the Republic of Albania" marked the end of the old District Councils, thereby reducing direct political influence over the local state governance.

In Albania, the fundamental rights for a normal functioning of local governments are already defined in the above-mentioned organic law. Local governments are legally recognized as legal persons and enjoy legal rights belonging to local authorities in maintaining properties, exercising fiscal autonomy and planning their local economic development, as well as enjoy the right to collaborate and associate. However, complementary regulations that specifically define these rights and powers for local governance and the creation of objective local conditions, including local capacities and resources are part of the ongoing strategy of the government for the implementation of decentralization.

This stable legal framework would enable the functioning of the decentralized administrative and fiscal structures, which would include self-governing districts, municipalities and communes. It is necessary that for the decentralization implementation, the government should have a well planned strategy-a strategy to play the right role, namely in the creation of skills and institutions. Although far from completing the design of political, administrative and fiscal decentralization that could improve significantly service delivery, governance and accountability, an important progress for the development of institutions, on the basis of the new legal framework for implementation of the decentralization policies was made.

Supported by the Technical Group of Experts with international expertise on Decentralization (GED), it was created the National Committee (ministerial) for Decentralization (NCD); adopted a Strategy for Decentralization and Local Autonomy by the National Committee for Decentralization (NCD).

Decentralization strategy is based on the current structure of local government in Albania and their legal status, rights, authority, powers and responsibilities, administrative and territorial division, internal administrative organization, operation and relations with the central government elected bodies of local government.

The main achievements include: the completion of the basic legal framework for the administration of the territory, the implementation of the arrangements for local government property rights, assigning specific responsibilities and authority to local governments - including relevant joint functions, determination of an appropriate scale of revenue autonomy to local governments and the creation of balancing mechanism to minimize the bureaucratic and political impact as well as the implementation of a training strategy for local officials; it was adopted a new law on Prefects role and their relationship with local authorities; adopted the Law on State Owned Real Estate, Law on Transfer of State Property to Local Authorities, and the creation of the Agency for Inventory and Transfer of Public Property; transfer of some special key functions to local authorities (including some second-hand functions that have passed to the districts) as defined by local law; were developed methodologies, guidelines, manuals and was aimed at increasing the management capacities of local elected bodies in the field of infrastructure and public services, in the area of socio-cultural and sportive services, in the area of local- economic development and in the field of order and civil protection. Reforms in the field of decentralization includes the contribution and experience of all stakeholders involved in the process; central government and local elected officials, civil society and donors or the international community<sup>318</sup>.

In addition to the European Charter of Local Self-Government and the drafting of: "On the functioning and organization of Local Self-Government" law, in 2000, was approved the implementation of the Government Strategy for Decentralization. Although desirable in the long term, the reform of administrative-territorial division of the country is not a necessary condition for the continued implementation of the decentralization strategy. In practice, many challenges remain to be overcome that this system can be fully enforced. Currently the implementation of the reform process has been different for various sectors and not always has been well-performed and understood.

The principle of subsidiary has not been fully respected, not in the standard level, low service efficiency, the implementation of specific responsibilities for the provision of public services and asset management and separation of powers in terms of funds is still waiting for a decision-making, significant spatial inequalities, conflicts over the management of border territories of local government, the role of the districts is still unclear, overlapping responsibilities between districts and prefectures, spatial planning with uncoordinated strategic planning, uncertainty about the form of regionalization in Albania, local capabilities are not in the same level with the scale of the problems in order to be faced

Going forward requires open dialogue between central and local government, requires that the transfer of resources from central to local government to be transparent and credible. Walking forward requires public services to improve their service management in order to have their funding and to not become a burden to central governments. Citizens need to hold accountable their representatives in the central or local government, and they should be fully engaged in setting priorities and making decisions that affect the lives of citizens. Although in Albania, as in many other European countries, continues the segment of local administration units as a major problem for an efficient and equitable realization of public services at the local level, there are various possible way to avoid this problem in the short and medium term without damaging social and political stability. In fact, mandatory mixture of mandatory and homogeneous assignment of responsibilities to local governments are not the only possible way to adopt the benefits of high efficiency, economy of scale and positive external economic factors that may associate the decentralization. In addition to strengthening capacity building (including the reform of institutions and training staff) at local level, and assigning responsibilities so asymmetrical, the government should facilitate and encourage the process of creating incentives for local government units to join their resources and implemented the services together (e.g. power supply, water, telephone, social services), including voluntary merger, creating temporary joint ventures and temporary agreements<sup>319</sup>.

Although the country began the path of political decentralization in 1992, the pace of decentralization increased dramatically during the past five years due to the strong demand for the improvement of public service delivery, governance and accountability in the use of public resources and the strengthening of local autonomy. Until 2000 in Albania was consolidated somewhat the political and administrative decentralization.

<sup>318</sup> "Democratic governance at local level - Case of Albania" published by the Albanian Institute for International Studies, Tirana, 2003.

<sup>319</sup> Report- document of World Bank, august 2004.

Despite the importance of this initial political move towards increased democratic representation, administrative autonomy and especially local fiscal autonomy remained very weak.

## 2. Administrative and Fiscal Decentralization

Administrative decentralization aims at transferring decision-making authority, resources and responsibilities for a number of public services from central to lower levels of government, agencies, representations, etc. In the reforms of decentralization system, fiscal decentralization is one of the major challenges. Article 112 of the Constitution, assumes that there can be no autonomy in the exercise of functions or powers without financial and fiscal autonomy. Fiscal decentralization is the most comprehensive and most measurable form of decentralization, and directly related to the budget. Fiscal decentralization has to do with re-allocation of funds from the central institutions at lower power levels. The transfer of complicated and numerous competences in many important areas must be preceded by a relevant transfer funds. Decentralization should be financially supported<sup>320</sup>.

The main goal of fiscal decentralization is to increase efficiency in the provision of public services. The increment of efficiency and accountability provided by the decentralization of public service delivery requires a degree of local revenue autonomy so that the fund allocation to reflect properly local preferences and needs. Only if local governments are guaranteed secure income and a real degree of autonomy, spending priorities can be planned and executed with precision.

This is a precondition for local responsibility. On the contrary, once again, it will be proved that gaining more rights without sufficient money, mainly represents a load than a right.

### 2.1. Legal basis of fiscal and administrative decentralization

Local authorities in Albania enjoys fiscal autonomy defined in the Constitution of the Republic of Albania, the organic law No. 8652 of 2000 and Law No. 9632 of 2006 "*For the local tax system.*" The constitutional principle defines that the types of taxes, the base and their level are determined by law.

Provisions in relation to local government revenues are in line with the European Charter of Local Self-Government, and are also reflected in the decentralization strategy, which defines that: "Local authorities should be given sufficient financial resources in order to cope with the responsibilities of expenditures; a good part of these financial resources should come from local taxes and tax rates, and in some cases, the tax base shall be determined independently by the respective local councils". In this context, the decentralization reforms described in the new law of local government (Article 16) has identified important income resources for communes and municipalities, such as:

- ∅ Tax on movable and immovable properties and their transactions;
- ∅ Tax on economic activity of small businesses, including local services;
- ∅ Tax on income from donations, legacies, wills and local lotteries;
- ∅ Other taxes prescribed by law;
- ∅ Fees for public services (for example: water supply and sewerage);
- ∅ Fees for the use of public spaces (e.g.: parking and billboards);
- ∅ Administrative fee (e.g.: for extrusion license, permit and authorization).

By the mid-90s, almost all local expenses were funded by conditional grants and local governments practically had no budget autonomy. Sources of revenue that belonged to local authorities were only a few local taxes that did not raise any weight. However, by 2001, the fiscal autonomy of local government remained modest.

<sup>320</sup> Fiscal Decentralization and Grant Transfers In Transition Countries: A Critical Perspective

State budget expenditures for local governments took only 5% of the total state budget expenditures. On the other hand, transfers from the state budget was dominated by conditional transfers, while block grant (which was a semi-conditional transfer), took about 16% of local expenditures. Until 2002 the state still controlled over 97 % of total government revenue and practically owned all the decisions related to fiscal policy and tax administration.<sup>321</sup> Only in December 2002 was approved a fiscal reform package that regulates the passage of most taxes and fees prescribed in the organic law of the local government and gave local governments potentially significant sources of income. Was conducted the reorganization of transferring income sources through the resetting of some former national taxes as local taxes such as: property taxes on buildings and land, small business tax, vehicle registration fees, creating new local taxes and fees as tax on the sale of properties, simplified profit tax, provisional tax, reclassifying previous tariffs and eliminating existing local tax on restaurants turnover, discotheques, hotels, cafés and bars.

In 2002 based on the state budget law was passed for the first time the concept of unconditional transfer to local governments based on an allocation formula for each unit of local government. The effect of this formula on local government transfers is evaluated as positive in terms of its criterion of proportionality, justice and equality (equalization) in the distribution of funds allocation. The unconditional transfer allocation formula has been improved year after year in order to have more objective criteria and a representation of local government units needs. While passing the taxes to the local government, an equalizing element was introduced in the formula in order to regulate the transfer of local government, coordinating their fiscal capacity. The correction of fiscal capacities also has corrected the equalization coefficient as in 2006. Local government bodies, in the exercise of their legal functions, have full rights to decide on the way, the destination and the amount of funding for each voice, in connection with its own funds, provided by internal resources or funding with unconditional funds from the state budget.<sup>322</sup>

Local government bodies do not develop economic activities with real intention to ensure profits. However, being treated as entities and legal persons with full capabilities for independent properties and finances, based on the law they are not excluded from the opportunity to develop economic activities. In particular, they arise in cases where the completion of a service by them requires such activities like: management and distribution of drinking water, waste refining, exploitation of the facilities in favor of the community and in general of public properties in administration, etc. In all these activities, the local governments, in accordance with legal definitions have complete freedom to find the most appropriate ways and forms, but in addition to transparency with the public, they should apply all the legal schemes of creation and income and public property usage, set by law.

Local government has the right to create revenues from other income sources such as rents and property sale, donations, interest income, etc. These are secondary tools because these are not an essential function of local government. Local government is allowed to borrow<sup>323</sup> only for capital investments or to refinance loans / existing debts and to issue financial instruments like bonds. The law establishes the rules and the specific qualitative and quantitative criteria for obtaining credit and loans. The municipal council has the authority to approve loans / credits while the Mayor has the power to negotiate the terms and conditions of the loan agreement with the respective banks.

Local autonomy is also expressed in the administration of local taxes and fees. The law on local government has established general criteria and norms for border control and decision-making power of communes and municipalities not only in determining the tax percentage within a margin prescribed by law and local tariff level in accordance to the general policies and principles defined by the central government, but also in determining a system for the collection and administration of their income in accordance with the criteria and guidelines set out in the relevant legislation. There are municipalities by themselves that collect the revenues from taxes and fees through local tax offices and independently can improve the tax and local fees collection system and unpaid tax liabilities. Local tax offices enjoy the same rights as tax offices depending on central government. In relation to the districts, local law provides the application of all the above mentioned criteria and norms specified for communes and municipalities. Local law allows them to impose regional taxes and fees for services, although it remains open to other specific laws for determining their income sources.

## **2.2. The performance of administrative and fiscal decentralization process (implementation-depth and its deficiencies.)**

<sup>321</sup> Monitoring Guide of Local Government.

<sup>322</sup> Budget Law of every fiscal year.

<sup>323</sup> Law No. 9869 dated 02.04.2008 "On local borrowing"



Political resolution to decentralize fiscal and administrative decisions has been taken, and a minimum institutional base and legal framework somewhat stable is created.

The implementation of administrative and fiscal decentralization shows encouraging results, which in accordance with the decentralization experiences in transition countries will become hope and encouragement for a more energetic and faster implementation of decentralization. Currently, significant improvements have been made in this area, as local tax laws or the right for decision-making for their financial resources. Significantly have been improved decision-making skills of local government units in terms of expanding the structure of internal financial resources, clearly have been defined the skills of local councils to assess opportunities and to set the level of fees, in accordance with regulatory legislation at national level, to harmonize development policies at national level with socio-economic stage of the entity, the right of local government to determine the tariffs for public services that are carried out by them, the right of decision-making for the way the funds are used (expenses performance).

However, the decentralization process is still hampered by several limitations. Despite the increased confidence in local government and the fact that some municipalities and communes have been able to achieve tangible results in service delivery and urban development, the implementation of reforms to successfully decentralize fiscal and administrative decisions was not at the right level and back with deadlines. Local government bodies (especially communes) are still skeptical and feared in the success of the decentralization implementation phase, primarily as a result of insufficient funds, namely of their available financial resources.

Although district councils no longer exist after the reform of 2000, the separate districts (as geographical and statistical concept) still continue to be used by central government institutions as a tool for planning and monitoring their de-concentrated activities in the territory. "Apparently Albania, continues to be a typical example of the decentralization of local authorities decision-making power that is confused with the simple de-concentration of the ministries functions in the territory. This approach has overloaded the central administration and has led to major problems with regard to allocation fund and operational efficiency and has created ambiguities and uncertainties about the strategic directions of the government's decentralization strategy."<sup>324</sup>

There is still institutional weakness and low implementation capacity, which limits the voice and participation of citizens in local affairs, as well as in the transparency and accountability of local governments. The concern of public, communities and civil society about the way these public funds are used and spent by local authorities is increasing. Political resistance and bureaucratic obstacles block and continue to delay the pace of decentralization. Ineffective system of transfers /grants makes financial system of local government unpredictable, because it remains dependent on adverse political and bureaucratic maneuvers.

Special competences of districts, municipalities and communes need more clarification, especially for common functions, to avoid the lack of efficiency and duplication or the non provision of proper services. The division of local government units and the undefined role of the regions negatively affect the efficiency of public service delivery, fiscal transparency and reliable accountability. There should be a further improvement in terms of report consolidation with the central government regarding the financing way of national incomes, the management of the budget by the local government units, financial control, etc., as the legislation in this area still does not reflect fully and clearly this constitutional principle. New Law draft "On national budget" and the new Law "On local Finance" (which includes all the necessary adjustments for national tax sharing) is still pending. In order to increase local revenue autonomy, it may consider as important the development of three main lines of action.

- Promoting fiscal efficiency and accountability;
- Maximizing local revenue collection;
- Improving the fairness of the tax system.

The continuation and deepening of the decentralization reform will be a measurable process. In this context, it is aimed to develop an independent and measurable evaluation of concrete results achieved through the decentralization strategy.

<sup>324</sup> "Albanian decentralization in transition", volume II. Analytic report august 2004.

This will be used to evaluate the effectiveness of the process, to modify the strategy according to the needs and to inform leaders and the public about the results achieved.

The main components of the measurement will be:

- Compliance with the principles of the European Charter of Local Autonomy
- Compliance with the objectives of the Albanian Government to the SAA<sup>325</sup>.

This means that the implementation of decentralization is a gradual adjustment process and not a political irreversible / fixed measure from the top to the base. A reliable program to implement the Government's decentralization strategy requires detailed scheduling priorities and time alignment of key reform measures.<sup>326</sup>

### 3. Conclusions.

In current practice three types of decentralization are known: political, administrative and fiscal decentralization. The decentralization process is generally regarded as a consensual process, accepted by all stakeholders and assisted and appreciated by the international factor.

In our country this process regarding the volume of transfers of functions and competences from central to local government has been slow but the steps taken were safe and during the recent years has not been noticed any failure or setback in this process.

The first level of local governance has been more consolidated in relation to the second level which is not yet clearly completed to the role and function that should play.

In the process of decentralization, local government units have their roles and responsibilities, which go beyond the performance of services, a role that belongs to short, medium and long term program drafting for, the local development, in accordance with the provisions of the local government organic law.

The decentralization Strategy, adopted in 1999, generally retains its value and is an important tool that guides the process. However, this strategy was not taken into consideration by special sectors for combined issues.

Fiscal decentralization in Albania recently has been developed in accordance with the basic principles of the strategy, improving and consolidating local finance schemes, increased fiscal and financial autonomy.

In accordance with the form that is applied it can be said that local autonomy is greater in the direction of local rates than for local taxes, however the discretion that the law gives the city council for several types of taxes allows the latter to make relevant policies for local taxes. The performance in the collection of local taxes and fees depends on the ability of local units.

In terms of a broader fiscal autonomy and transfer of a growing number of competences to local governments, in order to guarantee the effective exercise of the mandate by local officials as well as to ensure more public services carried out by the local government with more quality, loans allocation to local government will strengthen significantly their financial and economic capacity.

The implementation of decentralization is a gradual adjustment process and not a political irreversible / fixed measure from the top to the base. A reliable program to implement the Government's decentralization strategy requires detailed scheduling priorities and time alignment of key reform measures such as increasing efficiency and fiscal accountability, increased autonomy of local revenues, maximizing the collection of local fiscal revenues, by strengthening the local tax administration and improving the fairness of the fiscal system, reducing regional disparities in per capita income.<sup>327</sup>

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**SECTION IX: SERVICES INDUSTRIES BRANDING MARKETING AND CRISIS MANAGEMENT****COST QUALITY MANAGEMENT - IMPERATIVE FOR COMPETITIVE ADVENTAGE**

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**Abstract:**

*Within the contemporary economic conditions, enterprises might achieve a competitive advantage if only they sell goods and services with high quality and lower prices. Customers, usually, prefer quality goods with acceptable prices, while such goods create reputation with the particular brand. The perfect control system is necessary to achieve a high quality product, which the cost quality management is considered to be an indispensable part in. The cost quality is nevertheless created to ensure that customers' requirements are being appropriately attained. The most important objective of quality costs controlling is to assist the management in enhancing the product's value permanently. The superior cost quality control system helps the management to achieve other strategic objectives, such as: producing goods with acceptable costs and deliver the products to their customers in time.*

**Key words:** quality costs, quality management system, total quality management.

**JEL Classification:** M10.

**Introduction**

Within the contemporary economic conditions, enterprises might achieve a competitive advantage if only they sell goods and services with high quality and lower prices. Competitive advantage refers to the ability of enterprises to accomplish their operations better than the other companies, since they are proficient to produce goods and services more efficiently and effectively. The competitive advantage itself is being characterized by several factors, such as: efficiency, quality, innovation and customer's needs.

Enterprises might achieve enhanced efficiency if only they accomplish to reduce necessary recourses (manpower and raw material) in manufacturing their products and services. Within contemporary competitive conditions, enterprises are looking for new, better methods to reduce resources consumption, to improve their efficiency. The employees have been educated by their companies to learn new skills and techniques, which are compulsory to accomplish different operations on computerized equipment.

Global competition require from companies to improve employees' skills and abilities, which contributes goods and services with better quality. Companies apply different techniques to improve product's quality, such as TQM – Total Quality Management. Namely, employees who are involved in the process of TQM are organized in quality control teams and they are obligated to investigate new and better techniques to achieve their operations, as well as controlling and evaluating quality of their products.

Innovation is process of creating new products and services which customer desired, whereas exploring modern methods of producing new products is particular challenge. Management ought to create ambience for employees to motivate them to be innovative. Innovation management is one of the most difficult management's obligations.

Enterprises dispose quality products and services to the costumers to live up their expectations. Therefore, they are obliged to permanently educate their employees. Namely, retail subjects, services trade, banks, hospitals etc., truthfully depend of their employee's attitude.

Customers, usually, prefer quality goods with acceptable prices, while such goods create reputation with the particular brand, ensures to the company to sell the products with higher price than the competitors. On the other side, enhanced quality denotes better efficiency, and opportunity for the company to reduce the costs and to increase the profit.

Enterprises' strategy ought to base on quality products and services, because that brings many advantages, such as:

- customers can buy products with higher value;
- enterprises enhanced their reputation, because their products have been bought by further customers and they achieve better market participation, such as better financial result;
- management achieve better results, and better results contribute higher salaries and increased production;
- employee have better control on their activities;
- capital owners achieve additional revenues for different investments.

- **Quality Management System**

Quality Management System is very complexity process which starts with the customers' needs and ends with customer reaction on product quality. Actually, this system comprises six phases, such as:

- understanding customers' needs;
- establishing quality objectives;
- establishing business processes to achieve the objectives;
- accomplishing the activities and remuneration by effects;
- delivering the product to the customers and controlling the customers' experience and
- analyzing the sources.

Quality management first step usually considers the customers' requirements related to the quality. At this point the management evaluates the customers' necessities with respect to the performances of products and services.

The next phase in quality management system is transformation of customers' needs in adequate quality objective. Nowadays, many enterprises consider the percent of undetected products as the ultimate quality objective.

More complexity products convey increased opportunity for products' defects.

The third phase in quality management system comprises business processes that ensure producing products with required level of quality. This, imply permanently machine maintenance, creating control systems, controlling quality of raw materials, etc. All this activities are undertaking to avoid eventually defects, and essentially they are preventive costs.

The objective of this phase is to attempt activities to find out the defects or mistakes. Namely, it's verifying the quality of products whether they satisfy the customers' needs. These costs are assessment costs. If defected products are noticed, it should be re-processed, and the costs created for accreting the defected products are internal failure costs.

When the product is completed, it is delivered to the customers and waiting their reaction. If the product doesn't live up their expectations, the customer might complain or return the product, or claim its' price correction. All costs tied with the defects correction, explored by the customer are external failure costs.

If there isn't complaint of the product and the product live up customers' expectations, than management quality isn't completed.

The experience of many enterprises confirmed that customers eternally expect something new and more quality then previous. That's why, enterprises continue their researches to make perfect products' and services' performance.

The last phase of quality management is analyzing the major reasons of products' defects. Analysis should find out the reasons for the defects and give directions to satisfy customers' needs. The results of analysis might be used to redesign the business activities and to avoid the same or appropriate problems.

Information that produces the Quality Management System has an enormous significance for the management. Managing with the quality results with a lot of benefices to the organizations such as: better quality, reduced costs, fast market penetration and enhanced product distribution. All this contributes to increased profitability.

Many researches associated with this, argue that the enterprises which implemented the Quality Management System have quality cost around 5% of the income. On the other hand, that companies which don't implement the system have higher quality cost, i.e. 15-20% of the income.

- **The mean of managing with the quality costs to contemporary management**

To achieve high quality of the products, behind the Quality Management System it is essential to practicing perfect control system. In the structure of this system, one of the most important segments is the Quality Cost Control System. That is to say, good system of measuring the quality costs assists to the management to realize some strategic goals, as: producing products with acceptable costs and their appropriate distribute to the consumers. As a meter of fact, well designed Quality Cost Control System is espousal of the effective management with the quality and insure to the enterprises to compete with quality product.

The cost quality is nevertheless created to ensure that customers' requirements are being appropriately attained.

Many enterprises classify quality costs in subsequently categories: prevent costs, evaluation, internal failure costs and external failure costs.

**Preventive costs** are nevertheless created to avoid occurrence of quality problems. The preventive costs are actually those for education and personnel training ones usually associated with the production of the quality goods intended to reduce the defected products.

**Assessment costs** are created to evaluate and control activities tie with the quality. In fact, these are the costs in control department which have obligation to confirm the defected products.

**Internal failure costs** are created with the defected products correction revealed before their selling to the customers. Actually, these costs are created in defected products re-processing.

**External failure costs** are created in correction of defected products exposed by the customers, such as repairing products in guarantee period.

The main objective of the control of these groups of quality costs is to facilitate to the management to increase the value of the product. Awful products' performance creates costs for the company, as well as for the customer. The improved performances of the products reduce the manufacturers' costs, since there is no necessity of re-processing the defected products. Enhanced product's performances, also reduces the costs of the product's life cycle.

- **The concept and evolution of Total Quality Management**

Total Quality Management as strategic technique was developed by Edward Deming, professor on New York University Graduate School of Business Administration. But, this author hasn't had success in assuring the USA's companies to adopt Total Quality Management, unlike of success he realizes in Japan.

Namely, after The Second World War, General MacArthur took 200 scientists and specialists, including Dr. Deming, to Japan to help rebuild the country. While working on the Japanese census, Dr. Deming was invited by the Japanese Union of Scientists and Engineers to give lectures on his statistical quality techniques. After attending the lectures, the professor told his CEO students that, if they wanted to turn Japan's economy around in five years, they should attend Dr. Deming's lectures on using statistics to achieve quality at a reduced cost. Many of the CEOs took the professor's advice and attended the lectures. Eventually, many Japanese manufacturing companies adopted Dr. Deming's theories and were able to produce quality products at reduced costs.

While the Japanese business world was concentrating on producing quality products, businesses in the United States were more concerned with producing large quantities of products. Their emphasis on quantity at the expense of quality let the Japanese, with their inexpensive, high quality products; gain a substantial foothold in American markets.

Consequently, in the 1970s and 1980s, many American companies, including Ford, IBM, and Xerox, began adopting Dr Deming's principles of Total Quality Management. Namely, Total Quality Management was mostly accepted and implemented in the production companies which were confronted with pressure of global competition, especially of Japanese companies.

Total Quality Management is management style based on producing quality products and services to satisfy the customer needs. Namely, TQM is defined as a system based on quality products and customer needs, based on facts, team leading, and process lead by the junior management with elementary aim to realize the company's strategic imperative by continuous improvements.

The word total of Total Quality Management means that all employees in the company must be involved in the process of continuous improvement, the word quality is related with the preoccupation to satisfy the customer needs, and the word management refers to the employees and processes needed to comprehend the intended quality.

Total Quality Management is not a program; it is a systematic, integrated, and organizational way-of-life directed at the continuous improvement of an organization. It is not a management fad; it is a proven management style used successfully for decades in organizations around the world. TQM is not an end in itself; it is a means to an organizational end. Total Quality Management must not be the primary focus of an organization; it should merely be the means to achieve organizational goals. Total Quality Management differs from other management styles in that it is more concerned with quality during production than it is with the quality of the result of production. Other management styles have different concerns. This system recognized that the quality of the products that produced the organizations might significantly differ from the quality that wants the customers.

If the customer isn't satisfy with the service, then the service doesn't have required quality and the processes that produced it will result in failure. In such a way, the implementation of TQM became an imperative for the management of contemporary companies.

For successful implementation of TQM the organizations have to eliminate some determinants that have negative influence on TQM.

Namely, management has to recognize the process, to be involved in it, to understand the problems and to set up models to their employees. The management creates company's vision and set up long-term plan oriented to realizing the crucial goals, but the whole organization has to accept the plan. Then, the management ought to delegate authorities to the employees and to orient them in real direction. Thus, employees got control on their activities and believe that they are part of the process of decision making, more motivated, they begin to be proud of their job and contribute to performance improvement and enhanced quality.

Accordingly, the most important mission of the management is to ensure to their employees to feel like an integral part of the organization and to prevent workforce mobility which is unsatisfied of manipulation in the organization.

The second key determinant of successful implementation of TQM is the way of organizational results assessment. Namely, the application of organized performances assessments, annual inspections on performances might result in very high duress quotes which have negative influence on team working in the organization. Consequently, the management has to ensure individually explanations for the employees which will have positive influence on process improvement.

At the same time, management has to ensure trust from their employees that the organization emphasis the long-term despite short term improvements.

## CONCLUSIONS.

The perfect control system is necessary to achieve a high quality product, which the cost quality management is considered to be an indispensable part in. The cost quality is nevertheless created to ensure that customers' requirements are being appropriately attained. The superior cost quality control system helps the management to achieve other strategic objectives, such as: producing goods with acceptable costs and deliver the products to their customers in time. Namely, good designed cost quality control system supports effectively management quality and the enterprise might compete on the market with quality product.

The most important objective of quality costs controlling is to assist the management in enhancing the product's value permanently. Awful products' performance creates costs for the company, as well as for the customer. The improved performances of the products reduce the manufacturers' costs, since there is no necessity of re-processing the defected products.

Total Quality Management is management style based on producing quality products and services to satisfy the customer needs. It has some short-term advantages. Most of its benefits are long term and come into effect only after it is running smoothly. In large organizations, it may take several years before long-term benefits are realized. Namely, long-term advantages which may be expected from TQM are higher productivity, increased morale, reduced costs and better customer loyalty. These benefits may lead to greater public support and improved public image about the organization.

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## FINANCIAL CRISIS, CAUSES, IMPACT AND POSSIBLE SOLUTIONS

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### **Abstract:**

*This research concentrates on the fundamental causes of the current financial crisis and the impact of it in the banking system and more on the economy. The subprime mortgage crisis of 2007 was characterized by an unusually large fraction of subprime mortgages originated in 2006 and 2007 becoming delinquent or in foreclosure only months later. The banking crisis melted down a large part of the value of bank assets all over the world. This meltdown started with poisoned assets, notably subprime mortgages of US banks, but quickly spread to bank assets in other countries and a crash of global stock markets. The crisis that started in August 2007 originated from two factors: macroeconomic policy, especially the interest rate policy of the central banks, and a financial system built on the premise that there would always be too much liquidity, never too little.*

**Key words:** Banking system , Financial crisis, subprime mortgage, interest rate,

**JEL Classification:** G01, G15, G21, G24

### **Introduction.**

Two of the most characteristic features of financial crises are the :

- *Credit crunch*, a pervasive withdrawal of credit and decline in willingness to lend. Wojnilower (1985) defines a credit crunch as a “blockage in the supply of credit—a sudden and unanticipated intensification of nonprice rationing” (p. 351). At the time the term was introduced, it referred largely to bank lending, but fairly describes the behavior of nonbank intermediation as well.
- *Liquidity crunch*, an intense increase in liquidity preference and the desire to exchange other financial assets for money. In the most extreme cases, all but the closest money substitutes are rejected in favor of cash or precious metals.

According to the literature the general features of a severe crisis from a welfare point of view are the decline in real economic activity , which is the most important manifestation of a crisis, unemployment rises, economic growth slows or becomes negative, and output declines, causing widespread suffering. The deterioration in business conditions tends to be worse and longer-lasting, the more badly the financial system is impacted”. In the below sections of our paper we will be focused in the understanding the financial crisis that happened the last years and its consequences , the next section is about the long and short run measures that the governments must take in order to control the crisis consequences. Section three contains the measures that should be taken then closing with some conclusions in the last section.

### **1. Understanding the financial Crisis of our time, causes and consequences**

#### 1.1 What causes the subprime crisis of 2007?

The *subprime crisis* is seen as a historic turning point in our economy and our culture. Such crisis came as a result of a speculative bubble in the housing market that began to burst in the United States in 2006 and has now caused ruptures across many other countries in the form of financial failures and a global credit crunch.

The crisis that started in August 2007 originated from two factors:

- macroeconomic policy, especially the interest rate policy of the US Federal Reserve, and a

-financial system built on the premise that there would always be too much liquidity, never too little.

The Fed held interest rates at an extraordinarily low level for an extraordinarily long period of time after 2001. This low interest rate environment set the stage for a boom in asset prices, particularly in housing. After 2004 the Fed raised rates more sharply over a shorter period of time than at any time in the prior 25 years.

From the other side, since the late 1990s home prices and homeownership had been booming and its rate rose over the period 1997-2005 for all age groups, all racial groups and all incomes groups. Such an increase occurred as investing in a house had seemed a sure route to financial security and even wealth. From 1997-2005 (data from US home market) the homeownership rate increased from 65.7% to 68.9% (which represents an 11.5% increase in the number of owner occupied homes) c

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( fig 1).

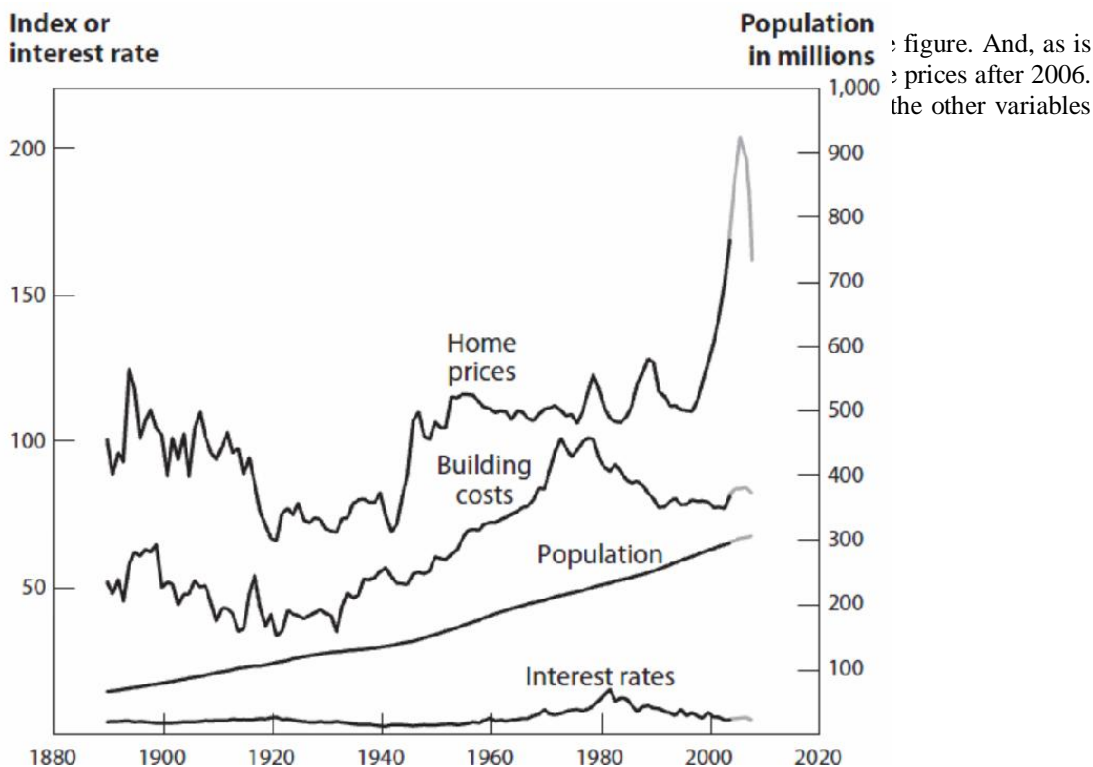


Fig 1- U.S. Real Home Prices, 1890–2008, along with Building Costs, Population, and Long-Term Government Bond Interest Rates, annual 1890–2008.

Source: From Robert J. Shiller, *Irrational Exuberance*, 2nd Edition (Princeton, N.J.: Princeton University Press, 2005), p. 13,

Low interest rates stimulate the economy by allowing more individuals to qualify for homes due to the lower monthly mortgage payment.

Encouraging homeownership is a worthy and admirable national goal. It conveys a sense of participation and belonging, and high homeownership rates are beneficial to a healthy society. But the subprime housing dilemma in the United States points up problems with over-promoting homeownership.

Mortgage originators, who planned to sell off the mortgages to securitizers, stopped worrying about repayment risk. They typically made only perfunctory efforts to assess borrowers' ability to repay their loans—often failing to verify borrowers' income. High home prices made it profitable to build homes, and the share of residential investment in U.S. gross domestic product (GDP) rose to 6.3% in the fourth quarter of 2005, the highest level since the pre-Korean War housing boom of 1950–51. The huge supply of new homes began to glut the market, and, despite the optimistic outlooks of national leaders, U.S. home prices began to fall in mid-2006. As prices declined at an accelerating rate, the boom in home construction collapsed.

At the same time, mortgage rates began to reset to higher levels after initial “teaser” periods ended. Borrowers, particularly subprime borrowers, began defaulting, often owing more than their homes were worth or unable to support their higher monthly payments with current incomes. Now many of the financial institutions that participated in what once seemed a brave new world of expanding homeownership and exotic financial innovation are in varying degrees of distress. The world's credit markets have shown symptoms of locking up. The crisis has bled over to other sectors besides housing.

The effects of the financial crisis have also filtered into other countries, as witnessed by the failures of IKB Deutsche Industriebank AG, SachsenLB, WestLB, and BayernLB in Germany, the failure of funds sponsored by BNP Paribas in France, and the run on the Northern Rock Building Society in the United Kingdom.

During this housing boom, most of the authorities simply denied there was a problem. The impact of the loose monetary policy was amplified by the large number of adjustable-rate mortgages issued after 2000, particularly to subprime borrowers.

Adjustable-rate mortgages were common because those who had been influenced by bubble thinking and wanted to get into real estate investments as heavily as possible were demanding them. The mere fact that interest payments would be going up soon did not deter them. They expected to be compensated by rapidly increasing home prices, and they believed that those higher prices would permit them to refinance at a lower rate. Subprime borrowers wanted these mortgages in disproportionate numbers both because they were less quantitatively sophisticated and because they were consumed by the mere thought of somehow gaining a foothold in the housing market.

The demand for loans made with more flexible standards was accommodated by lenders because they themselves (as well as the investors in the mortgages that they sold off) believed in the bubble. That is why the period of soaring real estate prices corresponded to a time when no-documentation loans became common and when option ARMs and other questionable new mortgage types proliferated.

Moreover, the rating agencies that pass judgment on securitized mortgages persisted in giving AAA ratings to mortgage securities that ultimately were vulnerable because they too believed that there would be no bursting of the bubble. Even if they did harbor some doubts about the continuation of the boom, they were not about to take the drastic step of cutting ratings on securitized mortgage products on the basis of the theory, not widely held, that home prices might actually fall. That would have been an unusually courageous step—and one that was all too easily postponed in favor of other business decisions that were easier to make, until it was too late.

Another factor often mentioned as a cause of the housing bubble is the failure of regulators to control aggressive lending. Yet the expanded regulation never came, and over time during the 1990s and into the 2000s, a “shadow banking system” of nonbank mortgage originators was allowed to develop without anything like the regulation to which banks are subject.

The weakening of credit standards that led to this situation is part of the normal process of a speculative bubble, as was argued long ago by many economists

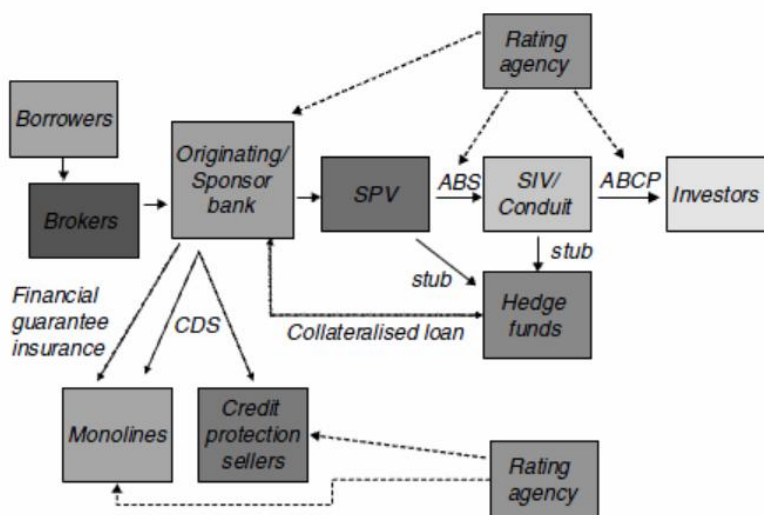


Fig 2. Shadow Banking  
 Source: Thomas F. Huertas, Crisis cause, Containment and Cure

1.2 Consequences of the financial crisis

The crisis that started in August 2007 is already among the most costly in history. Indeed, economists already refer to the downturn in 2008 and 2009 as the ‘Great Recession’.

The crisis broke on 9 August 2007, when BNP Paribas suspended withdrawals from three of its unit trusts on the grounds that they were no longer able to properly value many of the assets held in the funds.

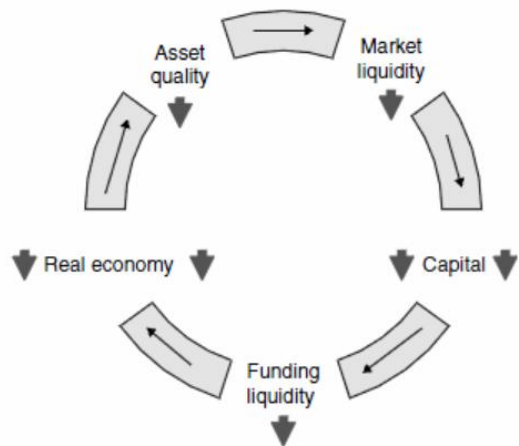


Fig 3- Vicious cycle of debt deflation

Source: Thomas F. Huertas, *Crisis cause, Containment and Cure*

ities. They were not unique to the BNP funds. > them, why could anyone trust the values that mately become a vicious cycle of debt deflation ed the potential for capital losses at institutions

The problems in the subprime mortgage market are now heard all around the world, which began in the middle of 2007 in the United States and then spread to other countries.

The consequences of the subprime crisis will probably run rampant for years, threatening more and more collateral damage.

Although most economies have started to recover, output in advanced industrial economies remains below its previous peak and unemployment remains high.

In cumulative terms, the crisis up to the end of 2010 has caused a cumulative loss of \$9 trillion in output – this represents the difference between output actually achieved and what output would have been had the economy continued at its pre-crisis trend rate of growth. And, the crisis will incur further costs.

According to a World Bank (2010) forecast, global GDP in 2015 will still not have caught up to the level that it would have reached had the pre-crisis trend rate of growth continued. And, the crisis will incur further costs. According to a World Bank (2010) forecast, global GDP in 2015 will still not have caught up to the level that it would have reached had the pre-crisis trend rate of growth continued.

The disruption in our credit markets is already of historic proportions and will have important economic impacts. More importantly, this crisis has set in motion fundamental societal changes—changes that affect our consumer habits, our values, our relatedness to each other.

Many people, unable to repay their debts, are being pursued aggressively by creditors.

The central banks in Europe kept interest rates relatively high for the first stage of the crisis, only in the United States did the central bank engage in significant reductions in interest rates.

The closure of the securitisation markets in August 2007 created a funding squeeze on those institutions that had relied on securitization for funding. Northern Rock was a perfect example of the so-called originate-to-distribute model

The fall in GDP was faster and steeper than anything since the Great Depression. Indeed, in some respects the economy was falling even more rapidly than it had at the start of the Great Depression. In the fourth quarter of 2008, the world's leading economies contracted at a 6% annual rate, and in the first quarter of 2009 the rate of decline was worse (see Figure 4).

The decline was quite widespread, affecting not just the United States, where the crisis had originated, but economies throughout the world. In Japan real GDP fell at double digit annual rates in the fourth quarter of 2008 and the first quarter of 2009. Other export-oriented economies were severely affected as well, particularly those, such as Germany, that specialised in investment goods and consumer durables. Central and Eastern Europe was extremely adversely affected as were Ireland, Spain, Italy, Russia and Mexico (IMF 2009a; OECD 2009).

## 2. Short-Run and Long-Run Responses.

It is very important to recognize what has been happening and to take fundamental measures and steps to restructure the institutional foundations of the housing and financial economy.

The meaning of this is to take short-run steps in order to relieve the crisis and also long-term changes that will restrain the development of bubbles, stabilize the housing and more over the financial markets, providing greater financial security to households and businesses, all the while allowing new ideas to drive financial innovation.

In the immediate **short run**, government and business leaders must deal with the problem created by the bubble and its consequences. The ship is sinking, and we have to save it before we do anything else. In fact, we have to bail out some people who have fared particularly badly, and we also have to arrange bailouts in certain extreme cases to prevent failure of our economic system. These bailouts must be done promptly and correctly, so that they do not come across as unjust or unfair.

In the **longer run**, we need to develop stronger risk-management institutions to inhibit the growth of bubbles—the root cause of events such as the current subprime crisis—and to better enable the members of our society to insulate themselves against them when they do develop.

This proposed subprime solution means embracing the following goals:

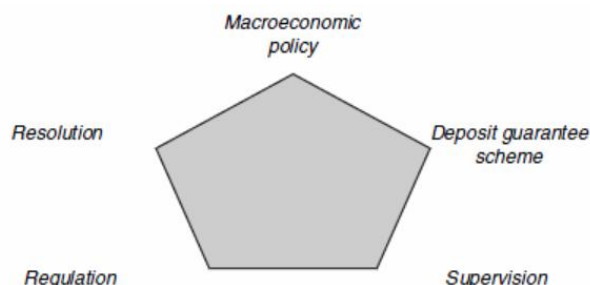
- First, improving the financial information infrastructure so that the greatest number of people can avail themselves of sound financial practices, products, and services
- Second, extending the scope of financial markets to cover a wider array of economic risks.
- Third, creating retail financial instruments—including continuous-workout mortgages, and home equity insurance—to provide greater security to consumers.

There has been a peculiar tendency during this housing bubble (as with other bubbles) to regard price increases as generally good news.

But it is in no way bad news if home prices fall. If home prices go down relative to our incomes, we become wealthier, better able to invest in new homes. In the short run a sudden drop in home prices may indeed disrupt the economy, producing undesirable systemic effects. But, in the long run, the home-price drops are clearly a good thing.

#### 4. Measures to be taken.

The cure will require a framework that is both comprehensive and consistent. It has to encompass macroeconomic policy, resolution, deposit guarantee schemes, regulation and supervision (see fig 4.)



**Fig 4. A cure requires a comprehensive and consistent framework**

Source: Thomas F. Huertas, Crisis cause, Containment and Cure

#### 3.1 Better Macroeconomic Policy

Even if short-term interest rates remain the primary policy tool of macroeconomics, the method by which central banks control short term interest rates may also need rethinking. Exclusive focus on buying and selling risk-free government securities is not the only way to implement monetary policy. Monetary policy can also be implemented during normal times through refinancing the assets of the banking system, as the practice of the European Central Bank amply demonstrates (ECB 2008),

In addition to the interest rate, the policy levers available to the central bank would include determining what assets are eligible to be pledged as collateral, what haircuts should be placed on the value of such collateral and how long the term of any such lending should be.

Variations in these terms and conditions can potentially be quite effective in changing conditions in financial markets, particularly for firms that mark their assets to market and finance themselves predominantly through secured borrowings.

By selecting the term on which funds will be made available to banks, the central bank can strongly influence the maturity of banks' liabilities and the degree of liquidity risk in the banking system.

Clearly, in the recession the opportunity to borrow at longer term from the central bank is an effective means of allowing banks to extend the maturity profile of their liabilities. This underpins the ability of banks to lend and to sustain economic activity. Conversely, during the boom progressive shortening of the term on which central banks are ready to lend to banks (along with the maintenance of strict liquidity requirements on the banks themselves) would tend to dampen the boom.

### 3.2. Better Resolution.

Ways must be found to assure that failing banks can be resolved at no cost to the taxpayer and limited cost to society at large. This exit strategy has four components: setting clear goals for resolution policy, the institution of special resolution regimes for banks, the creation of resolution plans and the ability to bail-in investors rather than bail them out.

The test that a resolution plan has to pass is simple to express, but complex to execute: the plan has to provide a route to resolution that (i) does not require taxpayer support for the bank's solvency, and (ii) minimises the social cost that results from the intervention/resolution.

### 3.3. Better Deposit Guarantee Schemes.

A credible and reliable deposit guarantee scheme requires that

- the scheme provide adequate coverage to consumers;
- be able to pay out insured deposits promptly, if called upon to do so; and
- have an appropriate funding scheme for bearing the ultimate loss incurred under the scheme.

The key choice in designing a deposit guarantee scheme is eligibility for coverage. Who should be eligible for deposit guarantees? Just consumers or any depositor? Most countries elect to limit deposit guarantees to natural persons or to natural persons plus small- to medium-sized business enterprises. This is appropriate. Deposits are effectively a loan to the bank, and consumers generally do not have either the knowledge or time to conduct a credit analysis of the bank in which they place their money. Without deposit guarantees, consumers could conclude that if one bank failed, all banks would be in trouble. This failure of one bank could lead to runs on others. Effective deposit guarantees put a stop to such contagion.

*Table 1* Total deposit guarantees available to each person, selected countries, April 2011

	Limit per individual depositor per bank	Number of banks in the country (approximate)	Total deposit guarantee coverage available to each individual
UK	£85,000	200	£17,000,000
Germany	€100,000	2000	€200,000,000
USA	\$250,000	7500	\$1,875,000,000

Source: Thomas F. Huertas, Crisis cause, Containment and Cure

### 3.4. Better Regulation.

Fixing regulation therefore carries high priority, and much progress has already been made, particularly with respect to reforming the regulation of banks. Prudential regulation, especially the regulation of capital and liquidity, constrains the risk that a firm can assume so that the firm will remain safe and sound.

Bank regulation must deal with both condition and conduct. Regulation should require firms to remain in good condition and give regulators the power to put firms into resolution, if they do not meet threshold conditions. Regulation should also require that firms and markets conduct themselves appropriately and give regulators the power to discipline firms and/or markets that do not. To assure that banks maintain both good condition and good conduct, regulation should also assure that banks have good governance.

### 3.5. Better Supervision.

The fifth and final element in effecting a cure for crises is better supervision. This has two aspects: micro-supervision, or the supervision of individual institutions, and macro-supervision, or the supervision of the financial system as a whole, including its interaction with macroeconomic policy, especially monetary policy.

Both types of supervision demand judgement. Supervisors have to focus on risk. The very essence of financial intermediation is the assumption and management of risk. Financial intermediaries have to be allowed to take risks, if they are to contribute to economic growth and development. At the micro, or firm specific, level supervision has to assure that financial intermediaries have adequate capital, liquidity, systems, controls and people to bear the risks that they assume without recourse to the taxpayer. At the macro level, supervision has to assure that the sum of what individual financial intermediaries do is consistent with financial stability.

Supervision starts with an assessment of the persons running the authorised firm. Are they fit and proper, will they act with integrity, will they exercise due skill, care and diligence and will they be open with the regulator about what might be wrong at the firm? In particular, taking deposits is a public trust, and the public needs to be sure that the bankers who take deposits will act responsibly and honestly. Letting the wrong person own or manage a financial institution is the first step towards problems. Essentially, supervisors have to make a judgement about the character and about the competence of persons who will exert significant influence over financial institutions, especially banks, as owners, directors or executives.

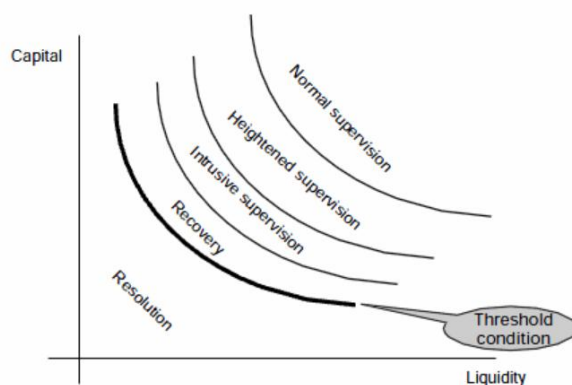


Fig 5.Strong supervision requires a proactive intervention framework

Source: Thomas F. Huertas, Crisis cause, Containment and Cure

#### 4. In conclusion.

The key to long-term economic success is rightly placed confidence in markets. In contrast, bubbles are the result of misplaced confidence.

The cure outlined in this paper (better macroeconomic policy, better resolution, better deposit guarantee schemes, better regulation and better supervision) will go a very long way towards doing so.

New institutions can be developed to solve many of the world's fundamental risk problems. But, this can be achieved only if the institutional foundations are retrofitted to produce greater economic growth through steadily expanded asset ownership—especially homeownership. Extensive reforms to the regulation of banks are being made, Capital regulation has been strengthened, both with respect to the quality of capital and the quantity of capital. Liquidity regulation has been introduced. Remuneration policies are now subject to regulation, and steps are being taken to strengthen governance and to make risk management more rigorous.

Better deposit guarantee schemes are a critical component of the cure for crises. They underpin and are a precondition for better resolution policy. Deposit guarantees must be able to pay out promptly the insured amount to the rightful owner.

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**LESSONS FROM FINANCIAL CRISIS: ALBANIA AND INTERNATIONAL ORGANIZATIONS**

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**Abstract:**

*Now a days financial crisis is one of the biggest problems in the world. It has affected all the aspects of the economy in developed countries and in the developing countries. Banking sector is one of the most affected sectors. This is the reason why we will try in this paper to describe the types of the crises and the main factors that cause the crises. Then we will focus our analyses on the last financial crises that began United States of America and then it affected even Europe and the developing countries. At the next section we will try to give some recommendations about the possibility to avoid or to minimize the effect of the crisis. This will be done by analyzing the causes of the crisis and the way to avoid these factors. In the last section we will try to briefly show what happened in Albania. Are we avoiding the factors that caused the crisis? Where successful the followed policies? One of our conclusions is that countries that were in a way 'away' from financial markets were not affected directly from the crisis. They are suffering the consequences that came from the countries that were directly involved in the crisis.*

**Keywords:** financial crisis, banking sector, bad loans, international organizations.

**JEL Classification:** E42, E44, G01.

**1. Financial crises: Causes and solutions.****1.1 Causes of financial crises**

Causes of the financial crisis can be divided into two categories: crises caused by macroeconomic factors and caused by weak microeconomic infrastructure which are independent of each other. For more the cause of the financial crisis is the lack of economic stability. These results affected the deterioration of the assets quality and strong fluctuations in asset prices and exchange rates that undermine core business of banks.

Although macroeconomic shocks can initiate major banking problems, these shocks latter may be aggravated by microeconomic structural problems as corporate governance issues, disfigured systems driven by weak regulatory structures and poor management practices, including internal lending caused by internal control and information infrastructure.

The following components are the main strengthening the efficient banking system.

- A system of laws and rules of corporate governance and property rights, including bankruptcy laws, and the laws that describe the rights of creditors in the seizure or the exposure of borrowers' assets.
- An uniform structure of transparency of accounting standards
- A facility that provides an audit and examination of banking sector
- A structure of rules for the public transparency of the financial information

Organization of supervision of banks varies from one country to another, for example in England and Italy while the central bank function exists in countries such as Canada and Switzerland exists banks supervisory authorities that are independent and separate from the central bank. While countries like Germany, Japan and the U.S. have mixed systems in which the central bank separates supervision responsibilities with other government agencies

**1.2. Current financial and economic crisis**

Concerns about the crisis are more than obvious. Let's update a little memory of how it started everything.

On 11 September 2001 the then head of the U.S. central bank (Fed), Alan Greenspan, reduces the percentage of the interest rate to 1 percent from the fear of a recession. Who saves even now is a fool. Millions of heads of households decide overnight to buy the house.

It was very clear that we had a big bubble in the market of houses, which sooner or later will rise and there would be serious consequences. This says economist Dean Baker, Center for Economic Studies and policy in Washington. Because in our history there are bankers that give credit binge, almost without risk. Requirements of heads of families returned just in securities and were sold. But in 2007, rates of loans increased and housing prices fall. In March 2008 Wall Street history: Banks do not trust anymore each other, do not give money, because they do not know who has money and how much does it have. Big banks are on the verge of bankruptcy. U.S. government helps these banks and pays. Then the big shock. There is no help for Lehman Brothers. Investment Bank bankrupt. Threatening bankruptcies in Germany, the UK and Denmark and so on.

**Financial crises affect all the economies.** This crisis emerged through the phenomenon of "spectacular fall of risk mortgage loans in the United States. With the fear that this crisis could be very dangerous and can seriously affect the real economy, central banks of many countries were forced to inject large amounts of liquidity in inter-bank markets, as well as to relax their monetary policies. As a result of this crisis many banks suffered substantial losses and tearing devaluation of their assets. Banks' losses in this period are about 500 billion dollars.

This crisis is the first test of facing the real world with globalization. Most of the experts decide that the current problematic American economic circumstances (declining growth rates, decrease the value of the dollar, the deepening of the budget deficit, the tremendous growth of internal and external debt, increasing unemployment, huge trade deficit, etc..) shall transmit its negative effects in many other economies. It certainly would have negative consequences for economic growth throughout the euro area

**Crisis effects:** The crisis gave its effects even in other markets and not only in financial ones:

Most affected, even at present, are the commodity markets, which suffered immediately what is called "catching effect" because of scholarships and capital markets crisis immediately caused a "drought liquidity" forcing many of the main actors of these markets, especially the so-called "hedge funds" to address the energy markets or other raw materials such as the opportunity to offset their losses in financial markets.

By many experts of these markets is estimated that the increase in crude oil prices to record levels of \$ 100 / Baril is more direct and indirect result of the impact of the financial crisis, as well as the operation of hedge funds.

To this trend are added even the increased prices of raw agro-food materials: wheat, flour, rice, vegetable oils, fruits and vegetables etc.. This visible growth influenced even the inflation rates in many countries.

- In Europe, the euro zone growth was and it is still significantly below its potential. But anyway, the Europeans feel more secure in comparison with Americans and other countries outside the euro area

### 1.3. Conclusions from financial crises.

First lesson that financial and economic experts and the greatest political leaders of the world are learning from this unprecedented crisis is that the current phenomenon of globalization "has put us all in the same boat", every "storm or turbulence" in finances or economy of some countries or economic areas immediately affects all countries and other areas. The second lesson ended once and forever the dominant theory so far that "the effects of the economy of developed countries are not heavily transmitted on economies of other countries." What is happening to American and European economy is deemed to have a direct impact on the Chinese economy, Japanese, Indian, Russian, Brazilian, etc.. So, for example, the decline in purchasing power in the U.S. has a direct impact on a Chinese or Indian exports crisis, the reduction of Russia's income from oil exports, the reduction of exports Brazilian of BIOENERGY etc.. The third lesson is very important and is that "the products and operations of financial markets and banks should be as transparent and verifiable" at any step in relation to the coverage of their correct balances and bank accounting.

**Economic crisis solutions:** A new philosophy in tackling and solving global problems seems that is what is needed. Instrument and widely accepted method is "to strengthen global governance." Financial and economic crisis that shocked the world had at least a positive value as visible as its negative consequences: "new world economic rule." At the end of the G20 summit, British Prime Minister Brown said primary as "the birth of a new world order", while German Chancellor Merkel emphasized that it was "a historic compromise in response to an extraordinary crisis." In this line aligned and French President Sarkozy, when he said that "at this summit were did you go much farther than could be imagined"

More than anything, the current crisis put many questionmarks on the efficiency and the role of some important international institutions. Most senior executives leading financial and economic powers of the planet stressed that it is necessary to "restructure planetary government". "New financial architecture", "new rules of transparency of supervision of banks and financial markets," "the final elimination of tax havens", "modern monetary policy instruments with broad spectrum of action", "the elimination of any super reward for executives and senior managers economic and financial ", "fundamental revision of norms and accounting standards ", "improvement of instruments and expansion of aid for the development of poor countries ", "the elimination of bank secrecy ", "to restore the confidence of the economic growth and employment ", etc., were the final declaration keywords London

Redesign and change of bases of planetary government begins with the change of status, the scope, instruments and objectives of four of the world's most important institutions, the IMF, World Bank, World Trade Organization and the Financial Stability Forum (FSF). Their reform constitutes the foundation of the new economic and financial architecture of the world for the XXI century.

All seem to agree that the biggest winner of this planetary governance reform is the IMF. Its financial assets are expected to increase in order to create opportunities to IMF to exercise a greater role and influence in its role as "guardian of global macroeconomic balances and support countries in financial difficulty ". G20 wants "increasing capacity and interventionist ability of IMF for crisis prevention and resolution." In the end, what was intended seems to be "IMF's new role as a world finance minister."

The second institution that requires a deep reform is not very publicized, but it is still considered very important. It is about the Financial Stability Forum created during the Asian crisis of a decade ago. The purpose of the forum was "wrong financial control practices that can lead to a deterioration of the balance of the international financial system," is estimated "unachieved" target, although in many cases, this forum has given alarm signals. The main aim is to transform it in "a guardian of world markets and financial institutions" on a global scale. Financial Stability Forum will be soon transformed into a "financial stability council".

Significant changes are expected to subject even the World Bank. Ability and its capacity to provide development finance loan will increase. In addition, the summit concluded on the fact that in 2010 the World Bank has to restructure the process of the voting rights in it, especially when it comes to important strategic decisions.

Out of this process can not stay even another international institution, the World Trade Organization, which, said with a somewhat diplomatic language, "was invited to close as soon as possible round of trade liberalization talks" known as the "Doha cycle"<sup>328</sup>. After the famous "Buy American Act"<sup>329</sup>, rated as more protectionist stance by the United States, admission by President Obama of the target for closing the Doha cycle is considered as a more meaningful indicator for the future of the WTO that, especially for uncompromising struggle against the increase of trade barriers by countries of different governments. WTO will only be one that will allow or design limits or barriers degree of protectionism "tolerated" by the individual states. Optimism and positive reaction of the financial markets and many of the world's foremost scholarship immediately after the summit in London is a positive impulse for all. But are all being so optimistic? Not entirely. Events in London and many other cities of the developed world under the slogan "Put people first" continue, and unemployment figures in the U.S. and Europe are alarming. Many voices in the field of economy and finance are skeptical.

## 2. Albania and the current international financial crisis.

<sup>328</sup> Cycle of negotiations to reduce trade barriers in the world in the context of the WTO, has its beginnings in late 2001.

<sup>329</sup>"Buy American Act" passed in the U.S. Congress in 1933 and signed by President Hoover. Strategy and action "buy as many American products" has the support of President Obama

Albania is not integrated in the European banking system, moreover, at the American one. At this point the fear of a financial collapse in our country is low. Obviously that Albania is part of the global economy, and a great shock would bring consequences especially in macroeconomic terms. In our country there is an increase, but not very large of bad credit. This is a minimum of two factors. First, it has come as a result of increased lending to the economy in the last five years, with an average of 50 percent, due to bad loans then outstanding. The more credit will be given, even more will increase the level of those customers who do not pay their debts, and this to some extent is normal, and happens in every country of the world. The second factor relates to the "credit registry", which started work in January 2008, categorically forbidding secret flow of evil customers. But this situation does not mean that everything will go well.

Some of the symptoms that indicate that our country would have definitely problems are listed and may include: decrease in the volume of exports and the price of raw materials; reduction of remittances; worsening of the trade deficit; deepening budget deficit; locking businesses; decrease in demand for home loans; reduction of price of agricultural products that has hit rural economies and the weakening of their welfare; reduction and tightening of credit in the banking system; reduction in the volume of deposits; increasing inability of businesses and individuals to pay the debts; liquidity difficulties in the banking system; rate reduction key interest rates by the Central Bank; decrease in the growth rate of assets, deposits and profitability of the banking system; weakening of the local currency; difficulty by the Government for providing financing to external and internal market; increase the cost of financing the budget... etc.

#### *Banking system - Negative escalation of the banking system indicators*

Although the banking sector appears sound and well-capitalized (capital adequacy index is 17.2%), risk weighted assets to total assets in the system as a result of rapid credit growth in recent years have increased approximately 44% compared with 36% in 2006.

As a result of the withdrawal of deposits during the fourth quarter of 2008, liquidity index, expressed through the rate "liquid assets to total assets" decreased rapidly to 43% from 50% in 2007 and 58% in 2006 - renewal. This increased even the ratio of loans to deposits to 65% at the end of February 2009 compared to the previous levels of around 50%. Meanwhile, as a result of the economic slowdown in the country and the growth rate of non-performing loans, loan portfolio deterioration expectation is troubling problems. For prudential reasons and additional security, the Bank of Albania required the banks (and other financial companies) to raise capital as much as possible, to suspend the distribution of dividends and capitalize all profit (measure seems already taken), providing additional security for the amortization of possible attacks. It would not be too excessive for BSH to require banks to have about specific contingency plans to meet liquidity needs and plans to increase capital in the future, if the need arises.

#### *Banking system - Monitoring investment portfolio and interbank deposits.*

Bank of Albania should be given careful implementation of its supervisory role, especially in conducting investment commercial banks as the international currency market, through deposits located in the interbank foreign market and in the international capital market by buying bonds of states and foreign institutions. Importing external crisis makes them more vulnerable to these items that were once considered safe from banks and supervisors. These deposits are usually with maturities of up to 1 month, but their maturity has increased in recent years, accounting for about 34% of interbank placements (deposits over a month).

Currently the second-tier banks have begun restricting lending, which has been a key factor in economic growth in Albania in the levels of 6% per annum. Interest rates of loans to businesses and individuals have shown strong growth, reflecting the Treasury bond yield and the lack of liquidity and uncertainty in the foreign currency markets. In the last three years Bank of Albania tried to play its role in determining the interest rate with the aim to encourage the banks to give more loans, but according to the data published from this institution, only in the last year is noted a slight increase of credits. This temporary favored inherited from unfavorable financial situation of 'mother' banks operating mainly in Europe but that have invested in equity markets in the U.S., will result in a reduction of the development of Albanian companies and some of them may be subject to the bankruptcy process (a phenomenon not encountered in our country). Construction industry is affected by this situation which will also lead to fluctuations in real estate prices in the U.S. and European countries. Bank of Albania's official records show that last year (2011), bad credit business grew by 63%, a rate twice as high as a bad debt of individuals. According to the figures, at the end of last year, out of every 100 ALL banks have given loans to business, 20.8 ALL are not turning back. Expressed in value it means that the only outstanding business loans have already reached over 800 million dollars, or about 7 percent of national output. But which are the most in need? Beyond advertised tourist boom, official figures show that tourism is one of the most severe financial difficulties. According to the Bank of Albania, in the branch of hotels and restaurants, bad credit grew by only 2.3 times a year, which means that currently every 100 ALL who have taken loans to banks, businesses, hotels and restaurants, no have turned back to the bank by 45.3 currency contracts.

The second problematic sector is that the real estate and construction, which some years stays paralyzed for a drop in sales, but also the strong contraction of public investment in infrastructure. According to official data, construction bad credit is stated at 30% almost 1.5 times more than the average of the economy. Business inability to repay loans received in the bank is more depth this year. In the first six months of outstanding loans rose by 2.43 percentage point and most of it has come back from the business.

Bad credit growth already is penalizing the real economy, because banks do not give new loans. Official data show that at the end of June, annual credit growth was only 8.2 percent among the lowest historical, and even in the first six months of the year the figure has been getting worse.

At a high-level regional workshop, organized by the Bank of Albania, under an agreement with the University of Oxford on "Southeast Europe: Preconditions for reforms", the Governor of the Bank of Albania, Ardian Fullani, in his speech highlighted two important issues.

First it was associated with incentives that can provide the Central Bank, such as the reduction of interest rate on the lek, which was not conveyed properly, and secondly, it should make policy. If the first stimulus, according to him, gave the expected effect due to wider developments need to find other means of support, such as reforms.

## CONCLUSIONS:

Financial crises are caused from different factors. The financial institutions should be careful to read the symptoms of the economy, so they are able to prevent the deterioration of the situation. This is very important for countries like USA, Great Britain, Germany etc. This because they affect the whole world. The last financial crises showed that this is true. The financial crises began in USA and it was spread in the entire world.

This caused the revolution of the logic of functioning of some very important international institutions. The 'big' winner is IMF and the economists agree that this institution should be 'the policeman' of the financial world. Developed countries are trying to recover from the crises. Even developing countries are trying to avoid the involvement in this crisis, or at least to alleviate the crisis consequences to their economies. This is the case of Albania.

In these last 10 years there has not been another case when the banking system was simultaneously exposed to so many risks, exercising pressure in many ways, within and abroad. Specifically, market risk through interest rate risk, exchange rate risk, country risk, the risk of deterioration of macroeconomic stability, credit risk, maturity risk, capital risk.

It must increase banks' costs for training of supervisors and bankers in the field of risk management. Commercial banks have to become more conservative in maintaining risk indicators within regulatory limits to be able to accommodate future shocks. BoA should review its analysis on testing scenarios under stress given the combination of different risk factors action, not only for individual banks, but for the whole system, and on the basis of effects, it should require banks to take corrective measures and to keep contingency.

Minimize the risk by lowering the lending rate witnessed so far the growth of non-performing loans and bad credit growth necessarily leads to the reduction of bank profits. Reducing lending has automatically stopped the economic growth. In this situation, the BoA had to continue easing policy by lowering interest rates further. High interest rates are high costs for business and as economic indicators are marked deterioration, it is necessary to take measures stimulating the economy and borrowing to provide more breathing economy.

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## MANAGING THE CRISIS IN THE ECONOMY BY THE RELEVANT STATE INSTITUTIONS IN MACEDONIA

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### **Abstract:**

*The issue of inclusion of the state, more or less, in the economy is causing extensive hearings and will always present theme in discussions conducted in the area of economic issues. The same is especially apparent in the moments when the world is facing or already in crisis, not only in developed economies, but in others, and in particular the case in Macedonia. The great economic crisis since its emergence in the U.S. with unprecedented speed expanded in the countries of the European continent and did not circumvent the Republic of Macedonia. For preservation of the existing macroeconomic environment and for creating a favorable business environment in which the economic subjects can conduct business and minimize the negative impact the crisis has on domestic subjects, the Government in its efforts repeatedly direct the taking of proper anti-crisis measures which aimed to maintain favorable ambiances for management in the state. Maintaining quality dialogue with the business community, undoubtedly is a necessary prerequisite for creating a good business climate and without crisis, but this it is of particular importance in crisis so it is necessary for all stakeholders to bear part of the burden to find the exit this crisis with as little as possible consequences for them. In this context the Government since the first announcements of the crisis in the world and euro zone in the last quarter of 2008, based on indications of the business community, passed four packages of anti-crisis measures. With these packages Republic of Macedonia wanted to minimize the effects of the crisis on its economy and the economic participants.*

**Keywords:** macroeconomy, crisis, anti-crisis measures.

**JEL Classification:** E29

### **1. Introduction**

The issue of inclusion of the state, more or less, in the economy is causing extensive hearings and will always present theme in discussions conducted in the area of economic issues. The same is especially apparent in the moments when the world is facing or already in crisis, not only in developed economies, but in others, and in particular the case in Macedonia.

The great economic crisis since its emergence in the U.S. with unprecedented speed expanded in the countries of the European continent and did not circumvent the Republic of Macedonia.

For preservation of the existing macroeconomic environment and for creating a favorable business environment in which the economic subjects can conduct business and minimize the negative impact the crisis has on domestic subjects, the Government in its efforts repeatedly direct the taking of proper anti-crisis measures which aimed to maintain favorable ambiances for management in the state.

In this way it was and still is wanted to mitigate the consequences of a major world economic crisis carried in the Macedonian economy. As one of the most important measures will be mentioned the following: the reduction of budget expenditures, the credit support to enterprises, changes in the tax area, improving the liquidity of Macedonian companies and others.

Maintaining quality dialogue with the business community, undoubtedly is a necessary prerequisite for creating a good business climate and without crisis, but this it is of particular importance in crisis so it is necessary for all stakeholders to bear part of the burden to find the exit this crisis with as little as possible consequences for them. In this context the Government since the first announcements of the crisis in the world and euro in the last quarter of 2008, based on indications of the business community, passed the first package of anti-crisis measures package containing two types of measures:

- one aimed at companies that have liquidity problems and that will undoubtedly be faced with the possibility of opening the bankruptcy proceedings, dismissal of employees, and other adverse consequences, which enable these firms, the existing commitments to the state to pay with delay, rescheduling of debt, forgiveness of interest and the like. This convenience took quite a number of business entities in the Republic of Macedonia in several stages during 2009. It undoubtedly helped many of these businesses to survive, retain employees and to spend the crisis and
- to other business entities expressed through measures aimed at reducing the taxation of costs that businesses have social benefits. As a result of the aforementioned activities from January 1, 2009 reduced rates of social contributions by 4% (from 32% to 28%) cumulatively and simultaneously cleared profits from taxation if it is reinvested.

Measures of the first package in November 2008 in the amount of 330 million euros, were mainly aimed at companies with impaired liquidity, but also to companies that work well (through incentives in the income tax, reduced tariffs and social contributions, reduced taxes for farmers etc.). Thanks to these measures prevent the closure of a number of economic entities and staying out of work thousands of employees.

Due to delay the crisis came second package of anti-crisis measures, which included measures targeted by one side to align spending with budget crisis and rebalance the budget and the other by creating a budget focused on infrastructure and to support capital investment.

In this second package of measures the government adopted 8 year program to deliver a number of infrastructure projects totaling about 8 billion euros. It included projects in road and rail infrastructure, energy sector, housing, environment, sports infrastructure and other capital projects. The implementation of this program provides short-term economic growth amid the crisis, by supporting the construction and other sectors, while the long term will improve the competitiveness of Macedonian economy.

To mitigate the consequences of the still present global economic crisis, the Government of the Republic of Macedonia adopted a third package of anti-crisis measures aimed at mitigating the consequences on the Macedonian economy.

Namely, in the first months of 2009 global economic crisis further deepened and projections for economic growth in the EU and U.S. for 2009 are more negative than the initial projections. The impact of global recession on the Macedonian economy was stronger, which affected all sectors.

The Government of Republic of Macedonia after extensive monitoring and analyzing of the situation made extensive consultation with the business community and economic experts, after which played upon that basis, was defined and adopted the third package of anti-crisis measures aimed at mitigating the consequences of the global economic crisis on Republic of Macedonia.

The package includes 70 anti-crisis measures related to 3 segments:

1. supplementary budget, which includes revising the macroeconomic projections and appropriate reduction of revenues and expenditures of the budget under new conditions
2. credit support to enterprises through credit line from the EIB in the amount of 100 million euros earmarked for: a / long term, investment credits, b / short term loans for working capital c / subsidizing interest rates for businesses and d / issue of guarantees and
3. other measures to support enterprises, including measures to facilitate the export of goods, reducing costs and so on.

## 2. Budget rebalances for 2009

The revised budget, performed adjustment of revenues and expenditures in order to comply with the revised macroeconomic assumptions for GDP growth of 1% and inflation of 1% for 2009.

Overall, the budget is reduced by about 9% and expenditures are rationalized and reduced.

With this, the Government sent a clear message to entrepreneurs and citizens that the budget deficit will not exceed the projected level of 2.8% of GDP.

To finance the budget deficit and relax in the domestic money market, the government temporarily drastically reduce the deficit financing through auctions and replace it with funding from external sources (Euro bonds, borrowing from commercial banks or borrowing from international financial institutions).

The revised budget shall provide a significant saving of resources, which allow you to maintain macroeconomic stability, including sustainable balance of payments deficit and most importantly, stable exchange rate.

To reduce costs, particularly important are the following measures:



- Interim prohibition for new hires in 2009 in public administration and public sector (except for employment provided under the National Programme for Adoption of the EU and implementation of the Framework Agreement). For all vacant posts permanently (retirement, etc.). Not anticipated adoption of new hires.
- Disposal of 10% wage increases in public administration and public sector scheduled for October 2009 for next year.
- Reduce the rate for current expenditures for all budget users.
- Continue the ban on procurement of furniture, equipment, vehicles and other unproductive expenditures in all budget users.
- Reduce the number of trips and significantly reducing the number of members of delegations when traveling abroad.
- Reduce the cost of entertainment, advertising and sponsorships for all budget users
- Stringent control of fees and other expenses of members of administrative and supervisory boards of public companies, agencies, funds, institutes and joint stock companies with dominant state ownership and reducing the cost of mobile phones, trips abroad and so on. And anticipating payment lump sums Performance (attendance at the session).
- Prohibition of payment of fees for commissions established within the ministries, agencies, funds, institutes, public enterprises and joint stock companies with majority state capital while performing their regular activities.
- Control through employment agencies for temporary employment, and control of wages paid to temporary employed persons in public institutions.
- Reduce current and capital expenditures of public enterprises, funds, agencies, institutes, joint stock companies in the dominant state ownership.
- Mandatory abolition of bonuses and reduce other costs of public enterprises, agencies, funds, institutes, joint stock companies with dominant state ownership.

### 3. Credit support to enterprises

In circumstances where the economy faces a problem of access to affordable credit funds as to maintain liquidity, and investment, the government adopted a package of measures to direct credit to support private sector.

For this purpose, provided a credit line from the EIB in the amount of 100 million euros to support small and medium enterprises.

Funds are primarily targeted at small businesses (50 employees) and medium enterprises (250 employees). These companies carry the majority of employment in the Republic of Macedonia, which means support will help keep jobs of most employees. Therefore, a basic requirement for using the support is to maintain the existing number of employees by enterprise customers.

Support of enterprises will be realized through MBDP and commercial banks, with the assessment of sustainability of projects, their risk and eligibility for support will be fully carried out by commercial banks.

It is anticipated the funds used to support export-oriented activities to 50%, and the rest for other business activities from which up to 50% for the reprogramming of existing loans with the same bank.

This package provides:

- financing of long-term investment credits amounting to 50% and fully guarantee the co-financed section, as well as subsidizing the interest;
- co-financing of short-term loans for working capital amounting to 50% and fully guarantee the co-financed section, as well as subsidizing the interest;
- subsidizing interest on loans from commercial banks;
- issuance of guarantees.

Through the co-financing and guarantees for long-term investment loans and subsidize interest Macedonian Bank for Development (hereinafter MBDP) shall co-financing and guarantee of 50% of the loans. The remaining 50% are own funds of commercial banks. Also, MBDP guarantee 100% self-financed part of the loan.

The maximum amount of credits will be:

- Micro enterprises (sole proprietor) to 20,000 euros;
- For small enterprises to 150,000 euros;
- For medium enterprises to 500,000 euros.

Repayment period: up to 5 years with a grace period to 12 months.

The highest interest rate the borrower is EURIBOR 3 month +4% per year (up 6% annually).

The program co-financing and guarantees for loans for working capital and interest subsidy MBDP performed co-financing and guarantee 50% of the amount of loans for working capital. The remaining 50% are own funds of commercial banks. Also, MBDP guarantee 100% self-financed part of the loan.

The maximum amount of credit is:

- Micro enterprises (sole proprietor) to 10,000 euros;
- For small enterprises to 70,000 euros;
- For medium enterprises to 200,000 euros.

Through a program to subsidize interest rates for short-term loans for working capital MBDP subsidize 5 percentage points of total interest, provided the rest who will pay the bank loan is not greater than 3m EURIBOR +4% per year (maximum of 6% per annum under the following conditions:

The maximum amount of credit is:

- Micro enterprises (sole proprietor) to 10,000 euros;
- For small enterprises to 70,000 euros;
- For medium enterprises to 200,000 euros.

The program guarantees provided MBDP issue Performance and other types of guarantees execution of contractual obligations, performance of Macedonian firms on foreign markets, a performance guarantee of services and other types of guarantees.

#### 4. Other measures to support enterprises

For simplification of customs operations and faster flow of goods at the border, within the Regulatory Guillotine, the Government passed through 50 measures, of which the most significant of mentioning:

- Continuous 24-hour presence at the inspection authorities of veterinary and phytosanitary administration of border crossings and their grouping for controls.
- Increase the number of border crossings where you have implemented all-day 24/7 import and export clearance.
- Introduce the principle of selectivity and risk analysis in supervision by the veterinary and phytosanitary inspectors.
- Provide an opportunity for deferred payment of VAT on imports.
- Wider application of simplified customs procedures, which are expected to increase the number of companies that use them.
- Electronic connectivity of the Customs Administration with other competent institutions, thus avoiding submitting the same documentation in several places.
- Removal of administrative fees for filing declaration and issuing proof of origin EUR-first
- Reduce the fees payable for veterinary-sanitary inspection at border crossings.
- Reduction or abolition of tariff rates for some materials, especially for shoes and food industry.
- Provide green tape at border crossings for empty vehicles and vehicles carrying perishable goods.

The realization of this package significantly accelerates the flow of goods at the border that facilitates the operation of economic entities, which way increases their competitiveness.

Also, this method shortens the time needed for completing customs formalities, and certainly the most important benefit is visible about it - the reduction of costs.

When adopting the package of anti-crisis measures the government made extensive consultations with the associations of businessmen (Commerce) and adopt more measures proposed by them, namely:

- Regulation of claims and liabilities between companies and state on all grounds. The government obliged all organs of state administration and urged the public enterprises and joint stock companies with majority state capital its obligations to settle within a period not exceeding 45 days<sup>330</sup>.

<sup>330</sup> To date the behavior of the mentioned subjects can be obtained assurance that compliance with these recommendations

- Full compliance with the statutory deadline for the refund of value added<sup>331</sup>.
- Rebalance the budget in order to maintain macroeconomic stability and exchange rate stability.
- Complete implementation of infrastructure projects in the budget for 2009<sup>332</sup>.
- Full payment of agricultural subsidies in the budget for 2009.
- More active role of the Shareholders (including the possibility of direct lending to firms).
- Support SMEs through easier access to credit at lower costs and support the export-oriented companies.
- Acceleration of activities together with the municipalities for the establishment of industrial zones<sup>333</sup>.

In the transport sector, to support the carriers, the government accepted some of the measures proposed by the Association of Independent Unions of transporters of the Republic of Macedonia, which relate to:

- Reduce prices for certificates of professional competence of managers and competence of drivers in international transport.
- Reduce fees transporters pay for veterinary and phytosanitary inspection at border crossings.
- Reduce prices for certification and additional technical inspections, receiving various types of certificates and certificates (certificates, checking the readiness of vehicles under Euro standards).
- Initiate procedures for signing of bilateral agreements on avoidance of double taxation.
- Examining the possibility of reducing the premium for the auto liability (green card) and faster and more efficient recovery of damages, but have not done anything special.

#### 5. Fourth package of anti-crisis measures of the Government of the Republic of Macedonia

With this package (since that would emphasize, in our opinion, the most important) is altered in terms of the credit line from the EIB and MBDP by:

- Limiting the interest rate for the first year 6%, limiting the maximum interest rate of the second year to 7.5%. and
- Change the amount of individual loans intended for end users (micro to 40,000 Euros to 400,000 Euros small, medium to 3.5 million Euros).
- It also made expanding coverage that trade companies will be able to apply for the loan.
- Changes to amend the Law on VAT:
- Possibility of submitting an interim financial report of bank accounts in electronic form to the PRO, which provides some positive financial implications for the economic sector;
- Segregation of the date of payment of liabilities on gross - wages and contributions to the liabilities for taxes and VAT from 15th to 25th in the current month (except for the postponement of other significant economic benefits can not speak;)
- Raising the threshold for registration of taxpayers for VAT from 1.3 million to 2.0 million denars<sup>334</sup>;
- Facilitating the criteria for receiving financial assistance under the Program for financial support for agriculture in 2010 for use of funds. This is especially important considering the structure of the population engaged in agricultural activity.
- Under the privatization project of the construction done is reducing the fee for the privatization of construction land for legal entities by 30%, which certainly will be a positive financial impact on companies that affects this process.
- Introduce Credit line to support micro, small and medium enterprises with guarantee scheme by the Shareholders.

<sup>331</sup> Same

<sup>332</sup> In almost all previous Supplementary budget after entering the world economy in the current economic crises interventions mostly done by dealing with that item cuts in investment, which it loses development component, while in the sphere of social transfers almost no government interventions are likely makes for the preservation of "social peace".

<sup>333</sup> Although the same in the Republic of Macedonia has a considerable number we can say that their existence has a significant impact in increasing investment activity.

<sup>334</sup> Although a definite positive impact, however this measure could significantly affect the increase in economic activity or lead to any such economic growth since the same principle applies to companies with insignificant number of employees, usually one, in the sphere of services.

- Coordination of procedures for obtaining grants under the Program for financial support to rural development and IPARD program with procedures for obtaining loans at commercial banks in order to provide a unique approach in preparing business plans and documentation that the applicant will serve for both uses. In this way shortens the time to provide the necessary documentation and course costs about the same.
- Prevent the import of products not manufactured by certain standards (HACCAP, CE) in order to protect domestic producers and consumers, while providing affordable financial implications for the domestic sector.
- Reducing the fee for this service abbreviated financial statements of annual account of the Register of annual accounts annual lump sum of 8,000 denars with unlimited access to 500 information on a monthly basis for the company user service. Although few subjects use these services, however the significance of this measure in terms of transparency of operations of the companies is of great importance.
- Adoption of the Law establishing the Agency for Foreign Investments of the Republic and export promotion.
- Building upgrades to Corridor 8 and Corridor 10 and construction of commercial buildings that would allow transit passengers to contribute to the development of national economy<sup>335</sup>.
- Preparation of a manual which will be detailed in the steps of the procedure for adoption of detailed urban plans and procedures for issuing construction permits along with the required documentation and establishing communication between the institutions that need to issue appropriate approval / opinion.
- Changes in the building in terms of shortening the proceedings - not to issue an approval for use of the facility or the Commission's technical review to be final.
- Amendments to the Law on Road Traffic, which will reduce the scope of the administrative procedure by the Ministry of Transport and Communications will use data from EHIM system.
- Introduction of administrative access authentication data required for submission of application for allocation of financial assistance in support programs to reduce the cost of application.
- Establish a fund of agricultural land for usufruct intended to provide unemployed people living in rural areas.
- Part of agricultural machinery which supplies the Ministry of Agriculture, Forestry and Water Management with funds from the revolving fund allocated by the Japanese government procurement of agricultural machinery, to be granted to unemployed persons to obtain land for usufruct of the previous measure.

To further reduce the impact of the crisis, the business sector is not suspended, on the contrary continues to "bomb" the government with their ideas and suggestions for overcoming the negative consequences suffered, which deserve special attention to their proposals for the same treatment for household foreign investors, reducing the costs of firms and changes to legislation aimed at reducing the fines stipulated.

In this context they note that they are not against foreign investors, but it is unfair to not give them the same benefits to domestic entities when they "fill" the budget and affect economic growth in the state.

Because they believe that government should find a way to compensated costs that increase the price of the product and service, especially those intended for export.

## 6. CONCLUSIONS.

If the world and Europe's crisis deepened, Macedonia can suffer dramatically in the field of exports. It would mean a decline of production, loss of markets, loss of jobs ... But Macedonia has cheap labor, competitive advantage in taxation and many other benefits provided by anti-crisis measures package - something that companies should use.

Macedonia should focus on what can sell in such a situation, when the crisis reigns worldwide, companies are on their knees, and when the output is not seen anywhere. But no matter what the economy does not stop because it can not even happen, it continues with its development and progress, and we need to find ways it can use. Like everyone else we have nothing to progress and what to emphasize.

Cheap labor for economic business sector is a huge asset because many people will work for relatively low wages, certainly if it is followed by improving working conditions and respect the rights of workers.

<sup>335</sup> The current share of transit tourism gross domestic product of the country was almost unremarkable.

The necessary pressure on employees to be kept to a minimum level, so that workers feel comfortable in the workplace. Time employers to begin to think and act as international companies that provide enormous benefits to its employees, and not vice versa, continually performing mobbing on employees by querying the workplace. Taxation in the RM is reduced to minimum rates because companies have to use better. Much money that previously went to taxes now in the hands of businessmen and they need to find appropriate economically viable way to invest productively. It is the only way forward in development, so much we need.

Given the recent actions taken by the Government in connection with the reduction of interest on the instruments that collect funds and reduce interest rates on Treasury bills issued by NBRM can be concluded that the firm defense of the Denar exchange rate does not give the expected results for the simple reason that banks are much more settle for using these instruments as more reliable than performing loans on their free agent in the economy. However, the government and the Bank must recognize that if they want to allow moving the economy would have to agree with in the permissible extent controlled increase in the rate of inflation. Thus as things stand it can not be expected revival of economic activity because the banks are not willing to follow the business sector.

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## THE ROLE OF SOCIAL PARTNERS IN COLLECTIVE AGREEMENTS NEGOTIATIONS IN R.M.: THE PERIOD FROM 1990-TIES TO 2012

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### **Abstract:**

*In our analysis of collective bargaining in the Republic of Macedonia in the period 1990-2010, we have applied the model of industrial relations of Harvard Professor John T. Dunlop. According to this model, collective bargaining is influenced by internal and external factors. Internal factors that affect collective bargaining are: the organizational capacity of the actors, followed by: the number of members, finances, personnel policy, unity and solidarity. External factors (external environment) that affect collective bargaining are: socio-economic and political context in the country, the legal framework, the ideology of the government, the policies of international financial institutions (IMF and World Bank), unemployment.*

**Key words:** collective agreements, Macedonia, external factors.

**JEL Classification:** F00.

### **1. Characteristics of collective bargaining in RM**

The development of the system of collective bargaining in RM includes two periods. The first is from 1990 - 2005, when it functioned on the basis of the majority model of representation and the second period is from 2005 to the present (2012), when the collective bargaining functions on the basis of delegate model of representation. According to this model the trade union or employers' association has the right to collective bargaining if it meets certain conditions and criteria established by law. With the provisions of the Labor Code of 2005 (Official Gazette 62/05) there was only one criterion (33% of membership). The amendments to the Labor Code in 2009 introduced other criteria.<sup>336</sup>

From 1990 - 2008 collective bargaining in RM is associated with only one union (SSM). In January 2008 KSS after obtaining representative status in the public sector signed OKD for the public sector. With the amendments to the Labor Code in 2009 (Official Gazette of RM no. 130/09), introduced new criteria for representativeness, KSS, apart from the public sector, private sector representativeness was proved as well. KSS also concluded 7 KD at the level of branches and activities which ended the long dominance of the SSM in collective bargaining in the RM.

In the beginning of the transition as a subject of collective bargaining on the part of employers appeared the Economic Chamber of Macedonia, which is contrary to the modern practice of collective bargaining. It was a temporary solution, because during that time employers had not established an appropriate association. By adopting appropriate legislation, this space temporarily was filled by the Economic Chamber of Macedonia (ECM). With the development of industrial relations in Macedonia, ie the adoption of the new Labor Code (Official Gazette of RM No. 62/05) a basic legal framework was created for the registration of employers' associations. First employing Association that proved its representativeness was the Organization of Employers of Macedonia (ORM), with which the Chamber of Commerce is definitely no longer a subject of collective bargaining.

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<sup>336</sup> According Art.212 of the Labor Relations Act (Official Gazette of RM br.130/09) union representation on the territory of RM is the union that meets the following conditions: 1. To be recorded in the register of trade unions run by MLSP 2. To be comprised of at least 10% of the total number of employees in the Republic of Macedonia who pay union dues; 3. To join at least three unions at the national level by different branches; 4. To act on a national level and to have registered members in at least 1/5 of municipalities in RM 5. To act in accordance with the statute and the democratic principles and 6. To be comprised of unions that have signed or acceded to at least 3 KD at the level of branch or department, according to NKD.

In Art. 213 of the Labor Code the representative employers' association for the republic is an association that meets the following conditions: 1. To be recorded in the register of associations of employers run by MLSP; 2. To be joined by at least 5% of the total number of employers in the private sector of the economy in the Republic of Macedonia or the employers association members to employ at least 5% of the total number of employees in the private sector in the Republic of Macedonia; 3. Members of the employers' association to be at least 3 branches or departments in accordance with the NACE 4. To have members in at least 1/5 of the municipalities in Macedonia; 5. To have concluded or acceded to at least 3 KD at the level of branch or department, according to NACE and 6. To act in accordance with its constitution and democratic principles.

In the period 1990-2005, especially between 1994-1997, collective bargaining took place with greater dynamism, enthusiasm, desire to succeed and understanding by employers and the government than in the second period (after 2005).

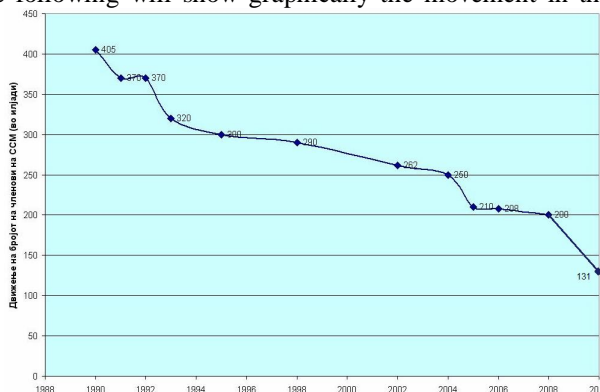
Consequently two OKD (businesses and public sector) and 34 GKD were concluded, covering about 70% of the total number of employees, while in the second period 2 OKD and only 21 GKD, with 35% coverage of employees, were also concluded, which is well below the European average that in 2007 was 62.5%. Also in this period were concluded over 400 KD at the employer level, and in the second period less 200 KD.

These facts show that the intensity and coverage of employees by collective bargaining in the second period fell by over 50% due to the subjective and objective reasons, mainly because of declining union power, but also because of the indifference of employers from certain industries<sup>337</sup> to be organized in employers' associations and to begin collective bargaining. This problem is particularly present in the industries in transport, storage and communication, wholesale and retail trade, wood industry, leather production, metal processing, manufacture of electrical equipment and appliances, financial activities, mining, energy and others. In these industries, the number of employees in October 2008 were employed over 131,000 persons<sup>338</sup> who were indirectly excluded from collective bargaining. This problem is partially bridged by signing KD at an employer level between the union of a specific company and the employer in the specific industry with the support of the respective branches of Syndicate.

## 2. Influence of internal factors.

- 3.1. The power of the entities is a very important factor in the system of collective bargaining. In our research we follow the power of union over an extended period of time through multiple indicators (membership, finance). Following his power, we came to the realization that his real power (political and financial) continuously declined. Membership declined and so did its financial power.

The following will show graphically the movement in the number of trade union membership in the period

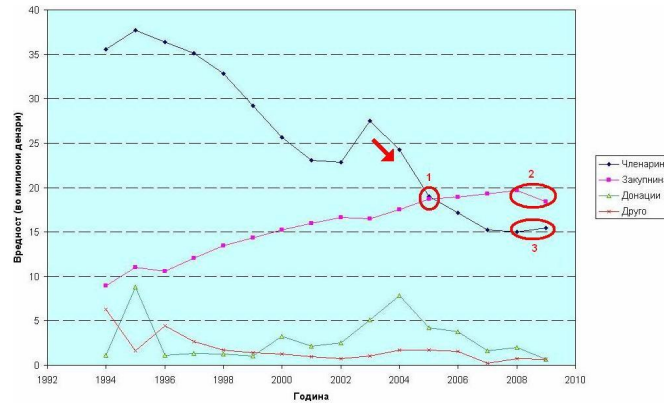


1990-2010::

Along the weakening of the social power of the union came the continuous reduction of financial power. Financial power is analyzed through union dues indicator. The reduction of the trade union membership decreased the inflow of funds on the basis of membership as well, and its financial power alike. We will move on to show graphically the movement of union funds in the period 1990-2010:

<sup>337</sup> Those industries are: Transport, storage and communications 27 446 employees, wholesale and retail trade with 75,855 employees, production of metal products 7124 mining 1326, financial activities, 8413, Wood Industry 2913, the production of electrical appliances 2819, leather production 4645etc.. or a total of 131,000 employees. Most problematic industry is wholesale and retail trade, not only because a board of employers has not been established in this area, but even more because of the small number of members

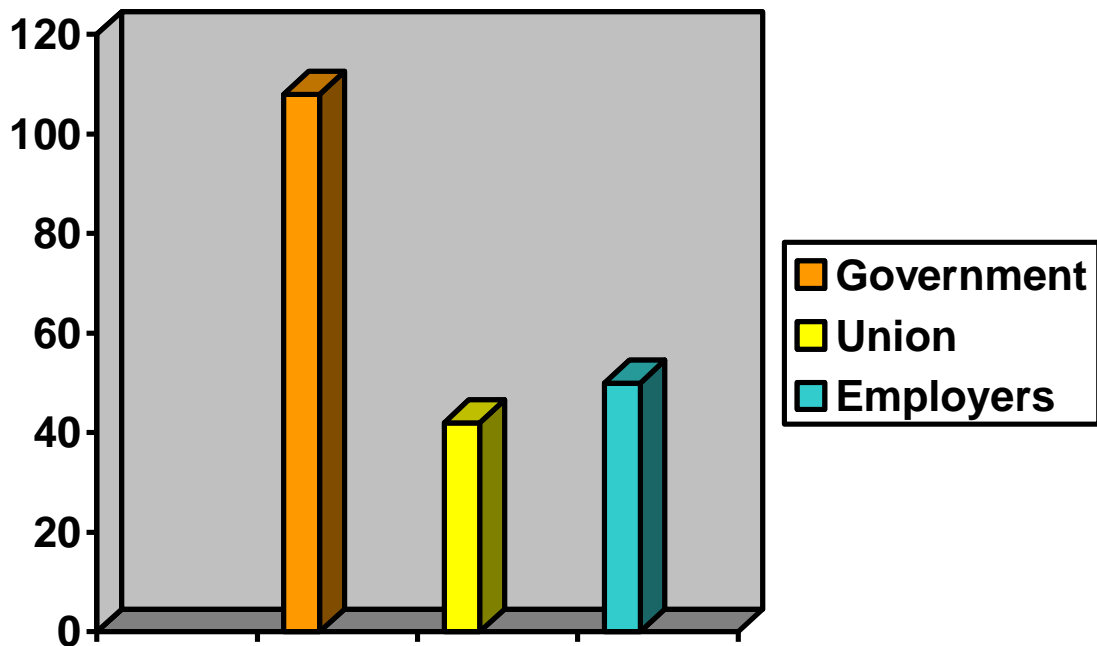
<sup>338</sup> Statistical overview of population, social statistics, employees and net pay of the State Statistical Office of the October 2008 number 2.4.9.09 (628), Skopje, 2009



Besides its membership and finance (fee), the union power is indirectly influenced by other factors that can not realistically be measured through effective figures (Personnel Policy, solidarity, disunity, political influence, etc.). In the early 90's, the financial power of the union was significantly greater. Therefore, it had a greater financial independence and political power in taking trade union actions, making a greater impact on the legislative process in the country, i.e. collective bargaining itself. Its greater bargaining power certainly resulted in incorporation of more favorable solutions in OKD of the economy and OKD in non-economz regarding Labor Law. One of the questions the respondents got asked was to rank the power of the social partners with a grade of 1 – 10.

At the first place ranks the Government, at the second employers, while the union ranked third, with little difference in the power employers.





These results suggest that union power has continuously declined and from an entity that at the beginning of the transition had approximately equal power with the Government, and greater than the employers, at the end of the transition it became the lowest ranked entity.

## 2.2. Reaction of the Union (manifestation of the power of the union)

The basic principle of law is that it should be respected. This means that collective agreements as part of the legal system of the country should be applied consistently. Labor rights of KD were grossly abused by employers (overtime, non-payment of contributions to the Pension, Health, Criteria for declaring redundancy.). Therefore the union applied appropriate methods of trade union struggle (strikes, protests, blockades, addressed the Court) to employers to protect labor rights. In the initial period the union as union struggle methods applied mostly strike and protests. Moreover strike was more prominent in election years, because this is the period when most messages and warnings are sent and to the current government, but also, the most sensitive labor issues. Union later applied other methods such as press conferences, addressing the Constitutional Court, informing international organizations and institutions (ILO), Labour Inspection, etc.. Regardless of which method was applied, the results of the actions taken were with partial or minimal effect.

## 4. External factors

### 3.1. Legal framework

The legal framework for collective bargaining continuously improved and refined. Once we became a candidate country for EU membership in 2005, the European Commission each year analyzes the progress of the Republic of Macedonia in all spheres of socio-economic, political and social life. Commission in its regular annual reports from 2006 - 2009 year noticed that the social dialogue or collective bargaining in the RM is not at the required level, urging current governments to amend Labor Code regarding the criteria for representativeness.

Because of this, access to new legal provisions was made in the Labor Code. According to the amendments to the Labor Code in 2009, in 2010 a regulatory body was set up, *the Commission for determining representation*, based on the new criteria procedure for determining the representativeness. With the amendments, except the required threshold for the number of members, other criteria were introduced to obtain representative status of trade unions and employers' organizations, and a legal procedure was established that will run the procedure for proving representation which created equal conditions competition. Census for representatives is significantly reduced from 33% to 5-10% for employers, ie 10 - 20% for unions.

The latest amendments to the Labor Code, experts in labor law say that the current legal framework in Macedonia generally meets the general criteria for a well-functioning social dialogue and collective bargaining within the European standards, ie, with the existing legislation, collective labor disputes on the basis of representation will be kept to a minimum.

### **3.2. Ideological affiliation of government**

It is known that left-wing governments favor social dialogue or collective bargaining, while right-wing governments are essentially conservative and represent the neo-liberal concept of economic and social policies, where collective bargaining is minimized. In determining the ratio of left and right to social dialogue or collective bargaining in our study we used two relevant data sources. One was through the voting files of the actual government, and the second through the interview. Following the behavior of governments towards the most important laws of the economic and social spheres, and who have had a certain impact on collective bargaining and the content of collective agreements, we came to the conclusion that the left and right lead restrictive policy towards workers' rights. Such tendency des-idiologization of political parties lead to the conclusion that they in their political activity do not assume their ideological matrix, but for pragmatic reasons of the current political elite and the policies of international financial institutions.

### **3.3. International financial institutions**

International financial institutions, at the beginning of the transition period, because of the financial arrangements between the Government and the IMF had more influence on the legislative process, and thus collective bargaining, ie the content of collective agreements. Wages instead of by KD were regulated by law. This way of limiting wage is unacceptable for a country with developed market and industrial relations, because the issue of wages is a central issue in collective bargaining in states with democratic industrial relations. This means that in collective bargaining you can negotiate everything but the salary, as opposed to the contemporary tendencies of collective bargaining. Thus, collective agreements are only reduced norm. In most of the KD, with the exception of 5-6 (KD for the textile industry, KD Leather Industry Health KD KD for welfare and KD PE "Macedonian Forests"), the minimum wage is not established, which is the basis for the application coefficient of complexity in the calculation of salary.

In the past, when the Left was in power in the public sector a practice was established of violation of collective agreements in the area of salaries and allowances, on the grounds that such a restrictive policy stems from RM arrangement with the IMF. In addition, we had a practice of freezing wages, holiday pay was not paid out (K - 15), food allowance was cut, as well transportation, retirement severance pay, the duration of unemployment compensation and other fees. Thus the state directly interfered in the regulation of wages and harmonized them according to the methodology and rules imposed by the IMF, which grossly violate the principles and provisions of the Convention no. 98 of free collective bargaining. In recent years the impact of these institutions has been significantly reduced. These institutions were basically alibi behind which governments hid to justify their policy taken in the economic and social sphere, and in this context the reduction of workers' rights.

### **3.4. Labour market**

Under conditions of a high rate of unemployment, which in RM for more than a decade is over 30%, the union tried through collective bargaining to establish equilibrium between protection of the jobs and the request for an increase in wages and improvement of the working conditions of the employees as a whole. Under such conditions, the union took defensive negotiating strategy, i.e. it is directed towards the struggle for the defense of their jobs, than towards increasing the salary. So the union had set a priority on keeping their jobs at the expense of other material rights of the workers. Thus, we can conclude that the high rate of unemployment considerably influenced the very contents of the KD.

Collective negotiation process in RM in the period 1990-2010 went on in continuity with grave problems, regardless of whether left wing or right wing was in power. In respect to the harmonization of the national labour legislation with the legislation of the EU (acquis communautaire), on one side, implementation of the policies of the IMF, on the other hand, ZRO permanently changed, sometimes, 2-3 times in the year, which considerably was hampering the dynamics of the CEA, and even more, the process of coordinating the KD with the changes of ZRO.

## **4. Violation of the provisions of Collective Agreement**

In the period 1990-2010 the concluded collective agreements, both in the economy and in non-economy were disregarded entirely. This had negative repercussions on the authority and importance of collective negotiations and the very KD. Collective bargaining makes sense and achieves its purpose only when all parties comply with the provisions of the concluded collective agreements (pacta sum servanda). When one side is evading the collective agreement, or does not comply with what it gave written consent about, then it is reducing the authority and meaning of KD as an autonomous mode of regulation of labor relations.

We analyzed the appeals, but also the grounds for the appeals of the union members to the Legal Service SSM. From the analysis of the data we received from SSM and independent unions, we can conclude that the provisions of KD had continuously not been complied with by employers, whether private or public sector.

They were not respected even by the state bodies and institutions, including the Government, which in fact is most responsible for the normal functioning of the legal system in the country. Most of all it refers to the violation of the right of allowance for holiday (K-15), travel allowance, reducing the basic amount for food, allowance for past labor, overtime (in defense sector), etc.. This is shown by the cumulative number of appeals where union help was sought by a total of 176,770 employees. Most of them have appealed by 3-4 basis (salary, benefits, fees, past work etc.), which multiplies this problem. Violated was any right to payment, (50,000), followed by the institute overtime. Roughest violation of this institute is present in the textile industry (clothing), where employers unscrupulously abuse this right. If we add to this other grounds (cancellation, K-15, a violation of trade union rights, CVT, etc.), then violation of the rights of workers multiplies. Most appeals were recorded in the economy, and many were employed in the public sector (public administration, public authorities), who demanded their rights by the courts through collective lawsuits for exercising the right of K-15, the food transportation, etc.

### 5. Recommendations

To improve collective bargaining in RM, we propose:

1. In the framework of the Economic and Social Council (ESC), to set up an expert body for collective bargaining which exclusively will deal with issues related to the functioning of tripartite and bipartite social dialogue, the application of collective agreements, and also to monitor and analyze situations and problems associated with Collective Bargaining in the country at all levels.

2. Commission for determination of representativeness, the state regulatory body should be composed on a tripartite basis (union, government, employers).

3. In the Republic of Macedonia a special law is to be adopted that would regulate all legal matters related to collective bargaining: Collective Bargaining Act, the Economic Social Council and the Law on Trade Unions.

4. Economic and Social Council of the Republic (ESC) is to immediately deal with the adoption of the National Strategy for Development (5-10 years), or to adopt a National Action Plan for the development of collective bargaining in the RM (1-2 g.).

5. Because the Collective Bargaining dynamics in the country, it is urgent to establish Boards of employers in those sectors and industries where so far they have not been formed

6. Collective Bargaining at all levels are to determine the minimum wage, which will represent the labor cost for the lowest level of complexity to be applied in determining the basic salary of the employee.

### Summary

Despite the above problems in the functioning of collective bargaining, we can conclude that in the past two decades it has played a constructive role in the development of social dialogue, social harmony, building mutual trust of the social partners, as well as in the reduction of social conflicts.

Through collective bargaining social partners established communication, meetings, exchanged information, consulted, negotiate and made joint decisions (making decision) on many issues related to the rights and obligations of workers and employers in the economic and social sphere (wages, working conditions etc..).

Thus the destructive social energy transform into institutional dialogue creating social and industrial peace (compromise). It also played an important role in improving the degree of negotiating culture of the subjects of collective bargaining.

To establish a real bipartite and tripartite social dialogue, the social partners should have a developed culture of dialogue, based on mutual understanding, respect for the views of others, acceptance of arguments, good will (bona fide), in good faith (goodfaith).

Collective bargaining should not be understood as a social relation in which superiority is being manifest, but as a relationship in which the holders of social power, based on the arguments, seek mutual acceptable solution (compromise), which will integrate (embed) the interests of both negotiating parties.

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**AN ANALYSIS AND ASSESSMENT OF CUSTOMER SATISFACTION WITH SERVICE QUALITY IN  
INSURANCE INDUSTRY IN ALBANIA. THE USE OF STRUCTURAL EQUATION MODELLING  
APPROACH FOR THE ANALYSIS**

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**Abstract:**

*This study sought to assess and analyze customer satisfaction with service quality in the insurance industry of Albania. Specifically, it examined the determinants of satisfaction and the effects of customer satisfaction on behavioral intentions of consumers in Albania's insurance industry, as well as the influence of background data on the relationship between satisfaction and behavior intention. The study was a cross-sectional survey that used self-administered structured questionnaire to the target population of customers of insurance companies in Albania. Out of the one thousand and one hundred questionnaire administered, one thousand and fifty-one usable questionnaire were obtained constituting 87.6% for analysis. Structural Equation Modeling (SEM) approach was used to analyze and test relationships among variables. The study found that Reliability and Responsiveness are Functional quality dimensions that were found to have significant impact on customer satisfaction. Again, Technical quality, Price, and image quality were found to be factors that do not significantly affect customer satisfaction determination. Moreover, customer satisfaction was found to have significant and positive impact on behavior intentions such as likelihood to recommend, switching intention and repurchase intention. Furthermore, demographic characteristics such as gender, age, education, and income levels were found to have no significantly impact on the relationship between customer satisfaction and behavior intentions. The implications of the study to management and theory are discussed and recommendations for future research have been made.*

**Key words:** customer, satisfaction, determination.

**JEL Classification:** M19.

## **INTRODUCTION**

### Background to the Study

The focus on customer-centric marketing philosophies has received considerable attention in the marketing literature by scholars and practitioners. Both practitioners and scholars are increasingly looking for ways to understand, attract, retain and build intimate long term relationship with profitable customers (Kotler, 2006; Gronroos, 1994). One of the key areas in the customer-centered marketing paradigm is ensuring that existing customers are satisfied. As a result organizations have been studying and developing strategies to satisfy customers and achieve customer delight. According to research, a very satisfied customer is nearly six times more likely to be loyal and to re-purchase and recommend a product/service to family and friends than a customer who is just satisfied. It is again believed that satisfied customers tell five other people about their good treatment, and that five-percent increase in loyalty can increase profits by 25% - 85%. Conversely, the average customer with a problem eventually tells eight (8) to ten (10) other people (SPSS White paper, 1996; Limayem, 2007). Numerous studies have established the fact that customer satisfaction (CS) drives customer retention and loyalty (Heskett et al., 1997; Heskett et al., 1994; Reichheld and Sasser, 1990). It is believed that the average business spends six (6) times more to attract new customers than to retain old customers. Customer retention is, therefore, basically a product of customer loyalty and value which in turn is a function of the level of customer satisfaction or dissatisfaction (CS/D) (Reichheld, 1996). Organizations that have long-term perspective for growth are, therefore, increasingly developing measures to ascertain customer satisfaction/dissatisfaction.

While effective customer complains could be used to ascertain, it has its own shortcomings since the average business firm never hears from 96% of their unhappy customers and 91% will never come back; they get back; only 4% of dissatisfied customers will complain (SPSS White paper, 1996). Consequently modern business organizations adopt rigorous qualitative and quantitative mechanisms to determine customer satisfaction (CS) for effective marketing strategy and decisions. In this regard, measuring customer satisfaction provides feedback on how successful an organization is at providing products and/or services to the satisfaction of customers at the marketplace and market' space.

The insurance industry in Albania, like any other service organizations, has the quest to deliver quality service to satisfy its customers in the midst of fierce competition for market share with its numerous local and foreign competitors. The insurance industry in Albania is regulated by The National Insurance Authority, which has the object of ensuring effective administration, supervision, regulation and control the business of insurance in Albania. Over the past decade, competition in the industry has greatly increased as many new entrants have joined the industry.

### **Problem Statement**

The problem of this study is principally informed by the fact that there is very limited empirical documentation in the area of customer satisfaction (CS) and service quality (SQ) in the insurance industry in Albania for both research and industrial management. On the one hand, in Albania empirical studies on the state of CS in the insurance industry is very scanty.

As far as the researchers are concerned, no study has been published on CS in the insurance industry in Albania to inform stakeholders, especially the industry regulator, the National Insurance Commission (NIC) in Albania, regarding the service quality delivered by insurance companies to customers. The increased competition in the insurance industry in Albania and the growth trend in the gross insurance premiums for the past decade, does not provide empirical support for the claim that customers are satisfied with the service quality delivered by firms in the industry. While there have been several attempts by the National Insurance Authority (NIA) to encourage players in the insurance company to improve upon service quality, there are no empirical information on the perception of customers regarding the service quality of these firms. Therefore, since NIA is mandated and aims at ensuring that insurance companies provide quality services that meet customers' requirement, it is critically important for its management to be empirically informed about how customers feel about the service quality in the insurance industry. Such a survey provides also necessary feedback for management decision and growth strategy for the respective insurance firms.

On the other hand, many scholars have endeavored to examine customer satisfaction with service quality in many industry contexts (Gyasi & Azumah, 2009; Mehdi, 2007; Asubonteng, McCleary, & Swan, 1996; Rust, & Oliver, 1994; Gronroos, 1994; Rust & Zahorik, 1993), few have related it to the insurance industry context in developing economies, like Albania. There is the need to increase understanding of the factors that drive customer satisfaction in the industry in order to provide management with empirical basis for developing effective marketing strategies. In view of the above, the main problem of this study is: How can determinants and effects of customer satisfaction in Albania's insurance industry be described?

### **Purpose of Study**

For the above identified research problem, the main purpose of this study is to assess and analyze the determinants and effects of customer satisfaction on behavioral intentions of consumers in Albania's insurance industry.

### **Objectives of the Study**

The following are the specific objectives of this study:

1. To examine the determinants of customer satisfaction in GII.
2. To examine the influence of satisfaction on consumers' behavior intentions.
3. To examine the influence of background data on the relationship between satisfaction and behavior intention.

### **Research Questions**

For the above problem and purpose, the study seeks to answer the following specific research

questions:

1. What are the determinants of customer satisfaction in Albania insurance industry?
2. To what extent does satisfaction influence behavior intention?
3. How is the relationship between customer satisfaction and behavior intentions

influenced by customers' background data (gender, age, education, income level)?

### **Development of Insurance Industry**

Insurance is dated back as old as the story of mankind and the instinct which prompts businessman of today in securing themselves against any incidental occurrences existed in primitive men also. There was the need to avert the evil consequences of these incidental occurrences to make some sort of sacrifice in order to achieve security. The concept of insurance is a development of the recent past, especially after the industrial era.

Insurance is grouped into three major categories as followed; Life Insurance, Non-Life Insurance and Reinsurance. The world trade organization breaks down financial services into two and all insurance and insurance related services falls under one category, while banking and other financial services also are on the other side. Insurance is further broken down into life, accident and health insurance services, non-life insurance services, reinsurance and retrocession, insurance intermediation, and service auxiliary to insurance. A financial service on the other hand is defined as any services of financial nature offered by financial services suppliers. This includes insurance and insurance related products such as: Direct insurance, both life and non life; Reinsurance and retrocession; Insurance intermediation, such as brokerage and agency services; Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

The range of insurance products, coupled with technology and the creation of new hybrid products, has given room to issues of classification. There are three most important stakeholders in the insurance process being the insured (customer), insurer (provider of the service) and regulator (being the Government or independent authority).

The economic growth rates and saving ratio in developing countries shows a positive correlation. It is prudent for Government and the National Insurance Commission (NIC) to be more innovative to ensure the financial viability of the industry while unleashing the insurance industry's tremendous potential through the liberalization of the investment premium. There has been significant improvement in developed countries economy, since the insurance industry is the major source of mobilizing funds and has made a huge investment that has facilitated the development of these nations. It can then be said insurance companies are the basic long-term financial institutions because they have access to vast potential of long term funds.

### **Determinants of Customer Satisfaction in Insurance Industry**

Many factors drive customer satisfaction that need to be examined in order to reliably measure it. Customer satisfaction could be influenced by service quality and the customer service experiences (Oliver, 1993a; Parasuraman, et al., 1988, Lovelock, 2000; Lovelock & Wirtz, 2007; Gronroos, 1994, 2000, 2001; Yonggui Wang & Hing-Po Lo 2002; Kotler & Keller, 2006).

Recent empirical studies have shown that customer satisfaction is not only driven by cognitive dimensions of customer perceptions of service quality but also by affective dimensions which have positive impact on post-purchase behavior like repeated purchase, customers loyalty, switching intention, and likelihood to recommend (Erevelles, 1998; Oliver, 1980; Oliver, 1993a).

### **Functional Quality (SERVQUAL)**

Many different models have been developed to explain and measure service quality in different settings of business operations (Nitin et al., 2005). Different service quality dimensions have been found in many different studies in different industry and service or product context.

One of the service quality categories that have been found to influence customer satisfaction is functional quality. Functional quality has been initially conceptualized in the GAP model which was proposed by Parasuraman, Zeithaml and Berry (1985). The model conceptualizes service quality to be the differences between expectation and performance relating to quality dimensions.

Based on the above review of the literature, it is expected that customer satisfaction will be positively influenced by service quality, and we hypothesize that:

H1: Functional quality positively influence on overall satisfaction in Albania's Insurance Industry. The higher the functional quality, the higher the customer satisfaction.

H2: Technical quality will have significantly positive influence on overall satisfaction in Albania's Insurance Industry. The higher the technical quality, the higher the customer satisfaction.

H3: image quality will have significantly positive influence on overall satisfaction in Albania's Insurance Industry. The higher the image quality, the higher the customer satisfaction.

H4: price quality dimension will have significantly positive influence on overall satisfaction in Albania's Insurance Industry. The higher the price quality, the higher the customer satisfaction.

### **Price**

Again, customer satisfaction is driven by perceived price or value. Though the concept of value is relative and has several dimensions to it, Zeithaml (1988) considers customers value as the overall assessment of the utility of a product based on perception of what is received and what is given. Dodds et al (1991), controveerter that customers perceptions of value represent a trade-off between the quality or benefit they receive in the product relative to the sacrifice they perceived by paying the price.

The perceived value process involves a trade-off between what the customer gives such as price/money, sacrifices, perceived risk, opportunity cost, and learning cost in exchange for what he/she gets such as quality, benefits, utilities (Yonggui Wang & Hing-Po Lo, 2002; Ravald & Gronroos 1996; Zeithaml 1988). One of the most recent research in the work of Hume & Mort (2008), confirms that value or price quality is a positive predictor of satisfaction. This is consistent with the findings of Rust and Oliver (1994) who suggested that value had a direct and encounter-specific input to satisfaction.

The present study will include functional quality, technical quality, image and price as the determinants of customer satisfaction. The implication of the antecedents of customer satisfaction is that managers must take effective strategies to manage customer perceived quality, customer expectations, customer perceived value in order to reap the full benefits of customer satisfaction measurement (Gronroos, 1990; Kauppinen-Raisanen et al., 2007).

### **Customer Satisfaction and Behavior Intention**

CS impacts the behavior of customers in a number of ways. First CS is found to be a key determinant of customer retention (Rust and Zahorik, 1993; Zeithaml et al., 1996). Again, according to Reichheld (1996) CS is regarded as a necessary antecedent of customer loyalty, which in turns drives profitability and performance (Heskett et al., 1997; Reichheld, 1993).

Also, Increasing CS and customer retention leads to improved profits, positive word-of mouth, and lower marketing expenditures (Reichheld, 1996). In many studies, customer satisfaction is positively correlated with customer re-purchase, likelihood to recommend, positive word-of-mouth, customer loyal and retention. But, CS is negatively correlated, to a large extent, with customer complaints and switching intention (Yonggui Wang & Hing-Po Lo, 2002).

It must be pointed out that customer loyalty and retention are not always attributable to customer satisfaction. It is because a customer may not be satisfied with the services/products but may find it difficult to switch to a competitor simple because of the circumstances he/she is faced with. This is usually common in most services context. For example with Insurance services, until the time period for a particular insurance policy or product a customer may have bought expires, the customer may be forced to maintain the policy.



Such a customer may be dissatisfied but will be forced to remain loyal to an organization; this is a kind of forced loyalty by implication. Loyalty is therefore affected by situational factors and switching cost.

In view of the above, the present study examines the relationships that exist between customer satisfaction, and behavior intentions such as likelihood to recommend, re-purchase intention and switching intention in Albania insurance industry. We, therefore, propose that overall satisfaction will significantly influence consumers' behavior intentions, and hypothesis that:

*H5 Customer satisfaction positively affects customer behavioral intentions.*

Many past studies have found that satisfaction of customers may be influenced by demographic variables such as gender, age group, income and educational level. There have been divergent views in the service literature regarding the impact of demographic variables on satisfaction of consumers.

However, these findings may not be the case for the insurance industry context, therefore the present study hypothesis that:

*H6. Demographic variables moderate the effect of customer satisfaction on behavioral intentions.*

*H6a. Customer's gender moderates the effect of customer satisfaction on behavioral intentions.*

Previous studies have found that elderly people are, on average, slower in encoding new information and in retrieving information stored in memory, thus reducing information processing capability (John and Cole 1986). According to Mittal and Kamakura (2001) older people may have lower "thresholds of acceptable satisfaction;" because information search for a new provider is more costly. However, research also suggests that age-related differences in product or service evaluations may be due to different expectations, driven by differences in other service-specific factors such as culture at birth, maturation and the type of service patronized (Bryant and Cha 1996). In general, past research has found that older people are more satisfied than younger people (Mittal & Kamakura 2001; Bryant & Cha, 1996); therefore, we hypothesize the following:

*H6b .Customer's age moderates the effect of customer satisfaction on behavioral intentions.*

Income and educational level. The influence of income and educational levels has been widely studied in many different industry contexts (Mittal and Kamakura, 2001). Such studies have it that the low income earners and low levels of education positively correlate with lower satisfaction levels while higher income groups and higher educational levels are associated with higher satisfaction levels. Though there are some differences in the findings on these demographics in marketing literature, it will be expedient to explore the impact of these variables in the insurance service context in developing countries like Albania to provide both scholars and practitioners with empirical evidence that will serve as basis for marketing strategies and further empirical enquiry. Therefore, we hypothesize that:

*H6c. Customer's income moderates the effect of customer satisfaction on behavioral intentions.*

*H6d. Customer's education level moderates the effect of customer satisfaction on behavioral intentions.*

## **RESEARCH METHODOLOGY**

Research methodology refers the procedural framework within which the research is conducted (Remenyi et al., 1998). Research methodology is characterized by procedures and methods for arriving at results and findings and tools for proving or disproving knowledge (Nachamias et al., 1996; Saunders approaches a researcher chooses to conduct a research which could be affected by the researcher's philosophical perspectives and paradigm.

### **Research Approach**

Research may be deductive or inductive. Deductive research approach begins with the development of a theory or hypothesis and later a development of a strategy to test it in a context to verify or reject its claims. So it is thinking from general to specific.

On the other hand, the approach is inductive where the research begins with an observation of a phenomenon in an environment, then data is collected upon which a theory is developed or generalization is made. Thus, thinking from specific to general.

In this study, we have carefully selected existing empirical theories and models, applying and testing them in assessing the impact of service quality on customer satisfaction in the context of Albania's Insurance Industry. Therefore, the study is deductive. Research design can be longitudinal or cross-sectional. A cross-sectional study examines a particular phenomenon at a specific period of time (Saunders et al., 2007). According to Malhotra and Birks (2007) one sample of a population can be taken

and studied at a particular time as in a single cross-sectional study or two or more samples of a target population could be studied once as in multiple cross sectional study.

**Survey:** A survey is a type of method in which the opinions of the sample or population is sought by the researcher, usually with a more objective research instrument, say a structured questionnaire. It is usually associated with a deductive approach and is conducted usually in business and management research to prove or disprove certain assumed propositions and hypothesis. It allows for the collection of large amount of data from a large population economically. It is most frequently conducted to answer research questions relating to 'who, what, how much and how many' involved in a problem of study.

### **Sampling Method**

A convenient sampling technique, which is a non-probabilistic sampling technique, will be used to select the respondents for three reasons. First the customers are scattered across the country, which makes it very difficult to contact each of them individually. Again, it is difficult getting the exact number of customers for each of the insurance companies in Albania which is required for the use of any random sampling technique. Third, the researchers are working within the demands of an academic schedule so very limited time and resources to conduct the study.

### **Data Collection**

Both secondary and primary data will be used. The primary data collection methods will be focus group discussion and the use of structured questionnaire. Secondary data will include search from companies' websites, internet, documentaries, etc.

#### **In-depth Focus Group Interview**

In this study a preliminary focus group interview was conducted to clarify service quality dimension in the context Insurance Industry in Albania. The focus group was used to discuss dimensions of service quality that matter to Albanian customers. The use of projective techniques, focus group, in-depth individual and group discussion, as well as observational techniques have been recommended for use in an exploratory study where researchers want to have more understanding of the key variables involved (Saunders et al., 2000; Cooper and Schindler, 2006; Malhotra & Birks, 2007).

### **Data Analysis Tools**

Data will be analyzed using Statistical Package for Social Sciences (SPSS), version 16.0 and AMOS 18.0. The following describes statistical methods will be used to analyze data: Descriptive statistics: First, descriptive statistics will be done using frequency counts, percentages, means and standard deviations for the dependent and independent variables. In this regard, the dimensions will be ranked according to their means to determine the relative importance of the service quality dimensions.

**Structural Equation Modelling (SEM):** SEM is a more robust statistical data analysis technique that is used for multivariate analysis with latent variable. SEM is a set of linear equations for testing the hypothesis about the relationship between observed and latent variable and uses a confirmatory approach (Lavee, 1988; Hair, Black, Babin, Anderson, Tatham, 2006). Observed variables are the indicators of the constructs in the questionnaire items and the latent or unobserved variables are the constructs in the theoretical model.

## DATA ANALYSIS

Genders of respondents are 57.8% of them are males and 42.2% are females. In terms of age, 0.6% of the respondents are below 20 years, 30.9% between 20 and 29 years and 48.8% between 30-39, 16.7% are between 40-49 years and 2.9% are 50 years and above, implying that majority of them are in the economically active population.

Respondents have a well educated background of which 88.6% of them having tertiary education, specifically first degree and Diploma/HND has a commanding percentage, while 11.1% with intermediate certificate.

The type of insurance policy respondents are engage in also reviews 43.6% in the Life insurance business, while 27% are in the Non-Life insurance, living 29.4% of them in both Life and Non-Life insurance. Respondents' relationship with their insurance company, with respect to time also brought to light 64.5% of them are below 5 years experience, 27.8% are within 5 years to 10 years experience, 6.5% have 11 years to 20 years experience and with 1.2% of them falling between 21 years to 40 years. The types or number of insurance firms Respondents patronize gave us 64.6% are in for only one insurance firm, while 35.4% are in for 2 to 4 insurance firm.

### Regression and Confirmatory Factor Analysis (CFA)

The suitability of the research model should be tested before the structural relationship could be examined to test the hypothesis for this study. A confirmatory factor analysis was conducted using AMOS 18.0 SEM for the measurement model of determinants of customer satisfaction and behavior intentions. The Unweighted Least Squares Estimation was deemed the best solution to fit the model's measures. The results are presented and discussed for the Model's fit indices, factor loadings (the correlation between the latent variable and the observed variable), and the variance extracted (the average square factor loading for each latent construct in the measurement model), specifically, the Average Variance Extracted (AVE).

The following results can be inferred: Factor loads of all the indicators are higher than 0.5 which shows that the questions highly explain the variance of their variables so we can say that the measurement model has high factor validity. Within technical quality indicators, TQ4 help explain technical quality most (.80), followed by TQ3 (.76), TQ2 (.73), then TQ5 (.73) and TQ1 (.71). Within the image quality indicators, MI contributes greatest, .82 in explaining image quality, followed by IM3 and IM2 with co-efficients .81 and .80 respectively. Regarding price quality, PX2 helps explain the price factor by .86 followed by PX1 being .60. In functional quality dimensions, TA1 is the strongest indicators in explaining

tangibles variable by .70, RL4 and RL2 contribute most in explaining the reliability by .81 and .80 respectively. Again, while RS3 (.79) is the most important variable in explaining Responsiveness dimension, EM5 and EM4 helps to explain most the Empathy dimension by .80 and .81 respectively. Moreover, in the assurance variable, AS2 loads the highest factor of .85, implying that although all the assurance indicators can explain the dimension, AS2 helps in explaining the variance in the assurance variable. The significant correlations between the variables are high except between image and price variables. This indicates that there latent factor among the variables which is described in this research as customer satisfaction.

Table: 1 Cronbach Alpha Reliability test for dimensions

Multidimensional items	Nr of items	Cronbach' alpha	Cronbach' alpha based on standartised item
Customer Satisfaction items	3	0.871	0.886
Behavior intentions	3	0.827	0.828
Tangibles	4	0.700	0.703
Reliability	5	0.881	0.880
Responsiveness	5	0.868	0.869
Empathy	7	0.891	0.892
Assurance	4	0.822	0.827
Price	2	0.681	0.693
Technical quality	5	0.863	0.863
Image quality	3	0.834	0.835
All items (excluding background data)	41	0.834	0.971

### **The Average Variance Extracted (AVE)**

The AVE is the average percentage of variance extracted among a set of construct items. It is a summary indicator of convergence (Hart et al. 2006). It is computed as the total of all squared standardized factor loading (square multiple correlation) divided by the number of items. Thus it is the average square factor loading that is computed for each latent construct in a measurement model. The conservative approach for establishing discriminate validity compares the variance extracted estimates for each factor with the squared inter construct correlation associated with that factor. As a rule of thumb a value of 0.5 and above is deemed appropriate. For this study, the variance extracted (VE) shows the values for the square root of the variance extracted, average variance extracted (AVE), all of which are around 0.5.

### **Analysis of Research Hypothesis**

This study examines a model in which customer satisfaction is postulated to be determined by eight latent variables, being tangibles, reliability, empathy, responsiveness, assurance, image price and technical quality. For the measurement model, there are 36 measures that are used to identify the latent variables. The first five latent variables are described as functional quality variables, namely: tangibles, reliability, empathy, responsiveness, assurance. The measures for each of these latent variables are presented in the questionnaire for this study.

Again, the model also postulates that customer satisfaction positively influences behavior intention and that the relationship between behavior intentions and customer satisfaction is moderated by customer demographic variables. The indicators for customer satisfaction, behavior intentions and demographic variables and their hypothesized relationships have been justified in the literature review section.

The results of the reliability statistics for the measurement instrument are found to be very good according to the Cronbach alpha for the latent variables that are presented in this study. The results of exploratory and confirmatory factor analysis also lend support to the convergent and discriminate validity of the measurement model.

H1: Functional quality positively influence on overall satisfaction in Albania's Insurance Industry. The higher the functional quality, the higher the customer satisfaction.

The significance of the standardized loadings between functional quality variables and satisfaction indicate that, only one of the functional quality items, being Reliability significantly and positively affects customer satisfaction by 0.717 ( $p > 0.001$ ). However, in some previous studies such as Cheng, Lam & Hsu (2006) and Ouyang, (2010) hypothesis can be accepted where  $p < 0.01$  or  $p < 0.05$ . Therefore based on this evidence in the literature, the hypothesized relationship between Responsiveness and satisfaction can be accepted since it has  $t > 1.96$  and significant at 0.05 and 0.01. The rest of the functional quality items such as Tangibles, Empathy, and Assurance do not significantly determine customer satisfaction in

the insurance industry in Albania. Thus, the hypothesized relationship between functional quality items and satisfaction is partially supported through Reliability and Responsiveness.

H2: Technical quality will have significantly positive influence on overall satisfaction in Albania's Insurance Industry. The higher the technical quality, the higher the customer satisfaction.

The p-value of the standardized path co-efficient between technical quality and satisfaction indicates that technical quality does not significantly affect customer satisfaction. Thus, hypothesis two is not supported.

H3: Image quality will have significantly positive influence on overall satisfaction in Albania's Insurance Industry. The higher the image quality, the higher the customer satisfaction.

The p-value for the standardized path co-efficient between image quality and satisfaction indicates that, though the relationship is positive ( $R = 0.183$ ), it is not significant. Therefore, hypothesis three is not supported.

H4: price quality dimension will have significantly positive influence on overall satisfaction in Albania's Insurance Industry. The higher the price quality, the higher the customer satisfaction.

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The p-values for path coefficient from price to satisfaction is insignificant ( $p > 0.01$  and  $0.05$ ) indicating that price does not positively affect satisfaction. We conclude that the hypothesized relationship between price and satisfaction is not supported in Albania's insurance industry.

H5 Customer satisfaction positively affects customer behavioral intentions.

The p-value for the path co-efficient from satisfaction to behavior intention is positive (1.16) and significant ( $P < 0.001$ ) which implies that satisfaction positively affects behavior intentions in Albania's insurance industry. Therefore, hypothesis five is supported.

In this study, the moderating variables are customer demographic variables such as gender, age, income and education level. The study hypothesizes that these demographic variables moderate the relationship between customer satisfaction and behavior intentions.

H6. Demographic variables moderate the effect of customer satisfaction on behavioral intentions.

H6a. Customer's gender moderates the effect of customer satisfaction on behavioral intentions.

H6b .Customer's age moderates the effect of customer satisfaction on behavioral intentions. Income and educational level.

H6c. Customer's income moderates the effect of customer satisfaction on behavioral intentions.

H6d. Customer's education level moderates the effect of customer satisfaction on behavioral intentions.

Following the above guidelines (Hair et al., 2006), the relationship between customer satisfaction and behaviour intentions in the original structural equation model estimated is used as a benchmark to compare with the new model that includes the moderating variables.

Table2: Total Variance Explained

component	Total Variance Explained								
	Initial Eigen values			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	16.705	47.729	47.729	6.284	46.525	46.525	5.723	16.351	
2	1.832	5.235	52.964	1400	4.001	50.526	5.490	15.684	32.035
3	1.633	4.665	57.629	1228	3.509	54.035	5.246	14.990	47.025
4	1.105	3.287	60.916	710	2.030	56.065	3.164	9.040	56.065
Extraction Method: Principal Component Analysis.									

### Findings under Research questions (RQs)

RQ1 What are the determinants of customer satisfaction in Albania insurance industry?

Reliability and Responsiveness are Functional quality dimensions that were found to have significant impact on customer satisfaction in GII. Generally, these findings provides evidence in support of previous studies (e.g. Kotler & Keller., 2006; Lovelock & Wirtz, 2007; Mehdi, 2007; Oliver, 1980; Parasuraman, et al, 1985; Zeithalm, Berry, & Parasuraman, 1996; Wang & Hing-Po Lo, 2002) that service

quality affects positively satisfaction and behavior intentions of customers. Specifically, these findings are consistent with previous studies such as Gyasi & Azumah (2009), Heskett, et al. (1994), Mehdi (2007), Parasuraman, et al. (1985), Pizam & Taylor (1999), Rust & Oliver (1994) and Sattari (2007) that also found Reliability and Responsiveness of the service provider to be important and significant predictors of satisfaction of customers in service contexts.

As noted by Parasuraman et al. (1988), the relative importance of service quality dimensions may differ from industry to industry in different service contexts, therefore, this study lends support to this fact in that reliability and Responsiveness of the service provider happen to be the most relatively important determinants or predictors of customer satisfaction in GII. Technical quality, Price, and image quality were found to be factors that do not significantly affect customer satisfaction determination in GII. Though there is theoretical evidence from previous studies that shows that technical quality, price and image quality affects customer satisfaction (e.g. Gi-Du and James, 2004), this finding appears to controvert some of these previous studies. However, the explanation is that, the fact that Technical quality, Price and Image quality are found in this study as insignificant determinants of satisfaction does not mean these determinants are not important but rather that regarding the insurance industry, according to the respondents, reliability seems to be the dominant factor determining their satisfaction.

RQ2 To what extent does satisfaction influence behavior intention in GII?

Customer satisfaction was found to have significant and positive impact on behavior intentions such as likelihood to recommend, switching intention and repurchase intention. This is consistent with the findings of Peighambari (2007) and many other similar previous studies (e.g Oliver, 1980; Wang & Hing-Po Lo, 2002) that also found that satisfaction plays a significant role in determining similar behavior intentions such as loyalty, switching intentions, repurchase intention and likelihood to recommend a service to friends and family.

RQ3 How is the relationship between customer satisfaction and behavior intentions influenced by customers' background data (gender, age, education, income level)?

Demographic characteristics such as gender, age, education, and income levels were found to have no significant impact on the relationship between customer satisfaction and behavior intentions. In other words, the impact of customer satisfaction on behavior intention as found in this study does not depend on the demographic characteristics of the respondents such as their gender, age, income and

education. One possible explanation to this finding is that fact that the insurance industry in Albania is a developing sector that is less sensitive to gender, education, age, and income of customers. This is probably due to the fact that, by nature insurance products are needed and required by customers irrespective of their gender, age, income level and education, and that these factors do not seem to have any such significant influence in determining customers' satisfaction in the insurance industry in Albania.

### **Conclusions and recommendations.**

In this study, through a cross-sectional survey using self-administered structured questionnaire and quantitative data analysis technique in examining the determinants and effects of customer satisfaction in the insurance industry, it could be concluded that Reliability and Responsiveness dimensions of service quality are very important in determining customer satisfaction in Albania's insurance industry, satisfaction in the industry in turn drives significantly customer behavior intentions, and that the impact on satisfaction on customer behavior intentions is not significantly influenced by customer demographic variables.

### **Managerial Implications and Recommendations**

Based on the findings of the study the following recommendations are given.

- Improve satisfaction through reliability of service provider
- Improve satisfaction through Responsiveness of service provider
- Improve satisfaction through other quality areas
- Influence behavior intentions through satisfaction

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**RISK MANAGEMENT FOR LIFE INSURANCE WITH HIGH INVESTMENT COMPONENT. THE ISSUES RELATED TO SOLVENCY RISK MANAGEMENT FOR A RANGE OF HIGH SAVINGS LIFE INSURANCE PRODUCTS**

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**Abstract:**

*Regulation of life insurance with a high investment component depends on the objectives of the regulator and the range of products offered. Risk management for these products may involve the use of sophisticated financial instruments, but the use of these instruments can create risk as well. Regulation is necessary to correct market imperfections, and the degree of necessary regulation depends on the sophistication of the market. Regulators must balance the need for simplicity of regulation against the need to permit product innovation. This paper discusses issues related to solvency risk management for a range of high savings life insurance products. Evidence shows that a competitive free market allocates scarce resources efficiently, enhances the value of products brought to market, and enhances consumer choice. Previous research found that liberalization and deregulation seem to have increase productivity. This rigorous research confirms the results of economic theory, that a competitive market increases productivity. What, then, is the proper role of insurance regulation? A perfect market might be able to operate effectively with no regulation, but insurance markets tend to have imperfections that must be corrected by regulation. The proper role of regulation is to compensate for these imperfections with the minimum interference with the functioning of the market. The most important imperfections in the insurance market are information asymmetry, market power, and systematic financial risks. The classic example of information asymmetry in life insurance arises as adverse selection, when an applicant is aware of adverse risk information that the insurance company is not aware of. While this is a common potential problem, companies usually handle it effectively in their underwriting process. The more pertinent problems for this discussion involve information that companies have that their customers do not have. This information includes company financial strength, the risk profiles of investment products, and comparative value of products. These imperfections bring about the need for regulation of solvency and consumer product disclosure.*

**Key words:** risk, management, insurance, life.

**JEL Classification:** M19.

**Introduction**

A further imperfection in the insurance market results from market power. This arises when companies are able to limit competition. Market power can arise from regulatory involvement. For example, complex regulations can create a barrier to entry, which can keep competitors out of the market. Taxes, such as premium taxes, can create barriers to entry if the cost for foreign companies is higher than that of domestic companies. Some sources of market power, such as product differentiation, or maintaining a good reputation, can be beneficial to consumers.

Systematic financial risks exist when the failure of one financial institution leads to the failure of others. This has occurred in the United States when the failure of a reinsurer after a major hurricane caused the failure of several primary insurers. A second type of systematic financial risk is the possibility of a “run” where the simultaneous cash demands of many policyholders overwhelm the ability of a company to liquidate its assets at a fair price. High savings life insurance is vulnerable to both types of systematic risk.

Having outlined the principal imperfections that are likely to exist in the market for high savings life insurance, the need to foster market entry and innovation lead us to a limit the role of regulation.

As stated by Skipper [2000]: “Government’s role in crafting insurance regulation should be limited to rectifying imperfections that can cause significant harm. A pro-competitive approach, therefore, would witness governmental regulation of insurance only with respect to matters that meet three conditions:

- an actual or potential market imperfection exists
- the market imperfection causes or can reasonably be believed to cause meaningful consumer or public harm
- government action can ameliorate the harm.

Conversely, if any one of the three conditions is not met, no government intervention is warranted.”

This dictum would support solvency regulation, where the potential for harm to the public is clear, the information that customers need to protect themselves is difficult for them to obtain, and where government has demonstrated an ability to monitor and promote solvency. It would also support disclosure regulation to the extent that the transparency and sophistication of the market, and the complexity of products, make it difficult for customers to obtain the information they need for their decisions. It would not support long-term barriers to entry, perhaps erected to protect a domestic industry from international competition. As the market increases in transparency and sophistication, it is possible to reduce the degree of regulation.

As markets are deregulated, there is, paradoxically, a need for more skill on the part of regulators. Deregulation involves a shift of the focus of regulation away from prescribing industry actions toward protecting from adverse results. This shift requires an increased level of expertise on the part of the regulators. Markets in which products and prices are controlled by regulation may not need sophisticated solvency regulation. For example, in the Japanese life insurance market the regulation of prices kept prices at a high level and thereby minimized the risk of default. As controls are eliminated and as companies compete on price, regulators must give more attention to solvency, and the challenge of evaluating solvency increases. Similarly, if products are constrained to follow regulatory models, product risks are well known. When innovative products are permitted, regulators will need a high level of expertise to evaluate the risk elements of these products.

### **Product Designs**

Traditional whole life policies have a savings element consisting of the increase in the present value of the future benefits in excess of the future premiums. When these products include a predetermined surrender value, significant cash-flow risks are created. Modern products with a high savings element introduce a much greater variety and degree of risks than exist for traditional life insurance, and challenge the ability of both companies and regulators to protect consumers from the risk of default. There are many product designs that have already been brought to market, and new designs depend only on the creativity of companies and the needs of the market. A challenge to regulators is to protect consumers without stifling product innovation.

### **Risk Elements**

Policy designs can be classified in relation to several elements that create risk. These risk elements include the existence of predetermined policy values, guaranteed or indexed account value increases, policyholder options to change investment options, premium flexibility, and guaranteed contingent benefit amounts, such as death benefits. Presented below are some actual examples of policy designs that have been brought to market, as well as a classification scheme for identification of risk elements of a particular policy design.

Here are some examples of actual product designs, and some comments on their risk elements. Universal Life Insurance: A typical universal life insurance policy in the United States has an identified accumulation account value, and a minimum guaranteed interest rate. These policies also provide a surrender benefit that can be withdrawn by policyholders at will. The experience has been that there is a positive correlation between withdrawals and interest rates. This creates the potential of negative cash flow at the time that the market value of the assets is low. A few companies hedge this risk with interest rate options, but most assume that it is provided for by their overall capital.

*Variable Life Insurance:* A variable life insurance design has an identified account value that is valued on the basis of a specific stock index. Surrender values are based on the market value of the index, but the death benefit is guaranteed to be not less than the basic benefit amount stated in the policy. This product has no cash-flow risk on surrender, because liquid investments are available to match the index value. There is a risk caused by the possibility that the market value of the account will be depressed at the time that the company must pay a death benefit.

The fact that the benefit guarantee is available only at death permits companies to assume an absence of correlation between benefit cash flow requirements and equity market level. This policy design requires payment of periodic level premiums. With a mature product portfolio the account value includes the effect of market changes that occur over a number of years.

*Variable Annuity:* A deferred annuity has an identified accumulation account value and a policyholder option to transfer the account between various investments, such as equity mutual funds, bond funds, and a real estate fund. In this case there is a risk that policyholder actions will produce worse results than any single investment type, causing guarantees to be even more costly than would be the case with a single investment type. The particular example has no guarantees regarding the value in the stock or real estate funds. The bond fund has an interest rate guarantee over a relatively short future period. Annuity values can be received only as a life annuity, or as a cash payout in equal installments over ten years. This limits potential liquidity risk.

*Stock Linked Savings Account:* A major bank offers a savings account that provides asset appreciation equal to the greater of a fixed interest rate, or a percentage (such as 50%) of the appreciation of a published equity index. The guaranteed interest rate is a below-market rate. The margin below market is sufficient to fund the purchase of equity index options that fund the alternative appreciation rate in case of good equity performance. Potentially, the entire asset risk of this product can be transferred to the options market.

The following table identifies product features that can cause risk, or limit its effects. This table is not intended to be a complete listing, as new policy designs may introduce risks not previously contemplated. The necessary approach is to carefully review policy features to identify the risk elements of each policy.

#### Limitation of the frequency of changes in the account value investment option Company Risk Elements

In addition to the risk elements that can be directly related to product design, there are elements that are related to company systems and personnel. Executives who are well-able to manage a traditional life insurance business may not have the special skills to manage products that involve more complex investment risks. The traditional accounting system can omit consideration of certain elements of a company's product or investment portfolio that have a zero current value, but have a possibility of creating future negative cash flow. Such off-balance-sheet risks require reporting scheme that goes beyond traditional accounting rules. Regulators need to rely on a more comprehensive reporting system to become aware of these off-balance-sheet risks while it is still possible to control them. Companies selling products that create off-balance-sheet risks may need to create a reporting system to allow them to manage these risks, and to demonstrate to regulators that the risks are under control.

#### *Relationship to Pure Investment Products*

Regulators may need to consider the relationship between life insurance products and other investment products available in the market. Tax or other regulatory considerations may cause companies to "package" investment products as life insurance, while including little or no mortality protection.

This is not necessarily a problem, but it can be confusing to consumers, and may be a way for companies to evade taxes or other regulations that were intended to apply to all similar products.

An example of this phenomenon may be observed with unit-linked life insurance policies in the United Kingdom. Some policies are designed with relatively low mortality protection, but with a savings element designed to fund the repayment of a home mortgage. The design of these policies appears to be driven primarily by a tax advantage given to life insurance premiums.

This issue causes special concern where banking, securities, and insurance regulation are separated. Communication between insurance regulators and the regulators of the securities and banking industries are necessary to avoid "regulatory arbitrage" where regulation of similar products is quite different depending on the type of company offering the product. It is clear that lack of communication can cause products to be offered by the least-regulated segment of the financial services industries, increasing the risk to consumers.

#### **Company Risk Management**

Regulation of company solvency risk should be built on a foundation of company procedures to control risk. Without a control process within the company, no regulatory efforts can be successful. Too many things can go wrong between regulatory reviews, and company procedures are needed to prevent them. The need for an effective system of internal control is basic. This discussion of risk management for high savings life insurance products is intended to consider only their unique risk elements, so the existence of the basic system of internal control is assumed.

The need to manage cash-flow risk for innovative products, and the need to demonstrate to regulators the effectiveness of this risk management follow from the need for company solvency. The costs associated with this risk management function are inherent in offering these products, and are appropriately included in the cost structure of the companies that wish to offer them. Regulators need to define clearly the information needed to monitor risk management, and companies should be obligated to supply this information on a timely basis. The information needed will, of course, vary by product, but there are common elements.

Companies need to maintain information that will allow regulators to evaluate the companies' risk profile as of any prior date. This information is needed to monitor the effectiveness of the companies' control systems. Specifically, all investment transactions, including transactions in financial derivatives, need to be recorded, and a process must exist to record or reconstruct each company's portfolio as of any past date. For instruments that do not have an active market it will be necessary to have software that will allow these assets to be valued. This may be done through the use of relationships to benchmarks with market prices, or through simulation analysis.

#### *Role of Professionals*

Company executives, and professionals such as accountants and actuaries have a role in assuring the proper functioning of companies. Company officers can be required to take responsibility for the system of internal control, and existence and compliance with an asset risk management system. In addition, company officers can be required to confirm compliance of policy forms with applicable regulations. These responsibilities can be enforced by requiring officers to make a formal, legally binding statement that the required systems exist and are being applied, and that policy forms comply with regulations.

The use of professionals to facilitate the regulatory process is, of course, common. Independent audits are an example. Professionals can be used much more extensively by regulators to go beyond the basic financial reporting functions. For example, actuaries are relied on in the United Kingdom, Canada, and the United States to monitor the company's asset/liability management system. This is accomplished either by requiring the consideration of a fixed set of investment scenarios, or by requiring a simulation certified by the actuary. The cultural differences in the implementation of these schemes are interesting when one considers applying this approach in other countries. In the United Kingdom actuaries have a direct responsibility to the regulatory authorities, and have some protection from adverse actions by the companies that employ them. In the United States such protections are absent or very weak. This could be a result of differences in legislation between the two countries, but sorting out cause versus effect is not easy.

The lack of full reliance on actuaries in the United States may be the reason for the U.S. legislation, rather than its result. The status of the professions in each country must be considered in determining the amount of reliance that can be placed on them.

#### *Use of Complex Financial Instruments*

Companies with complex account value guarantees frequently use complex financial instruments to control risk, as well as to provide profit to the company. Many of these techniques are proprietary to the companies involved, so it is not possible to give specific company examples. It is possible, however, to discuss the general techniques used by companies in relation to various types of guarantees.

Complex financial instruments can be used to control the risk of guarantees that cannot be replicated with direct investments. For example, a product mentioned above is offered by a large bank in which an account value floor is based on a combination of an equity index and a minimum interest rate. The account value at the end of a guarantee period, such as one year, is the greater of the result of accumulation at a portion of the increase in an equity index, such as 50% of the appreciation of the Standard and Poor 500 Stock Index or accumulation at an interest rate, such as 3%. Of course a direct investment by the bank in an equity and debt portfolio would not be able to replicate the values in this account. To control risk on this product the bank invests in debt instruments, and purchases options on the value of the equity index. This is a U.S. product, and the option market is efficient enough to make the cost of providing this product reasonable and predictable, and to make the risk of default on the equity options negligible.

A second example is a large insurance company that has special expertise in variable interest rate lending, but liabilities that involve fixed interest rates. The company usually finds that its returns are increased if it lends at a variable rate, and engages in swaps for fixed returns, as compared to its potential returns on fixed-rate debt. Of course this approach also creates a need to manage the counterparty default risk.

Managing risks related to complex financial instruments is different in several ways from managing more traditional investment risks. One important difference is that, because of leverage, their values can be much more volatile than the values of corporate bonds. This volatility requires more frequent monitoring to control risk.

A company that uses complex financial instruments might be able to demonstrate a “clean” balance sheet at annual or quarterly intervals, but could have very high risk at interim dates. Controlling these risks requires a system that monitors risk at least daily, and creates a log that can be used for supervisory review. A second difference is the difficulty of identifying all of the risk elements of complex financial instruments. The description of such instruments must have enough detail to allow all of the risk elements to be identified. This level of detail may not fit in to existing asset data systems.

As a number of highly-publicized examples demonstrate, control of the hedging function and elimination of speculation are difficult to achieve at the company level. Clearly the task is even more difficult for regulators who have limited information and time. The fact that speculative problems can arise quickly means that traditional year-end reporting is not adequate to control this risk. A better approach is a “systems” solution that requires companies to demonstrate the existence of a system to control speculative risk, and to further demonstrate that this control system is being applied effectively.

One answer to the problem of regulating the use of complex financial instruments is to simply prohibit the use of instruments that could create a risk of speculation. This solution, however, deprives companies of a powerful and legitimate risk-management tool. Regulators need to exercise care in restricting the use of derivative instruments, as derivatives can be the most effective and least costly solution to managing certain types of risks. A solution that simply limits the use of derivatives, while easy to implement, may actually increase risk in some situations, and will certainly limit the ability of companies to find creative risk-management solutions. Many of the notable recent examples of problems with financial derivatives involved a failure to adhere to basic principles of internal control

#### *Currency exchange rate risk*

Public policy may cause regulators to prefer investments in local currency, but regulations preventing or limiting overseas investments create a need for hedging that may be impossible in times of crisis, and may be difficult to control on a real-time basis even in normal times.

This problem is certainly not unique to insurance, so the regulatory controls developed for banking can generally be applied in the insurance context.

#### *Computer System Requirements*

Record-keeping for traditional life insurance can be as simple as recording the policy form, issue date, date of birth, benefit amount, underwriting classification, and premium “paid to” date. The introduction of flexible premiums and varying asset appreciation rates can require the policy record to include a complete transaction history. The size of the policy record is greatly increased, and needs to be flexible for each policyholder. This parallels the increased complexity of asset records as a company moves from traditional investments into more complex instruments. Database software that is adequate for traditional policy types and investments may be completely inadequate for flexible products. In addition, the demands on the database software increase geometrically over time, creating a risk that the operation of a system can degrade, and cause an adequately functioning system to become inadequate simply as a result of growth and the passage of time, without any change in policy types.

Seemingly routine hardware and software upgrades can create a higher level of financial control risk for companies whose products place high demands on their computer systems. There are actual examples of companies that were virtually unable to process transactions on systems that had previously functioned adequately, but were overwhelmed by an increased volume of data over time. The ability of software packages to handle transactions, as measured by transaction response time, can be highly dependent on hardware choices and on the volume of transactions. It is not possible to completely determine the suitability of a software choice for a given company solely on the basis of its success in other companies. A complete assessment requires consideration of the specific hardware choice and the specific volume and nature of the transactions required.

#### **Existing Solutions**

A practical and effective approach to regulation of high investment life insurance products involves a combination of product classification, simple safe-harbor capital requirements, and company obligations to create a risk management framework for innovative products. A product-classification scheme can be created on the basis of the risk elements identified above. An existing example of this type of scheme is the annuity classification system under the U.S. Standard Valuation Law as it is applied to annuities.

#### *Annuity Product Definitions under the U. S. Standard Valuation Law*

The Standard Valuation Law developed in the United States by the National Association of Insurance Commissioners includes a classification scheme for annuities in terms of the risk created by specific types of policy features. This classification scheme illustrates a practical approach to regulation of these products that provides some flexibility to companies, while providing a level of certainty to companies about the reserve levels that will be required for various types of products. This regulation covers policy features that involve interest rate guarantees, premium flexibility, and the timing of cash benefits. As a result of the classification of an annuity policy the interest rate used for valuation is selected from alternatives constrained by the classification. The classification system is described in

#### *Product Classification in General*

In general a product classification scheme should have a small number of classes, taking into consideration that the risk profile of products within a particular class should be similar. The classification of a particular product design should be as clear as possible. Much of the challenge of this approach is the wording of the classification scheme to avoid manipulation by companies through relatively insignificant design changes. A key element is to limit the characteristics used for classification to elements that are directly and substantively related to risk. This type of safe harbor regulation can allow complete flexibility of innovation for companies that are able to comply with reporting requirements to will allow regulators to confirm that the risks of their products are adequately managed. This approach also allows the smaller, less sophisticated companies to participate in the market without taking on undue risk, while the larger and more sophisticated companies are free to create innovative products to meet market needs more effectively.

The valuation requirements for various products may be fixed at issue, or may change dynamically over time. Requirements that are fixed at issue have the advantage of being simple to apply, and predictable. This type of valuation approach is effective only for a limited set of relatively simple products. Requirements that change over time in response to capital market conditions can be effective for a much wider range of products, but require constant monitoring, and create additional expenses for companies. In addition, care must be taken to avoid an adverse effect of regulations on solvency when regulations increase capital requirements at the same time that capital market conditions reduce the ability of companies to provide needed capital.

#### *Risk-Based Capital Requirements*

Risk-based capital is a standard that has been successfully implemented in a number of jurisdictions for both banks and insurance companies. It provides a relatively effective, low-cost benchmark with which to compare company capitalization. As implemented for life insurance companies in the United States, risk-based capital is calculated on the basis of mathematical formulas that take into account various risk elements within a company. Components of risk-based capital arising from various types of risk are combined in a way that depends on the assumed relationship that they have to each other. For example, components arising from investment risks of insurance companies are added together, but the combination of investment components and insurance underwriting components involves a “covariance adjustment” in which the total is computed as the square root of the sum of the squares of the two components.

The operation of the various formulas involved can be demonstrated with the provision for asset valuation risk. The basic components are amounts that are calculated by multiplying the value of each particular asset by a factor that takes account of the perceived risk of the asset. For bonds this involves a factor that is based on the bond’s quality rating from a recognized rating agency. The range of factors is from 0.003 for the highest quality bonds to 0.09 for the most risky bonds, requiring 30-times as much capital for the riskiest bonds as for the safest. Similar factors are multiplied by the values of equities, mortgages, real estate, and other assets. These amounts are then added together, but further adjusted by a factor that reflects the degree of diversification of the company’s portfolio. There is also a concentration adjustment that applies to any of the company’s ten largest asset holdings, if these are of lower quality than the highest investment classification. Other risks are taken into account in separate calculations, and also involve a process of multiplying certain values by factors that vary on the basis of risk. Companies that are involved in certain types of activities can be required to provide additional risk-based capital in relation to them. This could be as simple as requiring a multiple of the base-level capital when certain product risk characteristics are present.

### **CONCLUSIONS**

The introduction of new life insurance products with a high savings element challenges both companies and regulators to protect against insolvency while continuing to promote product innovation.

The popularity of these products where they have been offered shows that they fill an important perceived need of consumers. A prescriptive regulatory system may not give companies the flexibility they need to develop these products. Regulation is necessary to correct market imperfections, but should intrude as little as possible into the functioning of the competitive market.

A regulatory framework that combines safe-harbor regulations for predefined products with a systems approach for innovative products can allow companies at various levels of sophistication to function in the market, and can provide adequate consumer protection with relative market freedom for companies. Countries that are now starting the process of regulating these products can learn from the experiences of others, bypass their mistakes, and build on their successes.

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**SECTION X: SUSTANAIBLE AND REGIONAL DEVELOPMENT****CONSTITUTIONAL AND LEGAL BASE FOR SUSTAINABLE DEVELOPMENT IN MACEDONIA**

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**Abstract:**

*Sustainable development, as a new paradigm of development, imposes a challenge for every country which recognizes it as precognition for better life and wellbeing of its citizen's. Each country has a different, national solution for realization and implementation of this new philosophy of development. Yet, the essential elements that enable the creation of sustainable development policies are the Constitution of the state and its legislative, both containing the basic principles of sustainable development. The aim of this paper is to present the basis for conducting national policy for sustainable development policy in Macedonia. The subject of research is the Constitution of Macedonia and the Law on Environment which is fully complied with the Acquis Communautaire of the European Union. According to analysis done, the result is that the Constitution is founded on the sustainable development pillars and that the Law on Environment contains articles that impose obligations for fulfillment the concept of sustainable development. That leads to the conclusion that Macedonia follows the modern trends in implementation the sustainable development policy.*

**Keywords:** Sustainable Development; Constitution; Law on Environment; Macedonia.

**JEL Classification:** O10.

**1. Introduction**

The mankind is faced with a variety of choices related to quality of life and the condition of the environment. Each choice made will determine the world to be left for the future generations. Some choices will contribute to create a world in which the economic and social needs are balanced with the capacity of natural wealth and eco-systems; while others will lead to creation of a world with devastated environment where the poverty and famine rule.

The direction of global sustainability should be founded on the recognition of the evident connection between the environmental protection and the development. The concept of sustainable development was institutionalized for the first time at the UN Conference on Environment and Development, held in 1992 in Rio de Janeiro and since then it is a leading concept and global achievement. Macedonia, as a member state of the United Nations Organization and candidate country for accession to European Union, is obliged to ascertain durable policy for sustainable development, among all, by its enforcement in the legislation.

**2. Foundations of sustainable development in the Constitution**

When analyzing the Constitution, the starting point for assessment was the definition for sustainable development given in the Bruntland report by the World Commission on Environment and Development (WCED), which clearly indicates the responsibility of present generations towards the future ones and their obligation to create development which will provide possibility for the future generations to satisfy their needs. In our Constitution, the Preamble reads: "The citizens of Macedonia...taking the responsibility for the present and future of their country... and responsible in front of the future generations for protection and development of everything valuable..." [1].

If we take into consideration that the sustainable development is based on three pillars: economic development, social righteousness and environmental protection, than we will notice that Article 8 states that the fundamental values of the constitutional order of Macedonia are:

- the freedom of the market and entrepreneurship (economic dimension)
- humanism, social justice and solidarity (social dimension) and
- protection and promotion of the environment and nature (environmental dimension).



The Constitution [1] has also determined the basic human rights of the individuals and citizens, among which the right to:

- work and employment
- social security and social insurance
- healthy environment.

In the Constitution of Macedonia, it is stated that the Republic, “in order to provide balanced economic and social development...” [1: 9], which indicates that the economic and social development should be balanced. In Article 55 (Paragraph 1) “the freedom of the market and entrepreneurship is guaranteed”. In the same Article, Paragraph 3 specifies that: “the freedom of market and entrepreneurship can be restricted by law only for reasons of the defense of the Republic, protection of the nature, environment or public health”. It is obvious from this article that a possible negative impact of the market and entrepreneurship on the nature and environment has been anticipated, hence, although the freedom of market and entrepreneurship is determined as a fundamental value (Article 8, Paragraph 1, line 7) and the same is guaranteed (Article 55, Paragraph 1), it can be limited by law for the purposes of, among others, protection of nature and environment. In this Article, it is interesting that the protection of nature and environment is listed after the defense of the country (as a principal social interest of the citizens of each country), and even before public health.

Furthermore, in Article 56, Paragraph 1 states that: “All the natural resources of the Republic, the flora and fauna,...are amenities of common interest for the Republic and enjoy particular protection” and that “the law regulates the mode and conditions under which specific items of common interest for the Republic can be ceded for usage” (Paragraph 3 of the same Article). In Article 57, it is specified that the Republic stimulates the economic progress and provides for a more balanced spatial and regional development, as well as for more rapid development of economically underdeveloped regions.

The Constitution of Macedonia also stipulates right to education, guarantees the right to healthcare, etc. The Republic “particularly protects the mothers, children and minors” and “provides particular care and protection for the family”, etc.

It is indisputable that the Constitution of Republic of Macedonia contains the fundamentals of sustainable development. Besides taking into consideration the three pillars of sustainable development (economic development, social righteousness and environmental protection), it is also based on the responsibility, justice and righteousness, with maximum respect of the rights and freedoms of the citizens. The Constitution of Macedonia includes the key principles of sustainable development.

### 3. Sustainable development in the laws on environment

When discussing the national legislation for protection and promotion of the environment in Macedonia, it has to be pointed out that it is relatively new and incorporates the principles of the European policy for environment. In addition, significant attention has been paid to the principles of environmental protection with national, regional and local harbinger. The new corpus of environment laws in Macedonia is consist of the Law on Environment [2], the Law on Nature Protection [3], the Law on Waste Management [4] and the Law on Ambient Air Quality [5].

The Law on Environment pays attention to meet the requirements of the European Union directives and concurrently cares for maintenance of the traditional values regarding environmental protection and ensures sustainable development. Considering that this is a framework law, we shall pay some more attention to it. In the law, in Article 4, one of the goals of the law is “rational and sustainable use of natural wealth”; in the same article, the way of achieving the goals is determined as “integrated approach towards environmental protection and economic development”, “establishment of a system for planning the environmental protection, promotion and management”, “synchronization of the economic and other interests with the requirements for protection and promotion of the environment”.

In brief, it has been concluded that it is required to have an integrated approach, to establish a system for planning and management and, what is inevitable, to synchronize it with the economic and other interests. In the law, in the Chapter II determining the key principles on which the legal provisions are founded, the Sustainable development principle is included, which sets the obligation that when taking any action or performing any business activity, special consideration has to be paid to rational and sustainable use of natural wealth, so as to meet the needs for healthy environment as well as the social and economic needs of the future generations, without jeopardizing the rights of the future generations to satisfy their needs.

The sustainable development is also mentioned in the Consumer pays principle, whose objective is to make the user of the resources to reimburse the costs for ensuring sustainable development and rehabilitation of the environment needed because of usage of natural resources.

Particularly important for the sustainable development are also: Integration principle which ensures that the goals of the policy for environmental protection and promotion are integrated in the other sector policies adopted by the institutions in Republic of Macedonia (development agriculture, transport, etc.);

the Proportionality principle ensuring proportionality between the needs for development and the needs for environmental protection; the Principle for participation of the public and access to information, which obliges the authorities of Macedonia (central and local) to provide all necessary measures and lay down procedures to ensure the right to access to environmental information is practiced, as well as to ensure participation of the public and the conditions for expression of the public opinion when making all decisions related to environment, as well as the Principle for raising the public awareness for the importance of the environment, whereby the scientific, educational, health, information, cultural and other institutions, including the associations of citizens, are obliged within their activities, to promote and ensure enhancement of public awareness for the importance of the environment and its protection. The law contains other principles as well and they are all in function of ensuring sustainability of the development.

In Article 65 the obligation is set down that, by suggestion of the state government body competent for the issues in the sphere of environment, the Government of Macedonia lays down the strategies, plans and programs (planning documents) for which the procedure for determining their impact on the environment, the lives and health of humans is obligatory. In fact, this is a strategic assessment, which indicates a transparent decision-making system in the general planning and promotion of the principle of sustainable development; the same ensures awareness and prediction of the (possible) impact on the environment before the start of implementation of planning documents. In this fashion, preventive actions are taken and the possible negative impacts on the environment are minimized.

Especially significant is the Ninth Chapter “Sustainable Development and Global Issues in the Environmental Sphere” which contains provisions related to development and adoption of National Strategy for Sustainable Development. In this view, particularly important is Article 186. The following conclusions can be drawn after careful analyses of this Article:

- The state administration authorities (central government) and the municipalities (local government) are obliged to take care for the implementation of the sustainable development principles!
- The state administration authorities (central government) and the municipalities (local government) are obliged to promote and support the sustainable development in Macedonia!
- The Law on Environment is the first law (and according to our perception the only one!) in which the National Strategy for Sustainable Development is mentioned!
- The Law provides the Government of Macedonia with the opportunity to develop a National Strategy for Sustainable Development!
- The objective of the development of the National Strategy for Sustainable Development is to ensure synchronization of the economic development, social progress and the protection of the environment on national level!
- The Assembly, as a place where the interests of the citizens are represented and defended, should assess the Strategy before its adoption by the Government of Republic of Macedonia!
- The municipalities are given the possibility to develop and adopt Local Agenda 21, as local strategic, planning and program document for sustainable development!
- The objective of the development of the Local Agenda 21 is to ensure synchronization of the economic development, social progress and the protection of the environment on local level!
- Local Agendas 21 have to be designed and developed in accordance with the established methodology to ensure harmonization of their content and the way of their development!

In the Article 59 which refers to the system of planning, the paragraph 1 states that the development of the environmental protection and management is determined and directed in accordance with the entire economical, social and cultural development of Macedonia, whereby priority is given to the measures for environmental protection and management as it is of mutual interest for present and future generations. The same paragraph further states that this is done “for achievement of the goals” set in the law and “by the use of a system of measures and activities for long-term planning of the environmental protection and promotion”. In Paragraph 2 of the same article, it is stated that “with the system of planning.... the realization of the economical, technical, scientific, educational, organizational measures and activities is directed and synchronized....in order to protect and promote the environment and ensure sustainable development”. Paragraph 3 lays down the obligation for synchronization of the measures for environment protection and promotion with the measures determined in the strategic, planning and program documents for regional development, science and education, industries based on exploitation of natural resources and wealth, transport, telecommunications, tourism, spatial and urban planning and use of land”.

It is more than obvious that the environment protection is planned and managed in accordance with the other social fields on which the social development of a country as a whole is based, so as to ensure sustainable development and protect the interests of present and future generations.

In the Law on Nature Protection, one of the objectives is to ensure sustainable use of the natural wealth for the benefit of the present and future development. Article 5 clearly emphasizes that the protection of nature is not only beneficial for the current progress but also for the future development (similarly as in the Law on Environment, in this Law we also find the care for the future generations!); the need for incorporation of measures for nature protection in the planning industry documents has been identified and the awareness is raised that the use and management of natural wealth has to be sustainable<sup>339</sup> i.e. rational.

One of the principles on which the protection of natures is founded is Sustainable Development Principle, which will be quoted hereby in its whole, as it formulated the principle for sustainability of the development in a unique, very precise and clear way: "For the purposes of meeting the requirements for nature protection as well as satisfying the social and economic needs of present generations, without compromising the ability of future generations to meet their own needs, the non-renewable natural wealth must be used rationally and the renewable ones in a sustainable manner". Three points are of key importance in this definition: first - the economic, the social and the needs for nature protection are considered equal (the three "pillars" of sustainable development); second - the rights of future generations are taken into consideration and they cannot be jeopardized (time dimension of sustainable development); and third - difference is made between the use of renewable and non-renewable natural wealth: the first ones to be used in a sustainable manner, the second ones-rationally.

The obligation for incorporation of the measures and activities for nature protection in all development, strategic, planning and program documents, plans for special management and use, as well as in the plans for use and management of natural wealth is part of the Integration principle and further elaborated in some other articles. For us, Article 189 is also important which states that the Spatial Plan of Macedonia, the Specific Spatial Plans as well as the strategies, programs and plans related to development of certain sectors of economic and social fields will be harmonized with the provisions of this Law latest within three years after the day of implementation of this law; which indicates on the integration of the nature protection in the planning documentation of other sectors (industry, spatial management, etc.).

The law also provides for Assessment of the impact on nature by certain strategies, plans and programs developed on national and local level, which could have significant effects on nature. It is obvious that the Law on Nature Protection encompasses and includes the principles of sustainable development in a cross-connecting manner.

In the Law on Waste Management, Article 3 reads that the objectives of this law are to ensure, among other, sustainable development by preserving and saving natural resources. It is specified in the same article that one of the goals is prevention of negative impacts from waste on the environment, human lives and health; other goal is to achieve a high level of protection of the environment, human lives and health.

With the Law on Ambient Air Quality, it is intended to preserve the best quality of the ambient air in conformity with the sustainable development principles, and its objective is to "avoid, prevent and minimize the detrimental effects on human health and the environment as a whole, including the biodiversity, natural wealth, historic and cultural heritage".

The Law encompasses the approach of integrated protection. Strategic Assessment is also planned for (as required by the Law on Environment). The conformity is used for emissions of pollutants in the air. For us Article 17 is important where it is stipulated that "the ambient air quality is managed through ... adoption and implementation of planning documents", which implies complexity in the approach. The term "management" is used for the ambient air quality, while the planning refers to protection of ambient air quality.

Obviously, this Law is also founded on the sustainable development principles (comprehensiveness, integrated protection, appropriate planning and management, etc.).

#### 4. CONCLUSIONS.

The analysis of the Constitution and the normative acts regulating the issues which are vital for sustainable development enables us to ascertain and make certain conclusions. In the Preamble of the Constitution of Macedonia the three key pillars of sustainable development are encompassed - economic progress, social righteousness and environment protection and they are considered as a base when constituting the country. The Constitution also specifies the fundamental values of the constitutional order of the Republic with their economic, social and ecological dimensions [6].

The Law on Environment identifies the necessity for integrated approach, establishing a system for planning, management and synchronization with the economic interests. For the purposes of ensuring sustainable development beneficial for present and future generations, this law stipulates that the environment should be planned and managed in accordance with the other social fields on which the social development of a country as a whole is based.

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<sup>339</sup> Other article of the Law on Nature Protection also mentions the sustainable usage: of biodiversity (Article 46), of natural wealth (Article 47), resources (Article 81). The Law also contains provisions for sustainable management with wild species (Article 22) and lists the zones for sustainable use of protected areas (in Article 93 and 106).

The Law has identified the main principles on which it is based: they are all in function of sustainable development. Pursuant to the law, the Government lays down the strategies, plans and programs for which the procedure for determining their impact on the environment, the lives and health of humans is obligatory; thus making the care for environment integral part of all strategic documents, notwithstanding the area they are regulating. It is of vital importance that this Law provides opportunity for the Government to develop a National Strategy for Sustainable Development which, prior to its final adoption, should be submitted to the Assembly of Macedonia. This is the only strategy the Assembly of Macedonia is obliged to give opinion for. The Law provides the units of local self-government with the possibility to prepare and adopt Local Agenda 21 as local strategic, planning and program document for sustainable development.

With the Law on Nature Protection, sustainable usage of natural wealth is ensured, which is beneficial for the present and future development; the necessity for incorporation of measures for natural wealth protection in the planning economical documents is also stipulated. As in the case of the previously studied law, all principles in this Law are in aimed to ensure sustainability of development.

The Law on Waste Management ensures sustainable development by protection and conservation of natural resources; it contains the principles of sustainable development: comprehensiveness, integrated protection, appropriate planning and management of the specified area.

The Law on Ambient Air Quality also calls for integrated protection and suitable planning and management; demands strategic assessment of the impact on the environment. The Law intends to maintain the best air quality in accordance with the principles of sustainable development.

As a general rule, the laws related to environment, are based on the principles of sustainability of the development and their ultimate goal is to achieve sustainability in the specific sector. To this end, the interests of other sectors are also considered, especially the economic one. They also specify two very important instruments for protection of the environment: Environmental Impact Assessment (EIA) and Strategic Environment Assessment (SEA). The implementation of the methodology for SEA shall provide new possibility for further and more efficient integration of the objectives of sustainable development in the strategic plans and programs.

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- [2] Law on Environment (“Official Gazette of Republic of Macedonia No. 53/05”).
- [3] Law on Nature Protection (“Official Gazette of Republic of Macedonia No. 67/04”).
- [4] Law on Waste Management (“Official Gazette of Republic of Macedonia No. 68/04, 71/04”).
- [5] Law on Ambient Air Quality (“Official Gazette of Republic of Macedonia No. 67/2004”).
- [6] Matlievska, M., (2006), “Managing the Process of Creating National Strategy for Sustainable Development in Republic of Macedonia”, doctoral dissertation, Institute for Sociological and Political-Juridical Researches, Skopje.

**ENCIRCLED REFORM OF THE PUBLIC ADMINISTRATION BASIS FOR RESPONSIBLE  
WORKING  
(CASE STUDY OF THE REPUBLIC OF MACEDONIA)**

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**Abstract:**

*The aim of this paper is to analyze the legal and sub legal acts in Republic of Macedonia by which it is regulated the liability of the state administration. The organs of the state management as holders of the executive authority have key role in the policy conduction in the execution of the regulations by the Assembly and the Government of Republic of Macedonia. For that aim it is necessary to create good organizational basis and staff potential, followed by plans and action measures for implementation to reach professional and other directions for conduction of those measures. The organs of the state management as liable for law execution as well as the organs of the state authority should set rules and procedures by which through clear indicators will be able to confirm the liability and at the same time it will be created a base for effective working. The execution activity of the organs of state management is consisted of direct application of the laws and the other regulations by reaching decision in the management procedure by which it is decided for the rules, obligation and interest of the citizens and other legal entities passing separate acts outside of the management procedure, making management surveillance, passing of sub legal regulations for successful execution of laws and the other regulations and performing management actions and taking management measurements especially in the achievement of the surveillance authorizations.<sup>340</sup> As news in the work of the government is the methodology for analyses of the policies and coordination with the ministries and the other organs<sup>341</sup> as initial document which represents a good base for the following of the organs of the state management. These policies contain more principles which could be applied and should be worked out and made to be more detailed. In the laws there should be clear directions how to control and evaluate the working of the state and the public administration and by that the irresponsible working of the administration can be proved. The conclusion of this paper is that in Republic of Macedonia the legal and the sub legal acts should be changed in the direction of clear completion of the liability of the state and the public administration.*

**Key words:** state and public administration, liability, efficiency.

**JEL Classification:** M1.

## 1. INTRODUCTION

### 1.1. SUBJECT AND AIMS OF THE PAPER

The aim of the subject of this paper is to show by comparable analyses of the content of the legal and the sub legal acts in Republic of Macedonia, the necessity of their preciseness and clearness in order to produce liable state and public administration.

The ascent of these analyses refers to the provisions in the legal and sub legal acts directed towards the liability of the state administration from all aspects: prevention, confirmation and the proof of the liability.

In this paper the period of reform of the state administration has been covered which as urgent necessity was establishment of new laws which had for their aim conduction of the strategy for reform of the public administration in Republic of Macedonia, as part of the overall strategic policy for the progress of the country in all spheres of the social living.

<sup>340</sup> Article 13 and 55 of the Law for organization of the state managements organs (Official Gazette of RM number 58/00,44/02 and 55/05)

<sup>341</sup> The decision for the methodology for the strategic planning and preparation of the annual program for work of the Government passed on 50<sup>th</sup> Assembly of the Government of Republic of Macedonia held on 22.09.2003 Methodology for the analyses of the policies and coordination 9Official Gazette of RM number 52/06)

Precise and clear legal and sub legal acts are bases for liable working and that represents disciplined state and public administration responsible and civic oriented, that will efficiently answer to citizen's necessities and the other subjects and that overall will reflect towards all spheres of the social living. That means that even the non productional activity of the administration, if it executes its services in a transparent effective and efficient way, it will reflect the economic progress of the country.

So, the purpose of this paper is to cover the most essential laws of the state management and the state power, the rule books, codex and other policies which directly or indirectly are connected to the work of the state and the public administration in Republic of Macedonia. So this paper will give review of the advantages and the disadvantages whether the legal and sub legal acts represent not only a form but the same have partial usability. The overall analyses of this paper is in direction to give humble contribution in the scientific public in Republic of Macedonia and wider.

## 1.2.METODOLOGY OF THE RESEARCH

Taking into consideration the subject and the purpose of this paper as a logical continuation the general hypothesis is imposed that if the laws and sub legal acts and other documents are not clearly and precisely set there could not be produced liable state and public administration.

If in the laws there are regulations which have legal reasons, a possibility is created for irresponsible working of the administration from one side or there is no possibility to reward and motivate the liable working. In this context in order to get answers to my dilemmas, I realized analyses of the content of the legal and sub legal acts by which the organizations are managed, the rights, obligations and the liabilities of the state and the public administration of Republic of Macedonia.

The results in the paper are based on the empiric research with using of the methodology of analyses of the content of documents (legal and sub legal acts). Over 50 legal and sub legal acts have been analyzed where the regulations that refer to the set organization, the management control, corruption, discipline and material liability as well as the strategic documents by which the working of the state and public administration in the organs of the have been checked.

The results from the analyses are based on equal references that direct to same conclusions and recommendations.

## 2. RESEARCH REUSLTS

Important European regulation in the setting and confirmation of the liability of the state administration for the countries members of the European Union is the Recommendation<sup>342</sup> which refers to the public liability of the employees in the state organs.

The aim of this recommendation of the European Counsel is on the filed of the administration law and the purpose of the same is to protect the citizens in their relations with the state organs. As a result of the public authorization of the state (public) administration numerous cases of public conflicts appear and it is huge damage to confirm in such extend it will be requested from the officials to bear the damage.

In Republic of Macedonia pursuant to the Law of State Administration the liability is set hierarchically. Regarding the liability of the state administration, the relation has misbalanced the state administration with the same status. So, the state secretary is appointed by the Government of Republic of Macedonia and although he is in the group of the management state administration, he is not under the regulation of disciplined liability pursuant to the Law of state administration<sup>343</sup> and the same function is purely under political liability. From the other side the municipal secretaries and the other general secretaries are appointed by person in charge of the state management and the same are under the regulations of liability contained in the Law of State Administration.

The liability for the made criminal act that is violation does exclude the liability of the state administration. The Law of State Administration plans two types of discipline liability, discipline disorganization and discipline violation.<sup>344</sup>

<sup>342</sup> P(84)15 passed by the Committee of Ministries on 18<sup>th</sup> September 1984.

<sup>343</sup> Article 11-a by the Law of state clerks ( Off. Gazette of RM number 114/09)

<sup>344</sup> Article 65 a by the Law of state administration ( Off. Gazette of Republic of Macedonia number 59/2000, 112/2000, 34/2001, 103/2001, 43/2002, 98/2002, 17/2003, 40/2003, 85/2003, 17/2004, 69/2004, 81/2005, 61/2006, 36/2007, 161/2008, 06/2009 and 114/2009).

Under discipline disorganization is included the smaller violation of the reputation of the service and the reputation of the state administration.<sup>345</sup> As a discipline violation pursuant to the Law of State Administration heavier violations of the working tasks are considered which are planned by the Law of State Administration.<sup>346</sup>

The Legislator described the discipline procedure but he did not defined regulations which will refer to the confirmation of the liability. The Conduction of the discipline procedures in practice refers to a range of ambiguities. The legislator does not clearly point to what way certain behavior of the employees will be proved to be a base for discipline fine. In the context of the public liability the Law of State Administration introduced the category material liability in case when a state administrator is liable for a deliberate damage which is at work or in the reference with the work or with gross negligence caused by the organ where he is employed. The category material liability is news in this law and practical use of the same almost does not exist

The executive activity of the state management organs is consisted from the direct use of the laws and the other regulations.<sup>347</sup> The following of the conditions in the state organs is made by professional analytical activity which is made by the state administration and by the same certain opinions are given in order to prevent the irregularities.<sup>348</sup>

In the frames of its activity the organs of the state management also have great liability in the role as initiator for taking over certain measures or in the confirmation of certain policy for decision of the issues of its activity, on bases of professional analyses from the following of the conditions from those areas.<sup>349</sup> The organs of state management do not have clear procedure which will give clear direction how to prepare a proposal of a text of a law.

Also, the laws allow proposal of a text of a law which will pass all previous phases and will form qualitative proposal of a text and will be changed in the procedure of its reaching by the government coalition. This all results with laws which do not have ambiguities and emptiness and the same due to the noncompliance with the Constitution can be contested by the Constitutional court of RM.

With the Law of the Government of Republic of Macedonia<sup>350</sup> the organization is managed, the way of working and the authorization of the Government of Republic of Macedonia. In the part of setting of the liability of the president of the Government and the other liable persons that are named by the same, except the regulations that president of the Government is liable for its work and the liability of the ministries to conduct the legal regulations, we do not find concrete regulation how to confirm their liability.<sup>351</sup> Also, except numbering of the authorizations of the Government and the ministries from these legal acts, we can not concretely complete their authority with correct and precise authorization and liabilities. If we start with the role of the Government to analyze all proposed legal and sub legal acts. That refer to the working of the organs of the state management can not see which is the mechanism for the supervision of the ministries work, commission at the Government, indicators which will point to the positive and the negative crises in the working of the Government, the consistency of the conclusion, the legal support, the preservation of the knowledge, document management of the system, the managements systems, the informational and the other tools which are important for the effective and efficient working.

<sup>345</sup> Article 68 by the Law of State administration (Off. Gazette of republic of Macedonia number 59/2000,112/2000, 34/2001, 103/2001, 43/2002, 98/2002, 17/2003, 40/2003, 85/2003, 17/2004, 69/2004, 81/2005, 61/2006, 36/2007, 161/2008, 06/2009 and 114/2009).

<sup>346</sup> Non execution or unconscious unbiased or delayed or negligent execution of the official duty expression or presentation of political opinion in the performance of the official duties: rejecting for giving or giving incorrect data of the state organs or legal entitles and citizens, if disclosure of data is planned by law illegal availability with the material means; rejection for performance of the official tasks form the working post on the one ahs been distributed or denial of orders by the ministry that is the functionary who manages the organ that is managing organ ;disrespect of the act reached by the person in charge for execution of the functions in the organ during strike; inaction or partial action of the prescribed measurements for insurance of the security of the given object causing larger material damage, repetition of the discipline, disorder, receiving gifts or other type of benefit misuse of the status or exceeding of the authorization in the performance of the official tasks misuse of the sick leave giving classified information with the level of secrecy defined by law entering use an working under alcohol or narcotics disrepestc of the regulations for disease protection, protection at work fire explosion, dangerous action of poisons and other dangerous materials and violation of the regulations for protection of the living environment setting of the personal financial interest confirlct with position and the status of the state clerk and offensive violent behavior.

<sup>347</sup> Article 13 and 55 by the Law for organization of the organs of the state management ("Official Gazette of RM" number 58/00, 44/02 and 55/05).

<sup>348</sup> Article 13, paragraph 4 by the Law for organization of the organs of the state management ("Official Gazette of RM" number 58/00, 44/02, and 55/05).

<sup>349</sup> Article 13, paragraph 1 and 2 by the Law for organization of the organs of the state management (" Official Gazette of RM" number 58/00, 44/02, and 55/05).

<sup>350</sup> Article 1 and 2 and 3 By the Law for the Government of RM ("Official Gazette of RM number 59/2000, 12/2003,11/2005).

<sup>351</sup> Article 11 paragraph 1 By the Law for the Government of Republic of Macedonia (" Official Gazette of RM " number 59/2000, 12/2003,11/2005) which states:" The president of the Government manages with the work of the Government he is liable for its work and makes cooperation with other organs public companies and institutions and article 13 by the same law states "Ministry independently manages with the ministry he has been appointed for follows and he is liable for the condition of the laws and the other regulations. "

## 2.1. METHODOLOGY FOR ANALYSES OF THE POLICIES

The methodology for analyses of the policies and coordination with the ministries and the other organs<sup>352</sup> as starting document represents good basis for supervision of the state management organs and by that a possibility the liability to be located. Such methodology has many principles which individually are worked out in details with concrete direction to its supplement in the direction of the function applicability from the aspect of the liability and liable working.

The first principle is: The coordination of the policies and the acts with the strategic priorities of the Government confirmed with the decision of the Government that the government passes in March - April each year. The concrete indicator for the way in which this decision is passed except the suggested strategic plans by the organs of the state management that should worked out pursuant to the Manual for the way content and the form of the strategic plans preparation ( there is no concrete surveillance for the indicators on which it should be based this strategic plan as the Ministry of finances defines the possible financial means in advance for a certain organ of the state administration and on basis of that the strategic plans should be made which is opposite to the way on which one strategic plan should be made).

The second principle of the fiscal liability of the policies implies that ministries and the other organs of the state management should make evaluation of the fiscal implications, taking into consideration those decisions that give the most effect regarding the expenses. Again, we have opposite order in the conduction of one policy, if we have the financial construction in advance and if the expenses are planned in the strategic plans and the opinion by the Ministry of Finances is negative, whose the responsibility for deviation is from one policy that entered in the strategic plan and only one negative opinion without any consistency and explanation will postpone the realization of the same. Again, we have no liability and correct indicators in which cases Ministry of Finance can stop a certain policy.

Very important principle is the base of the policies of the previously made analyses. This principle implies that the organs of the state management when preparing its acts start from the previously made analyses of the conditions in the area for which they are authorized then definition of the issues and the confirmation of the disadvantages and in the acts that are proposed there should clearly confirmed the aims and the decisions that is to say the opinions that are discussed with explanation of each single decision. This principle covers the widest work of a state organ surely the applicability of the same will depend whether the activities are determined in the state organ that should be achieved by this principle. The setting of the steps for realization of this principle should be confirmed though procedures inside in each organ and the directions should come out from a concrete sub-legal act.

The transparency in the preparation of the policies and the acts implies that organs of the state managements should make transparent consultations with the authorized and interested ministries but not only with them but also with the units of the local self-government with interested citizen's associations, experts and other subjects. The applicability of this principle is left to free judgment of the state organs, as well as to the government who should be informed who should be consulted in what way, collecting opinion should be made according to correctly confirmed list of close activities. All that is left on free evaluation of the members of the government and that means it should be correctly discussed in what cases one opinion is accepted or denied.

The last is the principle of plan conduction of the policies that implies that the organs of the state management should make plans for the condition of the proposed acts with calculated expenses then thesis of sub legal acts for the conditions of the laws the necessary organizational capacities and human resources as well as procedures for supervision of the evaluation which from the other hand implies measurable indicators for successfulness of the policies condition. The conditions for the applicability of this principle still should be précised and standardized and directed to concrete sub legal acts.

## 2.2. LEGAL AND SUBLEGAL ACTS AND LIABILITY OF THE ADMINISTRATION.

The Law for corruption prevention is based on principles of legality, equality, publicity and liability. It regulates the issues for prevention of conflicts of interest the reporting of criminal acts and performance of discrete authorizations.

<sup>352</sup> Decision for the Methodology for strategic planning and preparation of the Annual program for work of the Government passed at the 50<sup>th</sup> Assembly of the Government of Republic of Macedonia held on 22.09.2003, Methodology for the analyses of the policies and coordination, (" Official Gazette of RM" number 52/06).



The Law plans active cooperation between the organs and the bodies that have important role in the fighting against the corruption and the organized crime.<sup>353</sup> The State commission in current existence gave recommendations regarding the précising of the liability of the state administration but it represents only minimal improvement.

Pursuant to the Law for corruption prevention, the commission passes annual program and plans for operation of that program<sup>354</sup>.

This program transparently is reprinted and the same contains recommendations for the necessary measurements and the activities that should be taken in order effective system for prevention and repression of the corruption to be established. In Macedonia there is still no complementary system of measurements for prevention and repression of the corruption.

The most important normative setting of the subject of this research we can see through the analyses of the Law of State Administration which sets the legal from of the state service the status, the rights, obligations and the liabilities of the state administration.

According to this research the current system for employment of state administration is only acceptable for the trainees. The progress in this service is made with application on public add for the free management and professional working posts which enables people to apply who really from the beginning do not fulfill conditions as they do not have experience in the organ where such necessity for that working post has been planned. The procedure for employment and selection of the state administration as well as the procedure for evaluation of the state administration are confirmed by sub legal acts. It all effects the motivation and the liable working of the public and the state administration.

The Law for General Management Procedure and its consistent use in combination with the application of the Law of Management Inspection represents basis for increasing of the effectiveness and the efficiency of the administration its transparency and liability as well as the basis of increased protection of the citizens' rights and the citizens' interest and the legal entities. The Application of this law in practice is far from liable administration can make. There is still no mechanism and procedure for supervision of the realized the quality of the done, the promptness and the respect of the terms.

In the direction of the establishment of the efficient control of working of the state administration in the part of the expenditures of the public means in 1998 the State Institution for audit as independent entity has been formed which is liable for its acts in front of the Parliament. With the changes of the Law of State Audit the existing control mechanism for the performance of the audit are strengthened. The state audit has legal obligation to identify the irresponsible working regarding the finance management but the further acts for confirmation of the liability are not worked out.<sup>355</sup> Expect the fact that the reports by the state auditor which aren't sent to the authorized institutions which point to irresponsible working, the other legal norm does not exist which will precise the steps for this procedure and will direct to the audit of the report. Also, it is of huge importance to precise the regulations which will give regulations and possibilities, the actions for confirmation of liability, directly to be taken by the step auditors in front of the public prosecutors.

Beside that, it is necessary to divide the levels in the confirmation of the irregularities in the working where it should be correctly précised which violations of the working obligation should be fined by the liable person of the organ and which violation points to misuses that gives indications of criminal acts which represents misuse of the official duty.

The introduction of the internal audit as obligatory working post represents good basis for establishment of liable and effective state administration. This category of post should be worked out in the legal and sub legal regulative from reason that there are no clearly defined steps of the liability. The internal auditor is liable in front of the management in front of the liable person and the same should be as a controller of the working of the management.<sup>356</sup> These categories of posts are not acting in practice and if there are employees at this function they just execute tasks of formal character.

<sup>353</sup> Article 60 by the Law for prevention of the corruption ("Official Gazette of RM" 28/02, 46/04, 83/04, 26/06, 10/08, 161/08) states: "In the execution of the works of its authority, defined by this law, the State commission can request to make direct inspection in the documentation of the organs and the legal entities that are on disposal with the state capital."

<sup>354</sup> Article 55, paragraph 1, lines 1 and 2 by the law for prevention of the corruption ("Official Gazette of RM" 28/02, 46/04, 83/04, 26/06, 10/08, 161/08)

<sup>355</sup> Article 11, 12, 13 By The Law for State Institution of Audit clear text ("Official Gazette of Republic of Macedonia" number 73/04).

<sup>356</sup> Law for public internal control ("Official Gazette of RM" number 90/09).

## CONCLUSIONS.

As a common conclusion from this research is the necessity for changing that is supplement of the legal and sub legal acts in RM in direction of establishment of clear rules for proving of the liability of the public administration as well as weakening of the feeling for liable working by which the fine will be prevented.

So, in order to be applicable the recommendation for public liability to be applicable, the standards for behavior should be clearly and precisely set planned in certain normative acts, regarding the public tasks by which the clerks are authorized by. At the same time, when the state organ does not act according to the duty which is requested, according to the legal rules there is damage for the citizens, the damaged should be paid by the state organ which is in question regardless for what kind of responsibility we talk about that is who caused the damage.

All this means fast rational competent unbiased and uncorrupted execution of the working obligations. Such principles will be achieved with clearly set rules and procedures for the holders of public functions which direct to liable execution of the working obligations and it could be clearly concluded liability if there is certain deviation from the procedures that is irresponsible execution of the working obligations.

Individual regulations for the liability of the state administration are contained in special laws by which it is regulated the work of the state organ management. Largely it has been left a discretionary right to the first people in the organs of the power to pass sub legal acts for processing of the system of liability of the state administration which largely does not exist and if there are such documents the same are different, they are not identical in the methodological and the legal setting.

In the part of the strategic setting of the Government policies there should be still worked on the completion of the circle of liability and by that it has to be finished the legal regulative by which clear procedures of control, clear working assignments, measurement of the worked out and clear division of the state from the public administration will be established. That means that the state clerk participant in the conduction of the policy who knows his authorizations and liabilities is to act in the execution of the working tasks, especially when the same are connected with the supplying of the citizens' services which reflects their professionalism, competency, confidence and liability.

The organs of the state management as holders of the executive power have key role in the conduction of the policy of execution of the regulations by the Assembly and the Government of the Republic of Macedonia. For that purpose, it should be created good organizational basis and staff potential followed by plans and action measures for implementation to pass professional and other directions for the conditions of the laws, to suggest measures to the authorized organs and to conduct those measures. The organs of the state management as liable for conditions of the laws should set clear rules and procedures by which through clear indicators liability can be confirmed and at the same time bases for effective working will be create.

It is very important procedures to exist which will be correctly explained when and in what cases the regulations from the text of the laws can be changed after the passing of the obligatory phases, necessary for the execution of the texts based on the relevant scientific and professional bases.

The system of evaluation and monitoring in the conditions of the policies of the Government should be developed in the direction of establishment of the circle of liability, where the process can be seen from the setting of the policies to their realization, the reasons and who are the people to blame for the deviations from the same. All this means that it should be confirmed who is liable for the policy choice, the strategic aim of the state organ on what scientific analyses it is based. So, through indicators and clearly set rules we can confirm the liability of the state and public administration, when although ideally set policy the outcome is negative.

The process of reform of the public administration in the part of the organization of the state management covers changes only in the number of ministries and the basic change in the law of organization of the state management is not executed. Although, this law was changed in the direction of improvement of certain legal decisions in correlation with the recommendations of the European commission, to create strong well trained, effective efficient and depoliticized state administration still essential issues are not touched which will create conditions of liable and effective working.

With the last changes of the Law of state administration<sup>357</sup> the legal decision that treat the liability suffered changes with the introduction of the obligations of the state organs for delivering of annual reports for the confirmed measures of discipline and material liability.

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<sup>357</sup> Article 76-à by the Law of state administration (“ Official Gazette of RM” number 114/09) states: “, 1) The organ from article 3 paragraph 2 of this law is obliged to send annual report for the imposed measures for the confirmed discipline and material liability of the state administration not later than 31<sup>st</sup> January during the current year for the previous one 2) The content and the form of the report from paragraph1 of this article is confirmed by the act of the Agency.”

If we analyze the liability of the state administration through everyday working which should be achieved according to the clear procedures the regulations should be set more clearly for the liability of the state administration. And that means all regulations in the Law for state administration that refer to the organizations, authorization, employment, motivation, evaluation the rewarding are not detailed and the same should be worked out by sub legal acts which will give direction for liable effective and efficient working.

According to this research, the opinions are that criteria should be created regarding the professional qualification the training period, the professional results and the capability of the management in order to avoid the non existing business interests and conjunctive necessities of the decisive factors which decide for these exclusively serious issues. The progressing on higher positions, the law for state administration regulates with the system of working posts which implies filling in of a post by announcement of public add at one unperceived procedure for employment and it is completely certain that on side door the spoils system will enter with all its negative consequences of the formal organization. From the other side it should be obligatory taken into consideration that the progress in service is important institute in the career of a state administrant as unique moral spiritual and professional stimulus and that means that the same should plan supplements to salary on basis of career and to plan strong legal decision in the direction of motivation of the state administration.

Regarding the public administration in Republic of Macedonia it is necessary to define the rules of the merit system of the employees in the area of health, education, science, culture and social protection. It is necessary to strengthen the rules for employment promotion evaluation and liability of the employees in the activities who make the public administration on bases of the generally accepted merit system.

This research shows that it is a rare appearance the application of discipline procedures as instrument for creation of liable administration due to ambiguous procedures for closing of the circle of liability.

The surveillance function of the state should be especially strengthened through promotion of the capacities of the inspection organs and their coordinated acting and a mechanism on central level by the Government, coordination body managed by the ministry without resources. In current practice this function is not real and the same is of huge importance for the strengthening of the control function of the state organs, the internal cooperation, avoiding of the overlapping of the authorization and at the same time this function should establish unified rules which will strength the authority and the credibility of the inspection organs and the inspection units.

Regarding the state administrators who consist the closest core of the public administration it is necessary consistently and completely already set principles to be applied in the Law of state administration as well as in the rest of the material laws which manage the employment promotion and the liability of the state service. Also, reaching of unique and consistent regulation for the salaries and the awarding of the employees in the public section at the same time respecting the principles of unique salary will contribute for avoiding of the prohibited risk of corruption and conflict of interests and it will have influence regarding the preservation of the motivation of the qualitative and qualified staff in the administration.

The openness and the transparency represent bases for functioning of the overall public section and the same should be promoted and strengthened. The transparent behavior of the authority protects the public interests and at the same time the possibilities for misuse of the authorization and the appearance of corruption are reduced.

Beside the legal measures as necessity, the activities for training and rising of the consciousness of the state administration appear for issues connected to the ethics in the state service, the conflict of interests as well as the anticorruption campaign for the state administration.

The current setting of the Law for state revision represents progress regarding the control of the work of the state organs, but the same should be detailed and processed so that the same could function and close the circle of liability.

The independent internal revision will direct to preventive and efficient working and at the same time will locate the disadvantages and the irresponsible working in the organ. The internal revision to gain the part of the independence should be legally set and it means to think of legal decision of independent where the control will be made by qualified people for work by an independent institution. In such way the same unbiased independently and liable can achieve the role of internal control of the overall working in the state organ. Such way will enable to create disciplined and liable institutions with liable structure of state and public administration.

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**BUSINESS STRATEGIES FOR ALBANIAN ENTREPRENEURIAL SMALL FIRMS**

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**Abstract**

*The first part of this paper discusses the current evidence on the nature and purpose of strategic planning in entrepreneurial small firms. The second part develops an analytic approach to planning analysis, which shows that few of the earlier approaches to strategic planning are appropriate for the Albanian entrepreneurial small firm. Instead, four Meta strategies are proposed that firms might employ to cope with uncertain environments. The management of the Albanian enterprise needs to be focused more on the strategic level in the context of the overall aims and objectives of the organization and less attention should be paid to the tactical level that implies a belief in the linearity of action and effect.*

**Key words:** business strategy, entrepreneurial small firms.

**JEL Classification:** M19.

**Strategy and planning in entrepreneurial firms**

Quinn (1980) provided a useful definition of strategy:

*A strategy is the pattern or plan that integrates an organization's major goals, policies and action sequences into a cohesive whole.*

This definition of strategy included planning as part of the strategy-formation process. Subsequent definitions of strategy— for example, Mintzberg's '5Ps of strategy' (Mintzberg, 1987) — recognized that strategy is a broader concept than just 'Planning'. It also can be seen as 'Ploy', 'Position', 'Perspective' and 'Pattern'. In consequence strategy formation is a multi-faceted activity. In this paper we have used 'Planning' to encompass the activity of preparing forecasts, in greater or less detail, of future business actions, activities, and possibly outcomes such as sales and profits. Another way of distinguishing between the strategy concept and planning is that they are seen to be on different levels — one at an *ideas* level and the other at an *actions* level. Organizations articulate their business plans at the actions level but the other facets of strategy are not easily articulated or written down. Instead, they can be regarded as higher-level ideas that we call *Meta strategies* that transcend formal written planning documents. Further, they can be separated into *ex ante* and *ex post* categories reflecting in Mintzberg and Waters,(1985) terminology, whether the strategy was *deliberate or emergent*. Specifically, 'Ploy', 'Position' or 'Plan' strategies might be seen as deliberate (and hence *ex ante*) because they are frequently the outcome of specific decisions which have been taken in order to achieve the desired end result. Alternatively, 'Pattern' or 'Perspective' strategies might be seen as emergent (and hence *ex post*) since they can be seen as retrospective rationalisations of past events and actions. Beaver and Ross (2010) note that for large firms strategic management is a predictive process but for small firms it is frequently an adaptive process, principally due to positional and resource disadvantage. The introduction of time as one frame of reference for categorizing strategy is important, as both strategy formation and planning are concerned with the future. There is an infinite number of possible futures but the extent to which firms choose one or more of these as templates for shaping action will be influenced by the nature and involvement of internal and external stakeholders and the organization's cultural attitude towards strategy and planning (Johnson and Scholes, 1999: 73). *De facto*, the future lies exclusively in the realm of ideas because the future is essentially unknowable.

McGuinness and Morgan (2006) argue that the use of history for strategic planning is limited and possibly erroneous. Thus it is our contention that, paradoxically, strategy which is based on ideas can be more useful than a mechanistic plan based on what has happened in the past.

In the case of some small businesses, external forces can dictate whether the business survives (Thomson, 2003). It is generally less possible for small firms to influence their environment because they are less powerful. Hall (1995) also suggested that formal planning might be less important for small firms. Until they grow the key consideration may be the psychology of the owners. Curran and Blackburn (2006) commented that it is fallacious to assume that the objectives of all, or even many, small business owners can be termed entrepreneurial in the sense of creating newness or striving for growth. In fact the entrepreneurial small firm can be distinguished from the typical small business by the incorporation of novelty in the firms' activity. Schumpeterian novelty or innovation is the crucial characteristic that sets the entrepreneurial small firm apart from the rest. This novelty may be in product or process but is defined as some new combination. Growth, as Storey (1999) pointed out, may well be associated with this novelty but for the working definition of an entrepreneurial small firm adopted in this paper, *a degree of originality is the determining demarcation*. Accordingly, entrepreneurial small firms have to deal with change, since change is an outcome of originality. Moreover, the outcomes of these changes are essentially unknowable and cannot be predicted by historical analysis.

Beaver and Ross (2010) cite Porter's (1987) trenchant comment that entrepreneurship unguided by strategic perspective is more likely to fail than to succeed. This presents a dilemma. Entrepreneurs are told that planning is a good thing but the nature of planning and subsequent strategy in entrepreneurial small firms raises both practical and conceptually interesting issues.

The literature indicates while the majority of new small firms do not formally plan (Robinson and Pearce, 1984) but the received and asserted wisdom is that planning is a 'good thing' (Castrogiovanni, 2007). However, the benefits of this 'good thing' are not immediately evident (Wickham, 1998). For example, the links between planning and improved performance are equivocal (Pearce *et al.* 1987), if not confusing. At best it can be said that growing firms tend to plan more (Storey, 1999), but the direction of causality remains unclear. This raises the question of why entrepreneurial firms plan. For the entrepreneurial firm the need for outside finance creates a requirement to produce a plan. Stokes (1995) suggested that most small business managers perceive the business plan as a document produced to raise money. Murphy (1999) went further and suggested that the plan serves as a written dialogue between the entrepreneur and the bank — it becomes a means by which outsiders can get a grasp on what the new business is about. Mason and Harrison (1999) examined informal Venture Capital funding and found that more than three-quarters of the investor respondents in their survey required to see a business plan before making an investment decision. They concluded that a business plan is a necessary but not sufficient condition for raising informal venture capital and that business angels need to see a 'comprehensive, realistic, investor-oriented business plan' but that 'ad-hocery and rules of thumb' dominate. They confirmed the overwhelming importance of 'people and product/market considerations' in an action based plan.

One of the key business skills that appear in most courses in Entrepreneurship is the preparation of business plans. Wickham (2008) suggested that they are essential because without a carefully prepared business plan no business would stand much chance of success in securing external funding. The danger for inexperienced entrepreneurs is that by highlighting the importance of the plan for funding purposes the plan may in fact, 'become the business'. Given the need to prepare a business plan that accentuates what the entrepreneur believes external stakeholders want to know, most business plans will concentrate on tactics and actions. Given this emphasis on action, (Schamp and Deschoolmeester, 1998) the typical business plan from a small firm is therefore likely to dwell on tactics but be lacking on strategy. (Anderson and Atkins, 2006).

### ***Approaches to strategy formation***

The following section moves from general aspects of planning in small firms, to specific elements of strategy formation. The analysis draws upon a number of strands of thinking on strategy formation. It provides a framework for analysing different approaches to strategy formation to identify their appropriateness for use by entrepreneurial small firms. The pictorial form of analysis used here also provides a useful link into the Meta strategies proposed later for use in entrepreneurial small firms.

#### ***The strategic plan***

The first approach to strategy formation is one we have simply termed *strategic* and is illustrated in **Figure 1**. This is a genre of strategy formation described by Mintzberg (1990) as 'The Design School'. From a particular starting point, a specific end-point is identified and the strategy justifies the choice of the end-point and the means taken to get there.



**Figure 1.** The 'strategic' approach.

This model of strategy might be considered totally conventional to anyone who has passed through a business school education in the USA or Europe. It would include an analysis of the industry together with a review of the key forces determining the direction and profitability in that industry (STEP or PEST analysis). This is likely to be followed by an analysis of the structure of the industry and the determinants of profitability of individual firms (probably using Porter's five-forces framework). It would probably include a review of the internal strengths and weaknesses of the organization and the threats and opportunities (SWOT). These components will form the background and rationale for a preferred strategic choice that will be presented as the best way forward.

Obviously this describes only the bare outline of this type of strategic plan and most plans will contain considerable amount of detail and financial analysis. In many respects it is similar to what Mintzberg and Waters (1985) described as the *vision* in their comparison of deliberate and emergent strategies. Indeed, in the context of entrepreneurship it is useful to quote Mintzberg and Waters:

*Because such strategies are rather common in entrepreneurial firms, tightly controlled by their owners, they can be called entrepreneurial strategies.*

In his critique of the Design School approach to strategy formation and its pedagogical foundations, Mintzberg pointed out the dangers of a rigorous adherence to 'the plan'. Essentially two factors are advanced for this. First, the strategy itself may be ill conceived and second, there may be slippage or drift in the implementation of the strategy, either because of a change in the environment or because of organizational resistance. However, a key part of Mintzberg's argument is that strategy formulation and implementation ought not to be distinct activities and both should be carried out together. Mintzberg described the assumptions of the Design School:

*That environments can always be known, currently and for a period well into the future in one central place, at least by the capable strategists there.* These assumptions, he claimed, are 'very ambitious' and he discussed how organizations might cope in unstable environments. Coping might be possible he argued, if the necessary information can be comprehended in one brain:

*Such close control of a leader over both formulation and implementation is characteristic of the entrepreneurial mode of strategy making.*

In larger organizations a number of possible relationships between thought and action are possible, one of which is organizational learning with allusions to logical incrementalism (Quinn, 1980a) and implementation as evolution (Majone and Wildavsky, 1978). These are important issues and ones to which this paper returns later.

### ***The implementation plan***

An implementation plan approach begins with an assumption or an acceptance that a particular course of action is correct and in this sense it lacks the 'vision' of the strategic approach. Mintzberg and McHugh (1985:160) described this type of strategy as the *systematic formulation and articulation of deliberate, strategies, which are then implemented*. **Figure 2** characterizes this approach by a series of actions, stages or building blocks necessary for the successful conclusion of a strategy. The approach may not be dissimilar from (and in certain types of organization may closely resemble) a network used for Critical Path Analysis planning. This type of plan is likely to be typical of the plans entrepreneurial businesses use to support funding applications because it appears to offer certainty. Courses of action are carefully detailed and programmed activities are checked. In short, the production of this planned strategy implies knowledge of future events. Belief in this form of plan can often result in the business coming to grief. In one case known personally to the authors, the two novice entrepreneurs unswervingly believed the advice in the business plan given by the Local Enterprise Agency and another provider of assistance to small firms. However, financial disaster could not ultimately be avoided because forecasts of some of the basic elements such as price and market share were incorrect.

The implementation plan approach can only be appropriate in the very short run or in environments that are inherently stable. For environments that are turbulent, or for initiatives that will take more than a very short time to come to fruition, this planning form is likely to be inappropriate. A weakness of this approach is its deterministic nature. It assumes almost mechanistically, that there will be a direct relationship between input and output.

Such an assumption applied to human organizations is heroic if not perverse! When the environment within which organizations operate is turbulent there are countless ways in which outputs fail to match expectations. **Figure 2** portrays a planning model that identifies four steps or building blocks. In practice most organizations will find there are many more. This compounds the concern **Figure 2**. The ‘implementation plan’ approach, that organizations that plan in this way will almost inevitably, be perceived to have *failed* to adhere to their carefully laid plans, yet *success* was never likely given the nature of the assumptions underlying the model.



**Figure 2.** The ‘implementation plan’ approach

Prahalad and Bettis (1986) criticized this sort of model on the basis of the ‘dominant logic’ and the presumption of ‘rationality’. As Hurst *et al.* (1989) state:

*Facts that can be plotted onto this map of the business are accepted. Data that cannot be assigned co-ordinates are not perceived and are ignored if they are perceived or treated as an aberration.*

Much earlier than this, Barnard (1934) emphasized the importance of ‘non-logical’ processes. Thus the advantages of nonmechanistic recognition processes are ignored in the naïve realism of this type of model. Further, such emphasis on logic and rationality precludes it from being helpful in the innovative, creative processes.

As Hurst *et al.* (1989: 234) noted:

*This appeal to rationality — measurability, efficiency and consistency — perpetuates the past. ... it cannot bring into being those new activities which may well be required as part of tomorrow’s business.*

### **Discovery-driven planning**

The third approach was proposed relatively recently (McGrath and MacMillan, 1995). **Figure 3** depicts this approach with four actions, stages or building blocks that are numbered in reverse sequence. Essentially, this approach considers first the assumptions underlying the model. Instead of emphasizing (for example) particular sales levels and cost structures which result in a given profit level, revenues and costs and the assumptions upon which these are based are identified from the anticipated profit level through an approach which may also be described as goal-seeking. This enables the organization easily to test assumptions against likely levels. There are considerable strengths to this model. It is holistic and concerned with outcomes and in the sense that there is a vision of the outcome, the model is strategic but also purposeful.



**Figure 3.** Discovery-driven planning

### ***Some strategies for managing in an unknowable future in Albanian context***

In this section a number of meta-strategies which may be appropriate for managers when the future is unknowable are discussed. Weick (1987, 1995) has suggested that businesses should *enact the environment* in the sense that they should be aware of and share in the changes taking place around them instead of reacting to those changes. These Meta-strategies go some way to operationalizing this concept particularly if Albanian entrepreneurs can see their role as change agents. Meta strategies avoid the fallacy of a direct link between actions and outcomes. They therefore reduce the emphasis there might be on actions. As Meta-strategies they are intended to reflect how this entrepreneurs might think about the development of their business, particularly a mindset that acknowledges the unknowable nature of the future. They emphasize the need for entrepreneurs to build a strategic overview of their enterprise and an openness about tactics.

### **Robustness**



The first strategy for an unknowable future draws upon the notion of robustness advocated by Rosenhead (1989) and we have linked to it the concept of the *umbrella* strategy proposed by Mintzberg and Waters (1985). (The diagrams of alternative strategic approaches develop some of the diagrammatic devices used in that paper.) The links between components (i.e. actions, stages or building blocks) are stochastic and not mechanistic.

The organization recognizes the stochastic nature of the environment in which it operates. Providing outcomes are within reasonable limits (the boundaries are set by the resource availability or the performance specifications determined internally or imposed externally), the organization will continue to operate. If actual performance takes the organization outside the boundaries of the umbrella, then failure will occur. Alternatively, a behavioural view of the organization (Cyert and March, 1963) would suggest that such an event would provide the trigger for reviewing performance specifications. The umbrella may change over time since it will be a function of internal resources that may expand or contract. In addition, performance specifications may be set internally or externally which, in the case of externally determined performance specifications, may also be subject to stochastic change.

### **Flexibility**

The significant difference between this and other strategies is the absence of an ultimate goal. Instead, the model suggests that given the stochastic nature of the linkages, there are multiple futures. In some cases there could be failures which result in the abandonment of an action. Alternatively, there could be a deliberate choice to withdraw from one type of action and substitute another. This is entirely analogous to the use of *options* as an appropriate form of decision making. Such advice is not new.

Textbooks on decision making have identified for many years how to calculate the value of perfect information or the benefit achieved from delaying a decision until more information has been acquired. Nor is such behaviour uncommon practice: Consider the following:

- Many staff are accepted on trial periods before their contracts are confirmed.
- Many organizations undertake test marketing before deciding to undertake full scale production.
- Oil companies have extensive experience of using satellite and seismographic surveys before making decisions about whether and where to make a test drilling.

All such actions are examples of flexible behaviour given that they imply the acceptance of the possibility of withdrawal from an action. It is important to consider the relationship between flexibility and other responses to the uncertain environment. In the context of farm planning, Heady (1952: 524) stressed the fact that flexibility:

*Allows for changing of plans as time passes, added information is obtained and ability to predict the future improves.*

He enumerated three forms of flexibility: *time flexibility*, *cost and factor flexibility*

and *product flexibility*. In the context of time flexibility, the farmer who makes medium- or long-term investments in, for example, orchards or cane fruit has less

opportunity to review farm activities from one year to the next than the farmer who has not made such a commitment. Cost and factor flexibility relates to the choices that have to be made about the factor combinations utilized in the firm. A flexible combination may not employ the absolutely lowest cost combination of factors but the chosen technology would permit a longer term cost-minimization avoiding the need for frequent changes of direction. Likewise, product flexibility implies the utilization of resources in such a way as to maximize the opportunities for switching production from one enterprise to another. This may involve some short-run costs (in terms of not achieving maximum revenues) but the costs of change are reduced and medium- or long term net revenues are enhanced because the likelihood of failure (bankruptcy) is reduced. Heady's discussion of farmers' reaction to uncertainty provides a very useful clear distinction between *robustness* and *flexibility* in terms of whether a particular action is intended to stand over time (as in the case of the former) or whether over time, changes in direction are accepted (and encouraged) as in the case of the latter.

Genus (1995) focused particularly on the contribution of organizational learning

to flexibility and how alliances and networks can deliver flexibility for the organization. Nevertheless, organizational structure and culture have to be right for flexibility to occur. Once again, the critical point is that the mindset has to be appropriate for the entrepreneur to contemplate flexibility.

Furthermore, this flexibility must be differentiated from Logical Incrementalism (Quinn, 1980a, b). Quinn, who was principally describing the strategy-formation process in large firms, saw processes as iterative whereby the strategy makers evolved strategy over time. Once a consensus strategy had been reached it was followed by the organization. The emphasis in this paper is to raise the nature of flexibility beyond that merely of accepting that *it may take some time* to reach a consensus, to that of accepting that *the future is likely to work out differently* from the way that had been anticipated. Clearly this model is particularly appropriate in highly turbulent environments or those where great uncertainties and risks arise.

Again there may be a cultural block on the acceptance of the possibility of uncertainties so great that they ultimately threaten the continued existence of the organization. Nonetheless, the reality is that the new small business failure rate in the Albania is very high. This approach may not suit the first-time entrepreneur or the decisive decision maker (one who likes to take action and believes that 'actions speak louder than words'). Furthermore, it does not suit those situations in which prevarication and delay may lead to downfall or the loss of any first mover advantages.

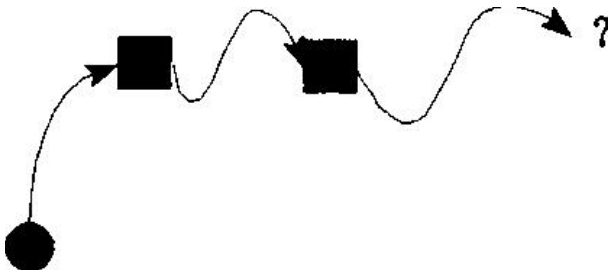


Figure 5. The flexible approach.

### The 'lottery' strategy

In the context of business behaviour, the 'lottery' strategy is defined as follows:

*Experimenting with various situations, scenarios or systems by random selection of actions.*

What clearly distinguishes this form of behaviour from the butterfly is the absence of deliberation and organizational learning. It is arguable whether such a strategy can be considered deliberate or not but this merely reflects the ambivalence of many aspects of strategy (i.e. it may as Mintzberg suggested, be *ex ante* or *ex post*). For practical purposes however, it may not matter whether it is deliberate or not.

The decision maker that follows this strategy recognizes and accepts the stochastic nature of the business environment and may use whatever decision-making rules are appropriate. Accordingly it amounts to little more than game playing, knowing that sometimes losses will be made but on occasions gains might also be made. We can observe this form of behaviour among some of the very smallest operators in the North Sea oil industry. They may invest (almost always through an equity-sharing partnership with other operators) in individual or a small number of blocks in the hope that oil might be found. To call these investments is really a misnomer. It may be more accurate to call them gambles. From time to time such gambles do pay out but the reality is that 90% of test boreholes drilled in the North Sea have been dry!

What links may there be between entrepreneurship and lottery playing? While there is presently no structured evidence on this, it is possible that in many cases the first business initiatives of entrepreneurs are carefully planned and crafted, representing deliberate attempts to build upon knowledge, skills and expertise learnt elsewhere and to deliver something new in the market. But serial entrepreneurs who create a number of new businesses in their lifetime may be different. A number of 'pull' factors can be seen to potentially contribute to the success of such a strategy. The ownership and access to capital and the prestige and skill networks that are opened up by earlier success are likely to be important. The serial entrepreneur may be more likely to indulge in 'lottery playing' than others do — on the basis that with an established capital base, there is less to lose. The nature of serial entrepreneurship is, however, open to interpretation. Tacit knowledge of what may work may be better developed in the serial entrepreneur and if that is the case, the serial entrepreneur's behaviour may be better described as butterfly behaviour.

### Conclusions

This paper has reviewed three conventional approaches to business strategy but all of them were found to be inadequate in situations where the future is unknowable. Accordingly, they are inappropriate for Albanian entrepreneurial small firms who operate in a turbulent environment. Despite this, small firms are required to prepare business plans because without them, external funding would be unavailable. The danger is that having written a business plan the entrepreneur's strategic thinking stops. In *The danger is that having written a business plan the Albanian entrepreneur's strategic thinking stops* this circumstance the plan is seen to become or even replace the strategy — so the analogy of the plan as a multi-purpose tool is applied. Instead we have argued that strategic thinking is an activity which cannot substitute for a plan and is separate from the planning activity. The tool is not multi-purpose after all!

Given the turbulent if not chaotic nature of the business environment, four alternative meta-strategies have been discussed which can provide new insights into ways of directing entrepreneurial small firms. Some may choose to adopt a **robust** strategy if survival is a high priority. Others may choose to be **flexible** in the belief that changes in direction are inevitable given the dynamic nature of technical and other forms of change.

Finally, some entrepreneurs may see their business involvement as a gamble and behave as if they are playing the **lottery**.

It cannot be said that any one of these strategies is right or best for any particular firm or circumstance, just as it is not possible to conclude — in the parlance of Miles and Snow (1978) — that it is right to be a *first-mover* or a *late-mover*. Such an approach reflects an attitude of mind in exactly the same way as the four Meta-strategies do. The critical point we believe is that Albanian entrepreneurs should be aware of their strategy and select an approach that fits context and conditions. The generic strategies espoused by Miles and Snow have generated considerable research into management style and performance. The framework presented in this paper provides similar opportunities for researching the management, survival, growth and performance of entrepreneurial small firms.

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## RIORIENTATION OF DURRES PORT INTO A REGIONAL PORT

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### **Abstract:**

*Durres port is the main gateway of Albania, where more than 85% of the seaborne cargoes go through this port. During the recent years, the volume of general cargo that has been handled in this port has been gradually reduced and instead, a continuous and rapid growth of containerized cargoes has been observed.*

***Objective:** the objective of this paper is to give an assessment of the reorientation of the trade in the western Balkans and its impacts on Durres port as the main Port of Albania. In order to have an effective and productive terminal, a number of factors need to be studied, because the higher the terminal productivity, the higher the competitiveness of the terminal will be therefore the port will act as a regional port.*

***Methodology and Results:** the methodology used in this paper includes an analysis of the trade situation in Western Balkans, main ports serving in the area, a picture of Durres Port and its activities compared to its competitors in the region, and infrastructure developments in Albania regarding to port activities. Durres Port handles more than 85% of the seaborne cargoes that are transferred in/to Albania and most of this cargo is originated and has as a final destination Albanian territory, making this port a port with local effects only. Lack of railway connections to pan European railway network, lack of available spaces for terminal expansion, lack of logistic centers or free trade zones compose some of the limitations of this port.*

***Conclusion:** Durres port as the main and biggest port of Albania has remained out of the main regional market due to its limitations. Development of transport infrastructure and logistic services will increase the effects of this port into the region's markets.*

**Keywords:** regional effects, Durres Port, infrastructure, logistic services.

**JEL Classification :** FO2.

### **1. Chapter I – Overview of the Durres Port and Cargo Traffic.**

#### **1.1 General**

The port of Durres is the main port of Albania. Its operational infrastructure consists of 11 berths with depths alongside ranging from 7.5 to 11.5 meters. Main products handled at the port are general cargo, cereals, containers, ferries and minerals. Being the main gateway to Albania and being positioned at the entrance of the Adriatic, the port of Durres has a strong strategic position. It offers a gateway to corridor VIII, in particular to the neighboring countries of Kosovo and Macedonia. The port of Durres is an important access for Albanian imports and exports and is connected to the main economic centers of the country.

This, results in a high captivity for Albanian cargo and therefore 85 % of the seaborne cargoes that are transferred in/to Albania go through this port. Location at the entry of the Adriatic Sea makes this port of a strategic importance from political and geographical point of view. Due to its geographical position this port makes it possible to shorten the transit time and consequently shortens the transport costs. Durres port has attracted the transit cargoes to Kosovo, while the country is going through restructuring process to opening the path toward further economical development. Albania is also a strategic gateway to the Corridor VIII which gives the port of Durres a particular access to the Macedonian market.

Durres port is well connected with national road network. The principal access to the port is 2x2 road between Durres and Tirana. The capacity of the port access can be estimated about 650 vehicles per hour per direction. The main routes for the freight transport through roads in Albania are:

- Durres – Tirane – (the new connection to Elbasan is under construction)
- Durres – Elbasan – and further to Macedonia border
- Durres – Milot – Kukes – and further to Kosovo border
- Durres- Lezhe – Shkoder – and further to Montenegro border
- Durres – Levan – Tepelene – and further to the Greek border

**Table 1. Road distances to main regional markets**

Portet	Tregjet			
	Shqipëria (Tirana)	Maqedonija (Shkupi)	Kosova Prishtina	Serbija (Beogradi)
Durrës	40	320	355 250	710
Selanik	375	225	310	635
Burgas	900	665	710	810
Varna	950	665	755	860
Bar	205	380	335	520

Even though the port is connected to the national rail network it is to be noted that the rail network condition is very poor. In the past the railway ran up to almost all of port berths. Today only the east part of the port (berths 10 and 11) is connected with rail and is operational. General Albanian Railways Directorate is responsible for the railways system in Albania. The total network of rail is composed of 447 km of primary and 230km of secondary railways. The rails are built to a gauge of 1.435m, and all routes are single track with passing loops. The system is built primary for freight traffic, but also passenger's traffic is operational. There is rail connection to Montenegro, but this connection is missing with other border countries, Kosovo, Montenegro and Greece. In the framework of Corridor VIII there are plans to construct the missing link between Albania and Macedonia.

**Table 2. Distances in Km via rail between selected destinations**

	Durrës	Podgorica (border Albania – Montenegro)	Port of Bar (Montenegro)
Durrës	-	143	255
Tirana	36	140	252
Fushe Kruje	17	126	240
Elbasan	73	216	328

## 1.2 Cargo handling in Durres Port.

The port of Durres represents the major interface for Albanian international trade and act as the gateway port to the capital. Being located 42 km west of Tirana, at the junction of the Adriatic Sea and the Ionian Sea, Durres is also a key location for ferry networks and passenger transit. This strategically positions Durres with regards to European integrated transport corridor VIII, facilitating transit of passengers and freight throughout the European continent.

The port currently serves 77% imports and 89% of Albania's exports; this equals to 78% of total seaborne trade on a national level. Meanwhile, Durres is primarily import-oriented, where inbound traffic accounts for 91% of the total throughput.

**Table 3. exports and imports handled in Durres Port in years.**

imports	kind of cargo	2003	2004	2005	2006	2007	2008	2009	2010	2011
	general	3922	3470	6700	20924	25136	20273	15428	237342	241422
	dry bulk	150058	182135	157258	272309	498336	249951	106155	348620	361236
	total exp	153980	185605	163958	293233	523472	270224	121583	585962	602658
imports	general	820204	874794	956424	924085	781783	714467	578135	311067	289344
	dry bulk	734983	856208	890022	894518	521112	466775	514485	487126	532644
	liquid bulk	220892	208004	223156	225166	270447	263363	159141	8690	0
	cereals	349850	414215	331545	349977	362429	276291	276291	313977	345799
	total imp	2125929	2353221	2401147	2393746	1935771	1720896	1528052	1120860	1167787
annual total	2279909	2538826	2565105	2686979	2459243	1991120	1649635	1706822	1770445	

Durrës represents an interesting alternative for land-locked countries such as Kosovo or Macedonia, being positioned at the key location to bridge South-Western and South-Eastern Europe trade networks.

A recent trend in Durrës development is the introduction of containerised services. Due to this high share in Albania's trade, as well as its proximity to the capital Tirana, the Port of Durrës represents the major driver of Albania's trade and economic growth. The throughput development over the last decade (1997-2006) shows a healthy average growth rate of 12% per annum for the total port traffic, up to just over 3.4 million tonnes in 2006. Although a share of this growth can be attributed to the relatively stable growth of the general cargo during the last 5 years, the main driver for the growth of the traffic is the dry bulk. The relative share of the dry bulk in the total traffic increased strongly from a level around 20% at the end of the nineties to nearly 50% in 2006. The port currently serves 77% imports and 89% of Albania's exports; this equals to 78% of total seaborne trade on a national level. Meanwhile, Durrës is primarily import-oriented, where inbound traffic accounts for 91% of the total throughput.

**Table 4. No. of containers handled in Durrës Port**

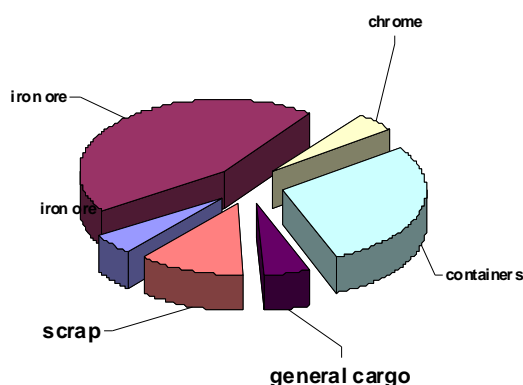
Years	Export			Volume in Tonne Export	Import			Volume in Tonne Import	Total number of Boxes	TEU Total	Volume in Tonne
	Number		TEU		Number		TEU				
	20"	40"			20"	40"					
2005	4,482	1,457	7,396	16,970	4,640	1,625	7,890	130,471	12,204	15,286	147,441
2006	5,797	2,445	10,687	26,443	5,898	2,647	11,192	188,178	16,787	21,879	214,621
2007	8,054	3,965	15,984	69,423	8,647	4,248	17,143	287,751	24,914	33,127	357,174
2008	11,450	5,405	22,260	157,185	13,518	5,510	24,538	424,942	35,883	46,798	582,127
2009	17,714	8,356	34,426	293,631	16,782	8,707	34,196	504,125	51,559	68,622	797,756
2010	18,040	8,820	35,680	460,823	17,664	9,135	35,934	507,678	53,659	71,614	968,501
2011	8,376	5,632	19,640	215,792	8,486	5,167	18,820	277,058	27,661	38,460	492,850

V.O. Year 2011 is 6/Months

Burimi: APD

Durrës represents an interesting alternative for land-locked countries such as Kosovo or Macedonia, being positioned at the key location to bridge South-Western and South-Eastern Europe trade networks.

**Fig. 1** The distribution of the cargo handled in the port of Durrës.



This new trend on handling the containerized cargo has been strong especially during the last years, thus appealing for new investments on infrastructure equipments and facilities in order to handle the increasing containers traffic. Actually port of Durres is operating in a start up containers terminal, but the capacities of this terminal are at the edge and a new terminal is considered to be built on the eastern part of the port where the water depth is sufficient to accommodate bigger ships. Without having a modern containers terminal, the port hardly will be able to reach beyond local markets, therefore its hinterland (trading area of the port, or the area where the port extends its services) will be very limited.

## Chapter II –

### 2.1 Main Ports Serving the Region

As we analyzed in the previous section, the container traffic is the prevailing mode of maritime transport nowadays. In order to have a better picture of the situation, we will analyze the main ports of the Adriatic and Ionian Sea which present the main competition to the port of Durres.

The region represents a hinterland of approximately 40 million inhabitants, and encompasses Albania Kosovo Macedonia and parts of Bulgaria and Romania.

The actual development of container demand at the port will be a function of the competitive position of the facilities offered. In addition to the relative competitive position of Durres, the overall development of competing port capacity is also considered. The review includes the following aspects:

- § Total terminal capacity – the overall development of regional container handling terminals.
- § Ship size capabilities – the ability of the existing and planned terminals to berth the size and type of vessels that will be required for the trades.
- § The intermodal and road links that are available to access the major hinterland regions.
- § Future planned developments.

The role of Durres will be as a terminal that serves the combined development of demand from local port competition, transit traffic gateways and transshipment competition. With regard to a terminal's physical capabilities, perhaps the most important feature is the ability to berth the correct size and type of vessels.

This combines the requirements for the suitable water depth, the availability of specialist container handling equipment and sufficient capacity to handle existing and anticipated demand. The following table 4 presents the current regional container terminal capabilities:

**Table 5**

#### Current Regional Container Terminal Capabilities

Port/Terminal	Berth length (m)	Berth depth (m)	Gantry cranes	Capacity m TEU/year
<b>Albania</b>	350			
Durres		7.5-11.0	0	0.08
<b>Greece</b>				
Thessaloniki - Pier 6	530	12.0	4	0.45
<b>Romania</b>				
Constanta: Socep	467	13.0	3	0.08
Constanta: Umex	421	10.5-12.0	0	0.08
Constanta: South Port APMT	238	10.6	0	0.08
Constanta: South Port CSCT	1100	13.5-14.5	5	1.30
<b>Adriatic</b>				
Bar	330	12.0	0	0.04
Koper	596	11.4	6	0.40
Rijeka	514	12.0	4	0.17
Trieste	1420	14.5	7	0.35

*The Port of Durres enjoys a competitive position, particularly for the local volumes going To/from Albania and for the transit volumes going to the “inner ring” of southern Balkan destinations. For the latter, it will face competition from the ports of Thessaloniki, Bar Montenegro and Rijeka. It is imperative that Durres ensures that it is able to maintain it’s competitive position in both the local and transit markets by securing the relevant finances to allow the dredging plan to be carried out quickly and efficiently. Port of Bar, too, is well placed for transit volumes although hampered by insufficient capacity and equipment. If this were addressed, Port of Bar would offer a viable, competitive alternative. The following table gives a theoretical approximation of the market share of the various ports of the region:*

**Table 6. Market shares of the ports of the region**

Ports	Markets			
	Albania (Tirana)	Macedonia (Skopje)	Kosovo (Pristina)	Serbia (Belgrade))
Durres	100%	11%	22%	10%
Thessaloniki	0%	85%	48%	19%
Burgas	0%	0%	0%	5%
Varna	0%	0%	0%	3%
Bar	0%	4%	30%	63%

A comment to the table should be that the calculated market share of 10% for Belgrade of Durres is likely to be on the high side. All cargo destined for Belgrade that is handled via the Port of Durres needs to be transported by road or rail via Podgorica, which is only 50 km away from Bar and along the route from Bar to Belgrade. In practice it is therefore expected that besides Albania itself the most significant markets for the port of Durres are Kosovo and Macedonia

For its transshipment potential, the deepwater berth is also absolutely crucial. Without it, the larger shipping lines will not bring their bigger vessels to the port and the port will already face stiff competition from established transshipment hubs.

However, provided that the twin advantages of deep water and a reliable inland distribution network can be realized, Durres will be able to establish a competitive position for the local volumes and for both the transit and transshipment markets and has the scope to be a major regional maritime gateway.

## Section 2.2. SWOT-Analysis

Considering the above we have done a SWOT analyzes in order to better understand the position of the port of Durres and its opportunities to become a regional port.

### Strengths



Location: Port is located in a strategic area within Albania and Southern Eastern Europe.

*In Albania is located in most important network link for road and rail transport. Is the biggest port and there is no competition within Albania.*

In Region is considered as Main Gateway of Corridor 8, which connect Durres Port, Albania (*Adriatic Sea*) – Scopje (Macedonia) - Port of Bourgas, Bulgaria (*Black Sea*).

Safe navigation to the Port, well-protected bay from winds. The bay provides shelter for ships waiting to be handled in the port.

Port is considered from Government as one of the main economic drivers of the country.

#### **Weaknesses**

Current economical and political situation in Albania it's not yet stable and is in Development phase.

Current Infrastructure, missing of regional railway connections to the European rail network, improvement of the road network, remains limitations for the international transport.

Port is in transition phase and privatization it's not completed and regarding to it the service offered by Port isn't in required level yet, to be able to compete rigorously with other Ports in region.

The approaching channel has a limited water depth, thus creating a restriction for the bigger vessels to accommodate and operate in the port.

#### **Opportunity**

Durres Port is considered as the Main Gate of Corridor 8, therefore numerous investments from Albanian Government, European Community, USA, World Bank etc, are taking place.

The opening of the new road that connects Durres Port with Elbasan (the new tunnel and highway Tirana-Elbasan), (part of corridor 8) which link Port of Durres with Macedonian's border will facilitate cargo movements from Durres to east of the country and further to Macedonia and beyond.

The so called "Road of the Nation" has created a new trade pattern and is considered a very important transit cargo corridor in order to connect port of Durres with corridor X of pan-European road network.

The Country is in development phase but is achieving high economical growth, which will have impact in volume of cargo transported via the Port.

Member of European Community in the future but is still in negotiation phase.

Regarding EC' member policy port will apply EU's policy in establishing the free zones in order to increase the throughput of the port as well as the overall port performance.

#### **Threats**

Strong competition in region with Thessaloniki, Igoumenica Port in Greece regarding to transit cargo, from West to East (Adriatic Sea to Black Sea). Greece is part of EC, currently due to better Port facilities, infrastructure (inland transport) almost all cargo is passing transit to Port of Bourgas (Bulgaria) through Greece, even though the shortest way is from Albania to reach Port of Bourgas.

Polarized political climate may have some effects on the overall economic developments, therefore might affect port performance and developments as well.

#### **Conclusions:**

This paper underlined that the reorientation of Durres port into a regional port is vital for the future of the port of Durres. It can be concluded that Port of Durres is the most important port for Albania and mainly is serving to the domestic market. In order to become a regional port it yet needs to improve a number of factors being those infrastructure or service ones.

After these analyses we can realize that in order to make the reorientation of the port of Durres from a port with local (national) effects into a port with regional effects the port should improve all factors that affect the performance.

The completion of the national road axes is important for reorienting the port of Durres into a regional port. This will facilitate the transshipment of the cargoes into the regional markets. Filling the missing links on the rail network and connecting road and rail with European network is of vital importance.

Improving the navigational capacities of the port such as deepening the access channel, basin and the quay sides will make it possible for the port to accommodate bigger ships and this will result in bigger throughput for the port.

Free zones implementation is of crucial importance for the port in order to increase its capacities and the quality of the services. Considering the competition from other regional ports like Thesaloniki, Bar, Rijeka etc, free zones will have a strong effect in regionalizing this port.

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## STRENGTHENING INNOVATION CAPACITY OF THE MACEDONIAN BUSINESS SECTOR

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### **Abstract:**

*Nowadays, the Macedonian companies are being faced with a strong pressure to improve the productivity, as well as to meet the high standards and quality requirements of the products and services in the global market place. It is therefore extremely important for the companies to systematically upgrade, innovate and improve their operations. In such a competitive environment, the business sector may possibly endure and function properly all the way through affirmation and adoption of the innovation-oriented strategies that will stimulate the creation and commercialization of new products and processes, but also the possibilities to obtain new knowledge and technologies from external sources. Thus, strengthening the firms' innovation capacity is to be a strategic priority that will possibly develop the potentials for creation and proper deployment of internal and external resources aimed at delivering a distinctive and superior market value. In the absence of developed innovation system, as well as the relatively limited resources for research and development, business sector in the Republic of Macedonia lags significantly behind the general trends on global scale and may not effectively respond to challenges imposed by new economy and the knowledge-based society. Hence, the main objective of this paper is to analyze the innovation capacity of the Macedonian business sector and to perceive the potential measures and policies for encouraging its innovation and technological development. Specifically, it aims at analyzing the level of R&D activities performed by the companies, as well as their capacity to acquire and use the knowledge from external sources and to increase the knowledge base itself. In addition, it explores the policy measures that affect the innovation performance of the firms, as well as the possibility to create an economy-wide framework conditions aimed at promoting innovation and technological development.*

**Key words:** Business sector, innovation capacity, Macedonia, technology

**JEL Classification:** O30, O31.

### **Introduction**

Nowadays, knowledge and innovations are considered the key to sustainable competitive advantage in global markets. The research, innovations and technological development are assumed to create high value added products, rising living standard and better quality of life. Hence, the company efforts to improve the competitiveness implicitly involve a continuous, dynamic and cumulative process of knowledge creation and strengthening the innovation capacity. Generally, innovation capacity of the companies refers to their capability to transform the general knowledge into specific one, using their competence and resource [2]. The notion of innovation capability applies to process and product technology, as well as the way in which production is organized and managed. Its importance derives from the fact that it is presumed to contribute to dynamic competitive advantage of companies since it enhances their capacity to keep up with, respond to, and initiate technological change on an ongoing basis [10]. Within the analytical context, the concept of innovations covers a series of interconnected changes hailing from different fields of firms' operations and focus on the possibility to improve their competitiveness and economic efficiency.

Therefore, innovations contain not only an isolated activity aimed at developing new products and processes, but also encompass a set of incremental improvements carried out in various functional areas [4].

In a broader context, innovation activities of the business sector are determined by a number of external conditions and resources. During the last decades, the “big wave” of innovations has increasingly initiated the necessity to estimate the scope they are affected by the policy instruments, taking into account the varieties of influence that ongoing innovations lay on the growth of productivity and the standard of living in different countries. However, one should note that innovating is considered an extremely complex process as it involves a large number of individuals or institutions. Relations among these entities, particularly at the flows of ideas and know-how, have a great impact on results of the innovating process. In other words, although innovations are developed in parallel with time, they have no linear character with the huge number of feedbacks, which, in turn, depend upon the economic institutions creating an environment for innovation. Within the empirical literature, institutions are observed as a set of prescribed rules administering and modeling the interactions among individuals and their expectations. One should therefore consider the institutions for property rights, the regulatory ones, institutions for macroeconomic stabilization, as well as those for social security and conflict management a crucial set of factors that have a direct impact on market [9]. It comes out that innovation capabilities of the business sector has been influenced, to a great extent, by the institutional system and policies providing a favorable environment to commercialize the research results, create innovation culture in all segments of the social life, provide mechanisms directly supporting the innovation activities, and to create a favorable innovation environment. Hence, innovations reflect a process which is quite multidimensional and endogenous, with certain dimensions to be possessed depending upon the location and time.

### 1. Innovation capability of the Macedonian companies – analysis of the current state

The World Economic Forum’s analysis about the national competitiveness suggests that the Republic of Macedonia is ranked among the countries with relatively poor innovation performance. As regard the innovation indicators the company spending on R&D is considered the most unfavorable one (table 1). It reveals that the Macedonian economy is placed at 111<sup>th</sup> out of 139 countries covered by the review. In fact, this ranking in particular, owes to the extremely low expenditures on R&D in the business sector (0,04% share of GDP in 2007). Moreover, the unfavorable conditions in this domain are clearly confirmed by fact that merely 3,3% of total R&D employment are located in the business sector.

Table 1

Capacity for innovation .....	87
12.02 Quality of scientific research institutions .....	71
12.03 Company spending on R&D.....	111
12.04 University-industry collaboration in R&D.....	74
12.05 Gov’t procurement of advanced tech products .....	110
12.06 Availability of scientists and engineers .....	95
12.07 Utility patents per million population*.....	90

Source: The Global Competitiveness Report 2010-2011 © 2010 World Economic Forum

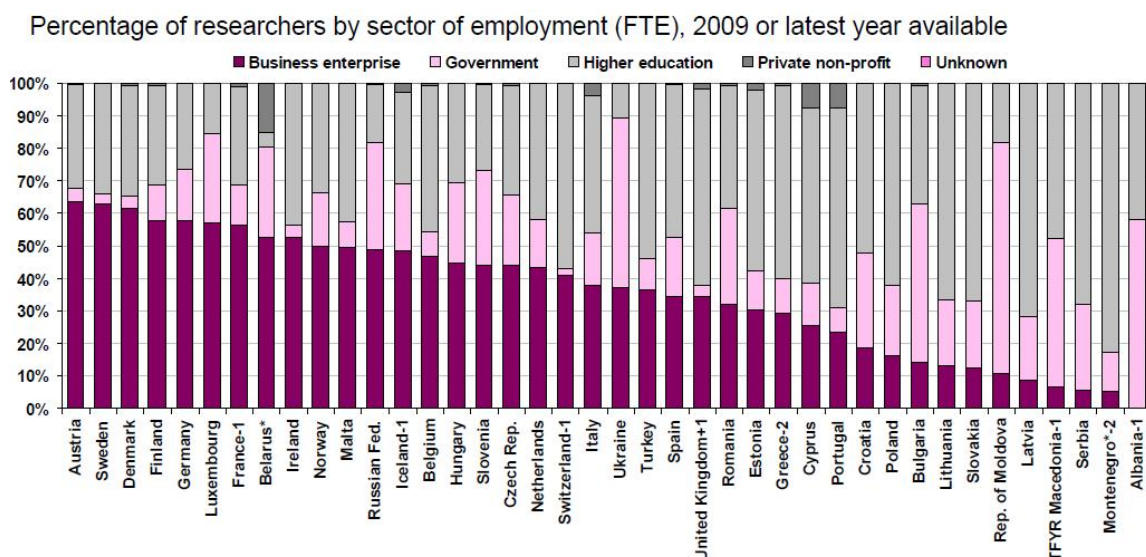
The results obtained from the research usually point toward a high level of correlation between the company size and innovativeness. The small and medium-sized enterprises (SMEs) are the prevailing type in the Republic of Macedonia, i.e. they constituted 99,9% of the companies in 2007. According to the analysis of the European Community one should note the difference between innovations arising from R&D and the non-R&D innovations. In line with the Innovation Scoreboard for the Republic of Macedonia, 11,3% of the total SMEs have created new products and processes, either independently or in cooperation with the other firms. Indicators recording the innovations introduced in the companies point toward a relatively good performance. Namely, 39,2% of the total SMEs have introduced technological innovations (product, services or processes), while 30,8% of the total SMEs have brought in non-technological (marketing or organizational) innovations. In addition, 28,1% of all the firms have completed a more efficient use of the resources (reduced labor cost, materials and energy).

Taking into account the extremely low figures for expenditures on R&D in the business sector, one may note that innovation activities of the Macedonian companies do not stem from the research and development activities. Namely, SMEs do not invest in their own research activities and development of their own technological base (i.e. they do not have their own R&D departments) principally due to the limited financial resources.

Consequently, Macedonian companies have mostly exhibited innovations not coming from research and development. In fact, Macedonia along with Serbia, Montenegro and Albania has the lowest level of researchers engaged in the business sector comparing with the other European countries (figure 1). Currently, most business innovations are incremental in nature, and relate to possible improvement of products and processes. Besides, companies prefer to acquire foreign technology by purchasing machinery and equipment and use the innovation benefits developed in external environment.

Likewise, the reasons for the relatively modest innovation performance derive from the prevailing share of traditional sectors in the production structure. They do not feature high intensity of technological development and implementation of new products and processes. In other words, the industrial structure has been determined for a long time by branches with the price as a main indicator of competitive performance. On the other hand, industrial sectors distinguished by intensive R&D application amount for a low participation in the Macedonian economy. In this context, the research activities have been completed by several companies within the pharmaceutical and ICT sector.

Figure 1



Source: UNESCO Institute for Statistics, Fact Sheet, August 2011 No.13

## 2. Determinants of innovation capability

While assessing the innovation capabilities of companies, one should emphasize the relevance of several factors, such as:

- Financial resources allocated by the companies for R&D. The most important factors limiting the innovation activities of the companies are: inadequate financial resources; lack of substantial financial mechanisms by the Government to improve the innovativeness of the business sector; difficulties to obtain financial resources throughout the bank loans; the other financial opportunities such as joint ventures and EU programmes have not been exploited enough; the concept of “business angels” has not yet been developed in Macedonia, etc. Yet, the Government has promoted the concept of innovation voucher so as to improve the innovativeness of the companies. It implies subsidizing the particular activities in certain amounts.
- Human capital. Education level and skills as the key determinants to generate new knowledge and innovations, as well as to adopt, absorb and apply the existing knowledge and innovations from the business environment. In principle, the firms are increasingly complaining about the shortages of skilled labor.
- 
-

According to recent analyses, graduates lack the necessary technical skills to perform the jobs offered by the employers. In other words, many students do not have the sufficient skills for the required positions - the relevant knowledge, the ability to apply that knowledge, and the know-how to complete tasks and solve the problems. Similarly, graduates lack the necessary behavioral (or “soft”) skills needed by employers, such as job attitudes and teamwork skills [11].

- Innovation infrastructure. During the last decade an intensified activity has been noted in developing the institutional infrastructure to support the innovativeness. The Government's, international organizations', the EU's and the US's financial support has been used to establish: The Agency for promotion of Entrepreneurship of the Republic of Macedonia, 5 regional centers to develop small and medium enterprises, 3 agencies to support the enterprises, Pelagonija Regional Development Agency (PREDA), 10 business incubators, Business Start-up Center in Bitola, 3 agencies for technological development, 17 offices for local economic development, University Center for New Business at the Faculty of Mechanical Engineering in Skopje, Human resource development fund within the Agency for promotion of Entrepreneurship of the Republic of Macedonia and the European Information and Innovation Center in Macedonia (EIICM). However, despite the fairly dispersed innovation infrastructure the problems persist as regards the establishment of mutual cooperation and links into a single network aimed at facilitating the information flows and providing greater support and coordination of innovation initiatives and activities. Moreover, most of the institutions established as a result of international programmes to build innovation capabilities are faced with the problem of normal operation and ensuring the financial sustainability.
- Cooperation between companies and higher education institutions. One may note the lack of cooperation between the business sector and the universities while completing the research projects for the business needs, especially in developing the new products, commercialization of knowledge and development of the innovation management. Merely 9,6% of the total SMEs in the Republic of Macedonia are involved in a kind of innovation cooperation with the public research institutions or other companies.
- Establishing a more intensive interaction with the suppliers, customers, and the industrial associations is also considered an essential factor to strengthen the innovation capabilities. They provide relevant inputs in the process of acquiring new knowledge for their needs and problems, permit the information for new technological solutions and markets, and make the additional input available so as to improve the internal process of learning, such as consultancy, trainings for employees etc. The mobilization of external resources aimed at technological progress is commonly referred to as 'learning by interacting' [5].

### 3. Internationalization and innovation

Internationalization of a certain company activities, i.e. the competitive relationships in world markets and foreign competition in domestic market make a strong pressure for developing innovations and research activities. Open trade and investment regimes are particularly relevant to boost innovations since they permit a free flow of technologies across national borders, opening the markets and increasing the competitive pressures. The enterprises having a more intense cooperation with the foreign ones, as well those to be export-oriented expose a greater propensity to innovations. According to European Commission's research almost half of the companies engaged in international activities have introduced new products and services (the research has been conducted during the period 2006-2008), while one-third has introduced a process innovation [3].

The Republic of Macedonia features a high trade openness that exceeds 80% over the last two decades. This is also the period with more intense liberalization of trade and investment policies. More than evident are the companies' efforts to ensure an effective adaptation to global trends and respond successfully to competitive pressures all through the constant improvement and innovating the products, processes, management and marketing techniques. The relevant studies indicate that improving the innovation capacity of the companies has a great impact on enhancing the ability to export. The success in the world of a global competition implies a leading role in creating and implementing new knowledge. Unfortunately, the analyses evidence a slow and inefficient adaptation of the Macedonian companies to modern dynamics of the global economic changes. The Macedonian companies are mostly oriented towards importing the technology, with a very slight share of those developing and applying their own technology solutions. The reduction of trade and investment barriers has not contributed as much to changes in technological modernization of production and certain improvements in export performance of the companies.

## Conclusions

Having in mind the aforementioned, one may note that innovation capabilities of the Macedonian companies are fairly limited and weak. Hence, the prospective activities have to be focused on improving the current state by introducing the measures to enhance and stimulate innovations. Nowadays, innovation is considered to be a condition sine qua non for successful survival on the global markets. Hence, the Macedonian companies are faced with the imperative to build their competitiveness by offering differentiated and innovative products and services with a higher value added. It certainly implies a strong and visionary management, high-skilled labor, new techniques to encourage the innovation culture, novel organizational methods, transfer of knowledge, technologies, innovations etc. Likewise, the companies have to develop an open and flexible system of innovativeness implying a broad network of interactions among companies, customers, universities, research institutes, etc. The new ideas and technologies are to be generated both from internal and the external sources.

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## WORK MOTIVATION AND WORK SATISFACTION IN THE HOTEL BUSINESS IN MACEDONIA

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### **Abstract:**

*This is a study for Macedonian staff that works in the hotel business in Macedonia. The study investigates the relation of person-organization and confirms that Macedonian employees have very low criteria for work satisfaction. The salary is still the basic factor that contributes to the work motivation. Macedonian employees are motivated from the external factors only and they hardly take any initiative to self-realize and self-actualize themselves. By using a sample of 96 persons, the objectives of this research are to study the differences in work satisfaction and work motivation among managers and employees in the hotel business in Macedonia. Furthermore, the paper investigates the relation of particular factors of organizational behavior to the level of work motivation and satisfaction, analyzing them with the use of the correlational method. The managers in the hotel business in Macedonia have better conditions to satisfy their needs which means that they are significantly more satisfied than employees. However, the results from the t-test that investigates the differences of factors of work satisfaction among males and females presents that the gender is not a significant factor for the level of work satisfaction. Both factors - gender and working place, do not contribute to the level of work motivation. The results of the correlation method between the variables of organizational behavior - work motivation and satisfaction, show that there is a significant statistical association between organizational behavior and work satisfaction. However, the relation between organizational behavior and job motivation was not confirmed. Finally, the results for the level of work satisfaction do not relate to the work motivation, which means that the internal feeling of satisfaction does not relate to the motivation for work. The factors that contribute to these results are the subject of analysis and discussion through this paper.*

**Keywords:** organizational behavior, hotel industry, work satisfaction

**JEL Classification:** D23; J28.

### **1. Introduction**

The relationship organization-person is topic of interest for many researchers in the field of organizational and industrial psychology. The main reason for that is the fact that the organizational life contributes to all individuals without exceptions. People need to control their feelings, needs and developmental tendencies for purpose of achieving the goals of the organization where they are employed. From the other side the formal organizations cannot function without human resources. Therefore, the organizations need to create and implement successful strategies, which will satisfy people's needs from one side and will obtain superior performance and productivity from the other. According to the recent analyses, there is a gap between the organizational and personal needs especially in undeveloped and developing countries. The formal organization nowadays, require from the individuals to be dependent, passive, under control and without perspective. Furthermore, the organizations are using just parts of the individual's knowledge and skills in the circumstances, which are inappropriate for progress, success and satisfaction. The mature employees are against these requirements because they are trying to actualize and develop themselves as a whole, they want to be creative and spontaneous; they want to obtain psychological success which is available only when the organizational goals are in same direction with the interpersonal goals.

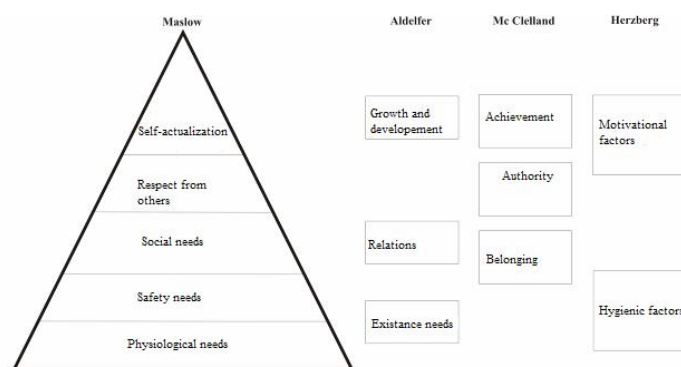
The work satisfaction (WS) and the work motivation (WM) are variables that present the ability of the organizations to accomplish a big percentage of predicted goals and in the same time to have successful and productive employees. These variables are sum of specific factors that are causing, canalizing and directing the organizational behavior in certain direction.



Those factors contribute to the dedication and commitment to the organization as well as on the psychological success, health and security of the employees. The work life is composed of many processes that influence the organizational behavior on many different ways that are explained best in the theories of human nature (according to the Shein, (1970), there are at list four different views for the nature of the human beings: humans as rational- economic beings, humans as social beings, humans as beings that want to self-actualize and human as complicated beings) as well as in the theories of WM. There are many theories of WM that explains the factor that motivate the employees as well as the process of motivation. Often, the theories of WM are separated in two different groups: content theories and process-oriented theories. Through the literature, the most cited content theories of WM are: Theory of hierarchy of needs of Abraham Maslow; Two factorial theory of Frederick Herzberg; Theory of Douglas McGregor; ERG model of Clayton Alderfer; Theory of needs of David McClelland. From the other side, the most famous process oriented theories of WM are: Theory of expectations of Victor Vroom; Theory of goals setting of Edwin Locke and Theory of fairness of Stasy Adams. In Figure 1 are presented the main differences and similarities of content theories of WM.

The WM in hotel business is very important factor since the employees are in direct contact with the clients which means that the employees directly influence the level of customer satisfaction. The motivation is a mental process that directs the goals of the employees and contributes to his/her behavior, skills and capabilities for self-realization. From the other side, WM is determined from the personality, attitudes, knowledge, competences as well as the personal and cultural values.

Figure 1: Comparison of content theories of motivation



WS is a variable that is often explored within the research on motivation in the workplace as well as in relation to work dimensions such as autonomy, stress, working conditions, material incentives etc. One of the first studies for WS was done by Frederick Herzberg and his associates. In 1959, Herzberg did a research which was the groundwork for the two-factorial theory, in which WS and work dissatisfaction are not polarities in one and the same dimension, hence they are independent and come from two different groups of factors separated in two different groups as negative (hygienic) and positive (motivational):

- Negative factors that cause dissatisfaction: physical working conditions, leadership, interpersonal relations, salary, work insurance, other benefits, organizational politics and other factors that contribute to the context of working.
- Positive, motivational factors that increase the WS: responsibility and development, love towards the job, self-realization, success from working and other factors that are important for satisfying the need for self-actualization.

In 2005, Rizoska conducted a similar survey in two Macedonian organizations. The survey included 70 employees who filled out a questionnaire for measuring the quality of working life. According to the results, the most important factor for the level of WS among Macedonian employees is salary which is hygienic factor. It means that Herzberg theory has not been confirmed in the population of Macedonian employees. The fact that hygienic factors are on the highest level of the list of factors that contribute to the WS has been confirmed in the studies of the working atmosphere in Former Yugoslavian organizations as well as in the research of Sokolovska (2002).

From the other side, numbers of studies that investigate the WS present the relation of this variable to interpersonal relationship among people, personal characteristics of employees and life satisfaction as a predictor or a consequence of WS. In the survey of Witt and Nye (1992) , the relationship with the superiors was more important for the level of the satisfaction than fair treatment. Furthermore, according to the results of their studies, males and females do not differ in the level of WS despite the fact that women have a lower position in the hierarchy of organization as well as lower salaries. As a conclusion, women have lower expectations or they do not have a tendency to compare themselves with other women that also receive lower salaries than men. Hence, they underestimate what they offer as employees. Finally, women appreciate interpersonal relationships at work more than money.

Since, hardly any study assesses the work position and gender in relation to WM and WS, the aim of this study is to explore that relation. The work position is specific sum of work assignments that require certain skills, education, qualification, abilities etc. Furthermore, according to the work position, employees have specific duties, certain level of responsibilities and authority, and the possibilities for development, promotion and autonomy. Depending from the work position, employees are different between each other because they have different roles in the organization, different needs and different possibilities for satisfying those needs. According to Bojanovic (1988), managers are considering needs for security, self-confidence and social needs as less important than the higher need for self-actualization (Maslow's pyramid of needs ). In addition, according to Guzina (1980) the managers that are on higher level of management positions have less fulfilled need for self-actualization than the managers on lower and middle positions where this need is the most fulfilled.

## 2. Research Method

For the purpose of conducting this research, the authors developed a questionnaire for measuring the WS, WM as well as the Communication in group and Education and growth as selected variables of the organizational behavior by using the combination of questions from Work Preference Inventory , Minnesota Satisfaction Questionnaire and Leader Behavior Description Questionnaire. The purpose of the study is to investigate the differences in WM and WM among managers and employees and males and females in the hotel business in Macedonia. Furthermore, the authors research the correlation between WM and WS as well as the relation of these two variables with the particular factors of organizational behavior by using the convenience sample of 96 respondents. The 62 male and 34 female participants work in 40 hotels in Ohrid, Struga, Mavrovo, Skopje and Tetovo-the Republic of Macedonia.

### 2.1 Research Model

Figure 2: Research hypothesis and variables

### 2.2 Results and discussion

The assumption that there is a significant connection between WS and WM was not confirmed. Although there is a positive relation between these two variables as it can be seen in the Table 1, still the relation is not statistically significant. According to these founding the factors that contribute to WM are not the same factors that contribute to WS. The results of the WM of the groups of participants divided by gender and work position (Table 2 and 3) present that the groups does not differ significantly. This is not the case for analyzes of the scores for WS where the differences of the arithmetical means among the managers and employees are significant. These results are in compliance with the expectations that a higher level on the work scale allows higher level of satisfaction from work life.

Table 1: Table presentation of the correlation analysis of WS and WM

Correlation		Work Motivation
Work satisfaction	Pearson correlation	,153
	Sig. (2-tailed)	,137
	N	96

Table 2: Results from the differences between the arithmetical means for WM and WS among managers and employees

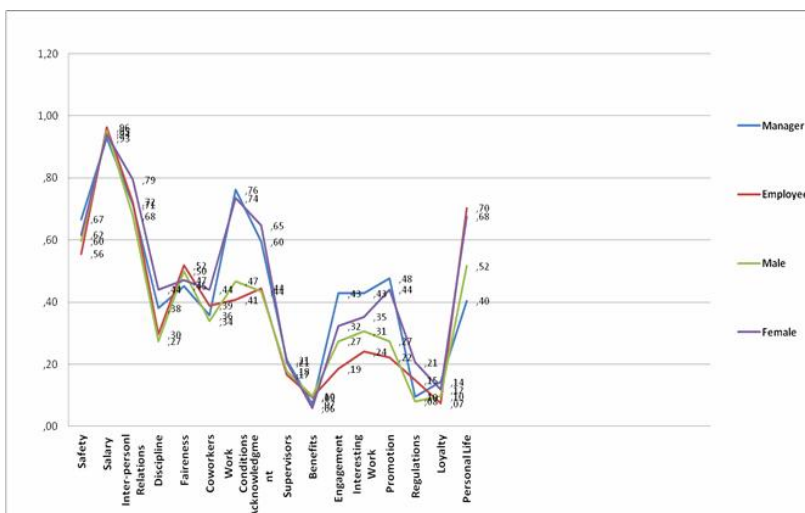
	Work position	N	M	Ä	äD	D	F	df	z	p
Work satisfaction	Manager	42	3,31	,715	,110	,754	7,533	94	3,781	,000**
	Employee	54	2,56	1,127	,153					
Work Motivation	Manager	42	7,74	3,548	,547	1,368	,002	94	1,852	,067
	Employee	54	6,37	3,620	,493					

Table 3: Results from the differences between the arithmetical means for the variable WM and WS among male and female

	Gender	N	M	Ä	äD	D	F	df	z	p
Work satisfaction	Male	62	2,77	1,137	,144	-,314	3,651	94	-1,430	,156
	Female	34	3,09	,793	,136					
Work Motivation	Male	62	6,44	3,624	,460	-1,506	,207	94	-1,971	,052
	Female	34	7,94	3,498	,600					

Furthermore, from analyzes of the individual factors of WM presented in Figure 3, there are statistically significant differences among managers and employees for the factors: Work conditions, Engagement and Promotion. These founding confirms the differences between managers and employees in the hierarchy of needs. Regarding the differences between the arithmetical means of the individual factors of WM between men and women the results present that the factors Work Conditions and the Acknowledgment are significantly different. This is in line with the research results from the study of Witt and Nye (1992). Regarding the results for the selected variable of organizational behavior, Education and growth, the authors confirm the expectations that managers differ significantly from employees. It means that their perceptions for the importance of knowledge, education, personal growth and development are changing in line with their position in the organizational hierarchy.

Figure 3: Results from the differences of arithmetical mean for each separate factor of the variable Work Motivation among male and female and managers and employees



Interesting fact in this research is that the variable Education and growth is related to the WS, however, this variable is not related to the WM. The process of learning bring personal feeling of happiness and fulfillments, however it does not motivate the person to work more or better. As it can be seen from the Figure 3, the highest factor for motivation in all groups of the participants employed in the Macedonian hotels is the salary. The highest needs are present and can bring satisfaction; however, since the basic needs are not fulfilled they are still the basic motivational factors in Macedonian organizations.

The results from the analyses of the researched groups of participants shown that the variable Communication in group (Table 4) is very important factor for the employees employed in Macedonian hotels since the results of the scores of the participants in all groups are high above the average ( $\bar{X} = 4$ ). For the variable Communication in group, the differences of the arithmetical means among the groups of participants separated by gender and work place do not differ, however, the relation of communication in group and WS is statistically significant. Furthermore, there is not significant correlation between the scores of the variable Communication in group and WM. Again, we can confirm that different factors contribute to the level of WM and WS.

Table 4: Results from the differences between the arithmetical means for the variable Organizational behaviour (Communication in group and Education and growth) among managers and employees

	Workplace	N	M	$\bar{X}$	$\bar{d}$	D	F	df	z	p
Communication in group	Manager	42	3,64	,692	,107	,272	5,933	94	1,383	,170
	Employee	54	3,37	1,121	,153					
Education and growth	Manager	42	4,21	1,180	,182	,751	,360	94	3,497	,001**
	Employee	54	3,46	,926	,126					

Table 5: Results from the differences between the arithmetical means for the variable Organizational behaviour (Communication in group and Education and growth) among male and female

	Gender	N	M	$\bar{X}$	$\bar{d}$	D	F	df	z	p
Communication in group	Male	62	3,37	1,044	,133	-,335	6,575	94	-1,645	,103
	Female	34	3,71	,760	,130					
Education and growth	Male	62	3,66	1,101	,140	-,368	,138	94	-1,574	,119
	Female	34	4,03	1,087	,186					

Table 6: Table presentation of the correlation analysis of WM and WS for the variable Organizational Behaviour (Education and growth and Communication in group)

		Work satisfaction	Work Motivation	M	$\bar{d}$
Education and growth	Pearson correlation	,412**	,174	3,79	1,104
	Sig. (2-tailed)	,000	,090		
	N	96	96		
Communication in group	Pearson correlation	,427**	,004	3,49	,962
	Sig. (2-tailed)	,000	,966		
	N	96	96		

General conclusions from this research that may be applied for other organizations on the territory of R. Macedonia are the following:

- The salary is still the basic factor that contributes to the work motivation. Macedonian employees are motivated from the external factors only and they hardly take any initiative to self-realize and self-actualize themselves.
- The managers in the hotel business in Macedonia have better conditions to satisfy their needs which mean that they are significantly more satisfied than employees.
- The gender is not a significant factor for the level of work satisfaction. Both factors - gender and working place, do not contribute to the level of work motivation.
- The results for the level of work satisfaction do not relate to the work motivation, which means that the internal feeling of satisfaction does not relate to the motivation for work.

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## THE EMPLOYMENT AND WAGE STRUCTURE CONNECTION IN ALBANIA, AND THEIR IMPACT ON THE STANDART OF LIVING

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### **Abstract:**

*The transition from planned economy to market economy has shown a powerful effect on key variables of the labor market: employment and wages. On the one hand wages are regulated by changes in relative supply and demand of different groups of employees. On the other hand, the redistribution of labor, an important element of economic restructuring is led by changes in the relative wages. Thus, the evolution of the wage structure, acts as an important signal of the labor market. The economic development has improved the structure of wages steadily over time and this shows that the wage structure is not rigid, but is a category that undergoes a dynamic change. Given that the income from wages constitute the bulk of income of workers, then they jointly determine the absolute and relative standard of living. So, wages have an important economic and social function. The aim of this paper is to determine the kind of connection between the wage structure and the employment structure in Albania, in order to evaluate the economic and social function of wages. Based on official data published by INSTAT and other official sources of information in Albania, this paper addresses the discussion in three main directions. First, it analyzes the evolution of the employment structure during transition in Albania, second, it analyzes the evolution of the wage structure during transition in Albania and third, it determines the impact of wage and employment on the Standart of Living in Albania. Interesting implications are explored for public authorities and policy makers to understand better this connection, in order to find new solutions for improving the standard of living in Albania.*

**Key words:** wage, employment, labor market

**JEL classifications:** J31, J21, J40

### **1. Introduction**

The transition from planned economy to market economy, has shown a strong effect to the key labor market variables: employment and wages. On the one hand, wages are regulated by changes in relative supply and demand of different groups of workers. On the other hand, the reallocation of labor, an important element of the economic restructuring, is led by changes in relative wages. Thus, the evolution of wage structure acts as an important signal of the labor market. Given that income from wages make up the bulk of income of the employees, they jointly determine the absolute and relative standard of living. So wages have a significant economic and social function.

### **2. The employment structure evolution during transition in Albania**

In many transition countries, employment is affected by the passage of the economy and its exit outside the agricultural sector and public sector, two sectors that have been very important in terms of employment. With the transition, in Albania, the economic activity has shifted from the public sector to the private sector, but did not come out from agriculture. The percentage of the private sector in GDP in 1990 was 5 percent, while in the years that have followed has grown steadily. However, the industrial structure is not transformed to the degree that has happened in most other countries of the region. The de-industrialization brought the fall of the share of industry in GDP by about 20 percent and services increased by the same amount. But the share of agriculture is approximately at the same level. Should be taken into account the fact that the transfer of economic activities towards services has not led to an increase in employment in that sector. Despite the growth of the sector in recent years, this growth has not led to the opening of new jobs in recent years.

Within the structure of employment by sectors are noticed significant changes during the transition period. While in 1995 the employment in the state sector was 33 percent, in 2005 this sector constitutes 16 percent of the total number of employees, as a result of privatization reforms developed in this sector, while the non-agricultural private sector employment tends to increase. This sector reaches 33 percent of the total number of employees in 2005, related to about 10 percent in 1995.

**Table 1. Employment by sector in percentage (year 2005)**

<b>Public sector</b>	16 percent
<b>Private agricultural sector</b>	51 percent
<b>Private non-agricultural sector</b>	33 percent

Source: Publication of Ministry of Labor, Social Affairs and Equal Opportunities, "Employment 2005"

At the end of 2005 the number of employees was approximately 932 thousand people. Most of the employees worked in agriculture (50.5 percent). A part of the employees worked in construction and transport (12.7%), trade (11.6 percent), followed by industry (7.1 percent).

The high percentage of employment in agriculture shows that Albanian society remains still a rural population, despite the large movements to the urban areas.

Employed women constitute 37 percent of the total employment. The analysis of employment levels in years, shows that during all the period 1993 – 2005, the employment rate of women has been significantly lower than that of males. This difference continues to be maintained at the same level. Differences between male and female employment levels are more obvious in the non-agricultural private sector, where the number of employed women is only 25 percent.

If we compare this data with the year 2010 data presented below, we note a growth of more than 2 percent of employment in the public sector, a reduction of more than 6 percent of employment in the private non-agricultural sector and an increase of more than 4 percent of employment in non-agricultural private sector.

**Table 2. Employment by sector in percentage (year 2010)**

<b>Public sector</b>	18.3 percent
<b>Private agricultural sector</b>	55.1 percent
<b>Private non-agricultural sector</b>	26.6 percent

Source: INSTAT; Ministry of Labor, Social Affairs and Equal Opportunities, 2011

The employment structure in the transition years shows that work in the private agricultural sector reached its peak in 2002, with 71.2 percent of the total employment, to go down then to 55.1 percent in 2010.

If we consider the structure of employment for the past four years by sector, in the following table there is a downward trend of employment in the agricultural sector, while there is an increasing trend in the private non-agricultural employment.

**Table 3. Employment structure by sectors (15-64 years)**

(in percent)

	2007			2008			2009			2010		
	M	F	Total	M	F	Total	M	F	Total	M	F	Total
<b>Public sector</b>	15	15.5	15.2	18	18.7	18.3	16	17.6	16.7	18	18.6	18.3
<b>Private agricultural sector</b>	36.7	60.4	47.2	33.3	55.8	43.4	33.2	56.5	43.2	48.2	62	55.1
<b>Private non-agricultural sector</b>	48.3	24.1	37.6	48.7	25.5	38.3	50.8	25.9	40.1	33.8	19.4	26.6
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: INSTAT (A.F.P. 2009), Ministry of Finance, 2011

Thus, the share of non-agricultural private sector has been increasing and this is followed by a decline in the share of private agricultural sector and state sector.

What is noticed is that the private agricultural sector employs about 55.3% of the total number of employees in Albania. This sector provides about 18% of GDP, while the share of this very important sector in budget spending, accounts for only 2.1% (for the year 2010).

The structure of employment by the major sectors of the economy and by sex, for the last years reflects the fact that women employed in the private agricultural sector continue to occupy the highest percentage. Under this structure, the percentage of women employed in non-agricultural private sector in 2010 decreased, in comparison to 2009.

If we refer to the employment structure by the economic activity, presented in the table below, we note that during the year 2010, the employment in the construction sector represents 7.9 percent of the total employment compared to 9.9 per cent it accounted for, in 2008. While there is a change in the structure of employment in terms of the group: Agriculture, Forestry, Fishing where, as shown in the table below, the percentage of employees in the agricultural sector has declined from 47.9 percent in the year 2007 to 44.1 percent in the year 2009 and is increased again in the year 2010.

<b>(in percent)</b>				
	<b>Year</b>			
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Agriculture, Forestry, Fishing</b>	47.9	44.7	44.1	55.1
<b>Industry</b>	10.5	9.4	10	7,6
<b>Construction</b>	8.1	8.4	9.9	7,9
<b>Trade</b>	11	11.7	10.8	8
<b>Transport and telecommunication</b>	3.7	3.6	3.7	4
<b>Other services</b>	18.8	22.2	21.5	17,4
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: INSTAT (Labor Force Survey 2009); Ministry of Finance, 2011

Over the past decade, Albania has experienced economic growth as a result of the shift of resources from agriculture to services and construction sector. Construction and services have been the main contributors to the economic growth, and they currently represent more than 60 percent of GDP.

<b>Year</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Agriculture</b>	58	58	58	59	58	58	48	45	44	55,1
<b>Industry</b>	8	8	7	8	8	8	11	9	10	7,6
<b>Construction</b>	5	5	5	5	5	5	8	8	10	7,9
<b>Services</b>	21	21	21	19	18	19	23	26	22	18,3
<b>Other</b>	8	8	8	9	10	10	11	12	14	11

Source: INSTAT 2011

Based on the above data, we see a continuing shift of labor force from agriculture to other sectors (from 58 percent in 2001 to 45 percent in 2008), like industry, construction and services, which have been growing slightly but with a positive effect on the overall productivity<sup>358</sup>.

<sup>358</sup> The Data of INSTAT are based on LSMS study, which show the decreasing employment figures in agriculture during the period 2002 – 2008.



However, agriculture remains the dominant sector, accounting for 18 percent of GDP and about 45 percent of employment in recent years, which means that there are still opportunities to increase the overall productivity and production, through incentives in agriculture and facilitation of the continuous movement of the workforce between sectors.

Concerning the informal sector, we can say that it occupies a significant portion of the labor market, but this sector is not included in the structure of employment. For this sector we can't have accurate data, but it is completed an analysis based on individual employment records and data on non-farmer family enterprises. It is estimated that about 10 percent of employees in Albania, work as a non-farmer family venture or as employees who work on their behalf. The informal sector in Albania is higher in urban areas (24 percent) than in rural areas (5 percent). Almost three-quarters of the individuals in the informal sector are employed for at least three years and about 10 percent of them are involved in the informal sector for more than 10 years.

With the closure of industrial enterprises and the restructuring of the economy, for the first time since 1992, is introduced the concept of self employment, with an increasing tendency from year to year. Nationwide, about 63 percent of people considered employed, are self employed and only 37 percent are paid employees. Self-employment in Albania are mainly family businesses, mainly commerce and inherited family craftsmanship. 62 percent of employees are full-time employees and 39 percent part-time employees, while full-time employed are more males (70 percent) than women (51 percent). Those who work full-time (75 percent), are more highly educated individuals, compared with employees with secondary education (73 percent), and those with low education (55 percent). Self-employment remains the main type of employment in the country, almost two-thirds of employment are self-employed free of payment in non-agricultural enterprises and agriculture, and one of third are wage employees. An absolute majority of individuals are self-employed in agriculture (MLSAEO 2010).

### 3. The wage structure evolution during transition in Albania

According to albanian Labour Code classification, the wage is composed by basic wage and allowances of a permanent nature, in the form of wage complements or wage supplements. In the basic wage are included fixed payments based on employee training, capacity and competence at work, working time and professional skill polyvalences.

Given that the basic wage is only a part of the total wage that an employee can benefit, other allowances are added to the basic wage, considered as wage complements and wage supplements. Wage complements vary for different countries and different companies. They are classified into different forms and relate to the labor difficulties and employment characteristics, risk at work, delegation of authority, personal behavior, night labor, Sundays, holidays or official holidays, sustainable jobs or circulating teams, seniority complements, dedication to work as well as the year-end holidays. According to the employer's obligation to pay, complements are distinguished in law (compulsory by law to be implemented) and free complements (not obligatory by law to be implemented). By the manner of expression we distinguish: monetary and non-monetary complements; complements that benefits all the staff and selective complements. In terms of bonus supplements, which are payments given to employees for achieving a specified result, are distinguished the payments that are calculated on the basis of partial results and fees that are calculated on the basis of the overall result<sup>359</sup>.

The difficult macroeconomic position of the country at the beginning of the transition from centrally planned, to the market economy, brought out the need for far-reaching reforms including wages, as well as in other Eastern European countries. Wage reform in Albania was based on the tax system and applied in two variants: first, through the direct control of the wage fund of the enterprises and secondly, by controlling the average wage of the enterprises. The first option is applied during 1991 - 1992, and is replaced by a second version in 1992 and later. Given the target inflation, wage system reforms in Albania are determined by the difficult economic situation of the country, political solutions and the lack of the legal framework. The changes in wage policies, such as the way of determining wages, wage increases and adjustments are associated with the introduction of new laws. The implementation of a new liberal strategy and a new legislation on wage policy, began during 1991, with an average wage increase of 50%, despite the negative impact on macroeconomic variables. With the new law on state enterprises, is limited the autonomy of the state enterprises in all sectors. Their competences in the determination of wages, in determining the number of employees, bonuses and individual wage levels and the minimal wage approved by the Council of Ministers were defined by law. The limits on wage level were removed. For the first time, the determination of wages in non-budgetary enterprises was done separately, without being affected by budget enterprises. They began to set wages based on the number of employees of each and based on the agreements with the trade unions. In this unstable economic environment, the monopoly position of some enterprises, the continuing pressures of the trade unions to increase wages and to liberalize them, soon led to inflationary factors. To overcome the pressures, the government regained some control over wages, deciding to apply a national monthly wage growth and at the same time it was determined a minimum wage and a maximum wage in the ratio 1 to 4 and it was limited the basic wage for the enterprise executives.

<sup>359</sup> Ceni, A. (2007)

For the first time, with the above changes, the public sector wage system was differentiated from the private sector wage system. In the public sector, ministries determined the average wage for each enterprise under them. In July 1992, companies were allowed to cross the median wage up to 5%, without sanctions. They could increase the average wage by 30% but only by meeting certain criteria, including the regular payments of the state taxes, the regular reporting of the funding sources, regular financial statements, etc..

The further decline in the industrial output in 1993, and the increased social pressure, fostered the need for increasing the flexibility. For this reason, the companies with a good performance were allowed to raise the ceiling allowed in 1992 with 5% - 20% and then, in the middle of 1993, with 30%. In 1995 these figures reached 70%, leading to further decentralization signals. In many cases, these benefits sharing schemes led to increased motivation and productivity of employees, and in some less profitable enterprise they had negative effects. The effect was also seen to the movement of the skilled workers from the public to the private sector, where profits were higher and wage differentials were larger, which belong to the restructuring process which necessarily is accompanied by privatization.

The economic development has improved the wage structure steadily over time. It shows that the wage structure is not rigid, but it is a category that is subject to a process of dynamic change. The above supplements, has been initially applied only to a limited number of enterprises. Given that the competition increased in the labor market, other companies created complements and supplements that were often artificial and arbitrary. In these circumstances changed the concept to express the wage that earns an employee in "complete wage" and not in "basic wage". This is proven by the studies on wages which indicate that wage income are complete income and not just basic wage.

Since the complete wage that takes an employee consists of complements and supplements too, as we have noted above, during the transition period there have been changes in this part of the wage structure. Depending on the kind of work, employees can take advantage of supplements which were given to achieve a determined result, which can be partial such as the sales commissions or overall, such as the participation in the fiscal profit. We also mentioned some criteria by which are classified the complements. Among the law complements we can mention the paid annual holidays, which currently under the law are not less than 4 calendar weeks and which are paid as normal working weeks. The payments for the work during holidays are not less than 25% added to the allowances during a normal working day, the second shifts are paid not less than 20% extra and night shifts are paid with not less than 50% extra. The additional hours during a normal working day, are paid not less than 25% of daily allowances and during official holidays or holidays with not less than 50% extra. In all the above cases, we may have compensation with the equivalent amount in days or hours off. In cases of work difficulties, are given complements to compensate for the difficulty, ranging from 5% - 20%. In the managerial functions, these complements vary from 5% - 30% over the basic wage, depending on the wage grade. For a specific nature of work and in special working conditions, the complements are defined by law, e.g. individuals who are in contact with convicted of a crime or the mentally ill persons, receive an additional payment of 5,000 ALL per month added to the basic wage. Complements of elderly, are currently at 2% after each year of work up to 25 years and are calculated on the wage of the group they represent. Among the complements of social character benefited by all the staff, are the payments of maternity and other social benefits, which have been in constant attention of the governments.

The social security reform has been a necessary aspect and one of the constant challenges of the governments. Through this system, are handled about 1/6 of the country's population. In addition to mandatory social insurance, voluntary and supplementary insurance schemes are created. Now, it is permitted the foundation of private social security institutions. However, the social security system suffers from a number of problems. Despite the rather low level of retirement payments (despite the frequent increases), the social security system is significantly subsidized by the state budget. The number of retirees is greater than the number of contributors. The percentage of participants from the private sector and especially from rural areas is very low. The social security contribution fee is considered high. The retirement payments have increased by 49 percent to 135 percent, according to the categories during the recent years. Specifically, the retirement payments in the urban area, shifted from 8350 ALL during 2005, in 12840 ALL during 2010, calculated as an increase of 53.8 percent. Minimum retirement payments in the rural area have been increased by 100 percent, while maximal retirement payments have been increased by 70 percent. Retirement payments in the city increased by 42 percent, while the payment of disabilities increased by 54 percent. In total, the average increase in the urban area was calculated by 54 percent.

The unemployment payment program aimed at mitigating the economic and social consequences of unemployment. The economic assistance program, funded by the state budget, aimed at helping low-income families or families with no incomes. During the year 2000, in the framework of this program are handled 150,114 families. The level of assistance varies, depending on the conditions of the families being treated with this kind of help, but in any case, it does not exceed the 250 percent of the unemployment payment. The number of the families benefiting from this program has decreased, while the budget has been increased. In comparison with 1993, in 2000 the number of beneficiary families is reduced by 2 percent, while the annual economic aid budget is increased 2.6 times. In 2008, the funds for the economic assistance amounted to 3.5 billion from 2.6 billion, or 34 percent more than in 2007. The economic assistance, for the first time, in July 2008 was indexed at 10 percent. This measure resulted in alleviating poverty.

The average aid per household in 2008 doubled compared with 2007. In this process were reassessed better the incomes from land and livestock for the families in rural areas, in order to determine the real extent. The average level of the economic assistance for families in 2008 rose to 3000 ALL compared to 1800 ALL in 2007, or 50 percent more. In 2010, the average level of the partial economic assistance was 3,150 ALL, while the full economic aid level was 3,900 ALL and the funds amount was 4.2 billion ALL. The state has shown the figures of the number of households that would be excluded from the aid scheme starting from 2010 until 2013. For 2010, it was predicted that the total number of beneficiaries of this aid must be 80,000 households. In 2011, as defined by the Labour Department, there would be even less beneficial to this scheme, whose total number would reach 74,000. It is predicted a more stable economic aid scheme in the years 2012 and 2013. In this time period is predicted the number of beneficiaries to be 70,000 each year, which means that the movements in the scheme will be reduced. In opposite to the number of welfare recipients, it is projected to be increased the size of this social charge. Thus, by 2013, it is proposed that the amount of economic assistance per family must tend in achieving the poverty level indicators per person, but within a ceiling limit that does not exceed the level of the minimum pension in the country. The monthly amount of the economic assistance will continue to be calculated in accordance with the structure of the family, differentiated for different groups of its members, depending on the characteristics of the poverty. The minimum and maximum limit of the financial assistance will be determined each year by the Council of Ministers, subject to the minimum pension growth rates in the urban area of the country, the economic progress and the budgetary resources. For the year 2010, the maximum level of assistance was 7500 ALL/month per household, while the minimum was 1,000 ALL/month for the partial economic assistance. According to the Ministry of Labour, the increasing of the amount of coverage to the needs of poor families, will be achieved by increasing budgetary funds that will be transferred to the economic aid program and by the reduction of the number of families, benefiting from the scheme, as a result of the economic growth. The economic aid program, suffers from nonconsidering the specific situations of the poor families, from a non balanced regional diffusion, from its simple passive character, from a low level of monitoring, etc..

The social care program aimed at supporting and integrating disabled individuals, the protection of orphaned children and the elderly alone. The number of people who have benefited from this program has been increased. However, the program fails to cover all the categories of people who need the services it provides and the network of relevant institutions fails to cover all the areas of the country. There is still much to be done to improve the quality of social care for the vulnerable groups.

#### **4. Employment structure and wage structure relationship and their impact on the Standart of Living in Albania**

The concept of standard of living is a concept that generally refers to the mode of living which is decided by the quantity of goods and quality of goods and services consumed by the average family of a particular group. Everyone chooses to have certain goods and services and of these, there will be necessities, comforts and luxuries of life. The quality and quantity of these goods consumed depend upon his income, his attitude towards living habits etc. Some factors which affect the standard of living are: Firstly, it depends upon the level of income of the people. There is a direct relation between the income and the standard of living which a person enjoys. Higher the income, larger the volume of goods and services which one can consume. Secondly, the standard of living depends upon the availability of goods and services in the country. When the money is not sufficient to procure goods and services, the money loses its value and there is no use for such money. The standard of living depends upon the wisdom with which people spend their money income. The governments of modern days are seriously inclined towards increasing the standard of living of the masses by increasing production and effectively distributing for the consumption of people. Planning and public expenditure are carried on for creating employment and income for the people.

Wages in general vary along with GDP, as a result of supply and demand shocks associated with the economic reforms. At the same time, changes in supply and demand for different jobs, along with changes in the institutions that determine wages have undermined the existing wage structure<sup>360</sup>.

When wages are determined largely by market forces, rather than by administrative decisions, they should be adjusted to reflect changes in labor market conditions. Looking at the wage structure in the system left behind, one can expect a return on the enhancing of skills in the labor market and as a result, an increase in the income inequality. This means that in transition, will benefit some groups of employees, e.g. those with better skills and will be damaged several other groups, with lower skills, in the labor market. This increase in inequality will be associated with implications in the poverty level. In the relative position of the low paid workers, the deterioration in the context of real wages decline, means that this category is lost in relative terms and in absolute terms.

<sup>360</sup> Redor 1992

The economic liberalization has led, among other things, at the decentralization of wage setting process in the most competitive markets too. The private sector developments have introduced competing ways of setting wages. The low level of wages in the budget sector is due to the high number of employees. At the same time, the increase in unemployment in this sector relates to the gradual increase of wages. In this context, a policy of low wages may lead to a delay in the restructuring process, particularly in the public sector. The state sector restructuring can be accomplished by increasing the efficiency by reducing the number of employees and by increasing wages for the employees who will continue to work in this sector.

According to the performance of wage structure during the transition period, the growing inequality is reinforced too, by changes in the working conditions and other forms of remuneration, in addition to the basic wage, which are part of the wage structure and that characterize all the economies in transition<sup>361</sup>. The wage differentials by level of education are also increased, where we can mention the labor market returns as the effect of the level of education, training, computer skills, etc.. These indicators are part of the market demand for skilled employees. With regard to workers without higher education, two indicators that have been influential in determining the wage structure, were age and experience, but this difference has recently been narrowed considering the labor supply in recent years, for both sectors, public and private. The demographic distribution and the occupational groups, also played a significant role in determining the wage structure. In view of all these elements, have changed the stable and transitory components of the wage structure. According to Gottschalk & Moffitt (1994), these are the reasons leading to instability of wages. But how are these changes in the wage structure related to the employment structure? Changes in the labor market in general favor the most qualified, who have a direct effect on improving the wage structure as their requirements grow with increased capabilities. Although this impact is attributable to a long period of time, the relationship between the structure of employment and the wage structure is evident, since wage increases can have direct impact on employment. Their both positive impact on the standard of living is seen in some main directions: First, there has been a substantial reduction in poverty, second, there has been a significant growth in real per capita consumption and third, significant improvements are observed in access to basic services, but there are still problems in terms of quality.

## Conclusions

As the living standard in Albania remains still low, one of the most difficult tasks to accomplish is to create an active labor market and to create incentives to promote growth. Although there are serious efforts to make the system more efficient, the proper balance is still unclear. Unemployment might be considered as a strong determinant in the living standards and level of poverty in Albania. Decreasing unemployment through active labor market policies, and managing with domestic and international migration, remain important targets for the government in the future. A proper social safety net program and an active social protection scheme is expected to continue since the vulnerability of Albanians to the transitional costs is higher. There are still many unsolved problems to face concerning living standard implications during the transition period in Albania. Taking into consideration differences among areas and groups of people, progress to date is very encouraging as a growing number of Albanians improve their economic situation.

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## UNEMPLOYMENT AND THE RELEVANCE OF THE SOCIAL WORK NORM IN ALBANIA

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### **Abstract:**

*In the modern welfare state, people who cannot make a living usually receive financial assistance from public funds. Accordingly, the so-called social work norm against living off other people is violated, which may be the reason why the unemployed are so unhappy. If so, however, labor market concepts based on the notion of promoting low-paid jobs that are subsidized if necessary with additional payments would appear far less favorable. For many countries, unemployment is one of the most pressing social problems. In the ongoing debate on the most promising policies in this context, economic advice focuses mainly on the real wage and its determinants. In line with the classical labor market model, in which wages above equilibrium levels lead to a labor surplus, the point is made that falling real wages can stimulate the demand for labor and reduce unemployment. However, even if not induced consciously by a particular labor market concept, large low-wage sectors are a reality in a number of countries. In contrast, there is widespread consensus that the community should ensure the minimum income needed to exist, at least for those who are not simply refusing to work. Given these facts, it is not surprising that, for many labor market economists, the design of low-wage sectors is seen as a fundamental economic challenge. It could be that people are employed, but still unhappy. Using Albanian data, this paper examines the relevance of the social work norm and finds a significant disutility effect of living off public funds. Although this is true for employed people as well, the results show that the individual is generally better off having a job that requires additional assistance, than having no job at all.*

**Keywords:** *Unemployment, Social benefits, Labor market policies, Social norms, Well-being.*

**JEL Classification:** *JO, J38.*

### **Introduction**

In the current economy employers can force anything onto any employee, take benefits away or otherwise abuse the employee. Where is the employee going to go? There are hundreds of people that are lined up ready to take my position. Even worse is the fact that our jobs are all going overseas where you can literally have six people in India for the cost of a single salary in the U.S. My company uses this and the threat of termination so much that it is part of the corporate culture: "The offshore people work 15 hours a day and all weekend," implying that we should all do the same. In less than two years they have quadrupled healthcare co-payments, taken away most of our vacation time, forced us into a much longer commute and told us we aren't working hard enough. Some would say, if you don't like it, well then leave. But realistically where can you go? How many of your readers are surfing the job boards every day to no avail? Remember the days, not so long ago, that you called a recruiter and they found you a job? Try to get a recruiter to call you back these days. Most of them are searching the job boards and posting positions that they weren't hired to recruit for in the hope that they will get a commission out of it. And, when you do talk to a recruiter, their suggestion is "have you tried the job boards?" It is so frustrating. I know there are SO MANY people MUCH worse off than me, but what about all of the people like me?

There have been so many times that I just wanted to quit, but I can't. I have a wife and kids and a mortgage and my working wife's income alone can't sustain us. I work for a manager who is arrogant and stupid; how do you reason with someone like that? He wants no negative input and only wants to hear "yes". How can corporate America afford "Yes Men/Women"? Even worse, how can they afford to have someone running multiple departments leaving a path of destruction in their wake?

There are many of us out here employed and I believe more miserable and stressed out than some people who are unemployed. And what is going to happen to companies who abuse their work force like this when the economy does get better?

For many countries, unemployment is one of the most pressing social problems. In the ongoing debate on the most promising policies in this context, economic advice focuses mainly on the real wage and its determinants. In line with the classical labor market model, in which wages above equilibrium levels lead to a labor surplus, the point is made that falling real wages can stimulate the demand for labor and reduce unemployment. However, even if not induced consciously by a particular labor market concept, large low-wage sectors are a reality in a number of countries. In contrast, there is widespread consensus that the community should ensure the minimum income needed to exist, at least for those who are not simply refusing to work. Given these facts, it is not surprising that, for many labor market economists, the design of low-wage sectors is seen as a fundamental economic challenge. Typically, proposals are based on the notion that individuals earning less than the subsistence level should receive additional payments from public funds. This financial support can be paid directly or indirectly, such as via tax credits. Yet, although such concepts have indeed been implemented in some cases, the viability of the economic advice is often refuted. Laymen and researchers, mostly from non-economic disciplines, are skeptical of supplementing earned income with taxpayer money. The disagreement over how to arrange the labor market is surely related to the particular perspective. Traditionally, economists have a rather pecuniary view, but rarely distinguish between different kinds of income, although the number of researchers refuting the notion that “income is income” (Moffitt, 1983, p. 1024) might be growing. Indeed, if people aim at earning their own living, so as to avoid depending on others, they do in fact distinguish between different sources of income. The corresponding belief that it is not right to live off public funds, which induces pressure to earn one’s own living, is referred to as the social work norm and has been introduced to economics over the past years. In reference to the philosopher and social scientist Elster (1989a), this social norm against living off others has been used primarily to explain the occurrence of multiple unemployment equilibria. Economic researchers, such as Stutzer and Lalive (2004) or Kolm (2005), argue that regional unemployment interacts with the pressure on the affected individual to comply with such a norm, resulting in “weak norm” and “strong norm” communities, with correspondingly different levels of unemployment. Apart from this argument, however, the relevance of the social work norm to labour market economics and policy-making has not yet been considered comprehensively, despite the important implications to be drawn simply from its existence and the probable consequences of people suffering psychologically from a dependency on benefits.

While happiness research has shown convincingly that unemployment makes people unhappy, researchers have not yet answered the question of why this is so (Winkelmann, 2009, p. 429).<sup>3</sup> Therefore, one of the research objectives of this paper is to find out whether unhappiness from not conforming to the social work norm is the true reason for unemployment-induced disutility.<sup>4</sup> Hence, if there is a norm-induced impact on well-being, demonstrating the relevance of the social work norm, the next step is to compare both potential sources of unhappiness with one another, that is unemployment and benefit dependency. Furthermore, if non-conformity also exerts a happiness-reducing impact on employed people, this would have strong implications for labour market concepts based on the notion of promoting low-paid jobs that are subsidised if necessary with additional benefits. It could be that people are employed, but still unhappy.

### 1.1 Social work norms and their relevance.

Economic analysis has so far neglected social norms, although they are important in explaining many social phenomena. On the labor market, for instance, unemployed people’s behavior may be influenced by a social norm to work and a strong social work norm may inhibit the emergence of a welfare culture. Thus, social norms may contribute to the understanding of moral hazard in social insurance or the puzzle that unemployment rates display large unexplained regional variance.

In this paper, we analyze the role of a social norm to work in the individual duration of unemployment and in unemployed people’s subjective well-being. In line with the literature, the social norm is defined as “a behavioral regularity; that is [...] based on a socially shared belief how one ought to behave; which triggers [...] the enforcement of the prescribed behavior by informal social sanctions” (Fehr and Gächter, 2000). Unemployed persons are supposed to be sanctioned by social pressure from other members of their community and feel internal pressure to comply with the norm to work. This norm is documented back at least to the apostle Paul’s letter to the Thessalonians, quoted at the beginning of this section. More recently, Elster writes: “There is a social norm against living off other people and a corresponding normative pressure to earn one’s income from work” (1989: 121).

The social norm to work is expected to affect individual behavior and well-being in a simple way. Individuals may differ with respect to their belief whether it is right or wrong to live off public funds, such as unemployment benefits. Suppose that communities are populated to a different extent with individuals holding the attitude that it is wrong to live off public funds. Thus, one may distinguish two extremes: 'weak norm' communities, in which a large proportion of the inhabitants believe that it is right to live off public funds and 'strong norm' communities, in which a large proportion of the inhabitants believe that it is wrong to live off public funds.

The main payoffs off unemployment are unemployment benefits and leisure time. Leisure time is not valued in itself, but is best viewed as an essential time input into the activities that can only be undertaken during non-working hours (Becker, 1965). Arguably, these leisure activities are to a large extent social. If individuals choose to undertake *less* social activities with people who violate their belief on how one ought to behave, unemployed people will not enjoy leisure to the same extent in strong norm communities as in weak norm communities.

As a consequence, unemployed people's efforts at job searching, as well as the probability that they accept a regular job is higher in strong norm communities, when compared to weak norm communities - all else being equal. Moreover, unemployed people, who have not yet found a regular job, are systematically less satisfied with their life in strong norm communities than in weak norm communities. While progress is being made in including social norms into economic models, systematic empirical evidence is still rare. For an empirical analysis of the effects of norms, a measure of a person's beliefs about how one ought to behave is required. So far, research mainly relies on observed group behavior as a proxy for the group's norm. However, this is not satisfactory, because a group may behave in a similar way even in the complete absence of social norms. Moreover, the channel through which social interactions affect behavior is often unclear and it is not possible to distinguish between social pressure and alternative interaction like imitation, learning or getting help. In this paper, a novel measure for the strength of the social norm to live off one's own income is applied that directly captures people's belief about appropriate working behavior. We consider citizens' beliefs as reflected in actual political decision-making in a country-wide referendum on the level of benefits to be paid out to unemployed persons in Switzerland. The public discussion that took place before the vote, and the quantitative analysis conducted after the vote, suggest that the proportion of voters in favor of reducing unemployment benefits in a community can be taken as a proxy for the strength of the belief that it is not right to live off public funds. The voting measure of the strength of the social norm to work can be used to test whether social norms are a determinant of the duration of unemployment and subjective well-being, along the lines outlined in the previous paragraphs. However, this inference is difficult, because social work norms are formed over time and are thus endogenous. In particular, there is the possibility of reversed causation: in structurally lagging regions, where poverty and high unemployment prevail, a weaker work norm may have developed. We address these possibilities of an endogenous social norm to work in a specific setting. Suppose that the strength of the prevailing social norm to work depends both on the state of the labor market in the region, as well as on individuals' work ethic. Differences across labor market regions in the voting proxy for the norm thus reflect both differences in labor market conditions and differences in the strength of the social norm to work. Cross-regional differences can therefore only be informative to a limited extent regarding the effect of social work norms on job searching. Therefore, we apply a stratification approach to control for *unobserved* regional differences in labor market prospects that might simultaneously affect citizens' voting behavior, as well as unemployed people's job opportunities.

The issue of social norms has long been ignored by economists. Yet, over the past decades, skepticism towards their relevance and measurability has diminished, so that social norms have found their way into theoretical models (e.g. Akerlof, 1980; Lindbeck, 1997; Azar, 2004; Sliwka, 2007) and into a series of empirical investigations (e.g. Goerke and Pannenberg, 2004; Heinemann, 2008; Torgler et al., 2009; Halla et al., 2010), including studies using experimental methods (e.g. Fehr et al., 1998; Alm et al., 1999). Since interdisciplinarity and behavioral approaches have become common practice, increasing numbers of economists feel uneasy about leaving the issue of social norms to other disciplines such as sociology. Although there is now a large and continuously growing body of economic research, the measurement of social norms remains a challenge.

The New Palgrave Dictionary of Economics (Young, 2008) characterizes social norms as customary rules which affect the behavior of individuals and thereby coordinate social interactions. This can lead to uniform behavior within social groups, the more the rule is established and the more people expect others to conform. Since these expectations and the establishment of rules are in most cases very different, the adherence to norms often varies substantially between social groups. Elster (1989b) characterizes social norms similarly, pointing out that they must be shared and sustained by other people, through their approval and disapproval, as well as by feelings of embarrassment, anxiety, guilt and shame in the event of norm-violation.



Without doubt, a variety of social norms are potentially relevant to many different sectors of the economy, including the labor market. In his article on the significance of social norms to economic theory, Elster (1989b) lists a number of examples. As an instance of a work norm, he defines a behavioral regularity that Stutzer and Lalive (2004) refer to as the social work norm: “There is a social norm against living off other people and a corresponding normative pressure to earn one’s income from work.” (Elster, 1989a, p. 121) This particular phenomenon was introduced to economics in the mid-1990’s to explain multiple equilibria, mostly in the labor market. The argument is that there are regional differences in unemployment levels, which correlate with normative pressure to conform to such a norm and thus the varied degree of adherence to it. If more people violate the norm of earning one’s own income, such emotions as embarrassment and anxiety should decline, because it is more socially acceptable to live off public funds. As stated above, people tend to conform to informal rules when they expect their peers to do so as well. Depending on the level of norm-conformity, social interactions in a specific region determine the conviction that people should earn their own income and therefore, in turn, determine the non-pecuniary costs of failing to comply with the social work norm. Since the regional strength of norm adherence also affects unemployment levels, this relationship contributes to explaining different unemployment equilibria in otherwise similar communities (Kolm, 2005).

### 1.2 Social work norms, unemployment and social protection in Albania.

Social protection of categories of persons in need is carried out through three core programs, aiming at poverty reduction:

1. Economic aid program;
2. Program for persons with disabilities; and
3. Residential and community services program on individuals and groups in need.

The above programs are implemented in national level and funds are covered through central budget allocations.

#### Legal and institutional framework

- Law no. 9355 of 10 March 2005 “On Social aid and services”
- DCM no. 265 of 28 April 2005 “On the adoption of the sectoral strategy on social protection 2005-2008”.
- DCM no. 80 of 28 January 2008 “On the adoption of the sectoral strategy on social protection, 2007-2013”.

Article 27 of the abovementioned law no. 9355 provides that the Ministry of Labor, Social Affairs and Equal Opportunities is the responsible authority for the drafting policies, legislation, programming of economic aid funds, payments to persons with disabilities and social services, norms and standards of services provided, as well as their implementation in all levels, central and local, public and private sector.

The State Social Service is responsible for implementing policies of the Ministry of Labor, Social Affairs and Equal Opportunities, in the area of aid and services of social care on:

- Programming and control of state funds on economic aid, payments to persons with disabilities and social services;
- Implementing standards and services and proposals for review and adoption of new services;
- Compilation of a unified documentation for the applicants for social services. The Law provides for detailed responsibilities of local government units, municipalities and communes, namely through their respective Councils and social administrators in the process of identification of individuals and groups in need and adoption of funds for the purpose of social aid.

**Social economic aid program** consists of a program of transfers in cash, in financially assisting families without income, or with non-sufficient income. The program is fully financed from the state budget and it is provided on basis of social and economic assessment of living means of the concerned families. It is unlimited in time and it may consist of a full or partial financial aid.

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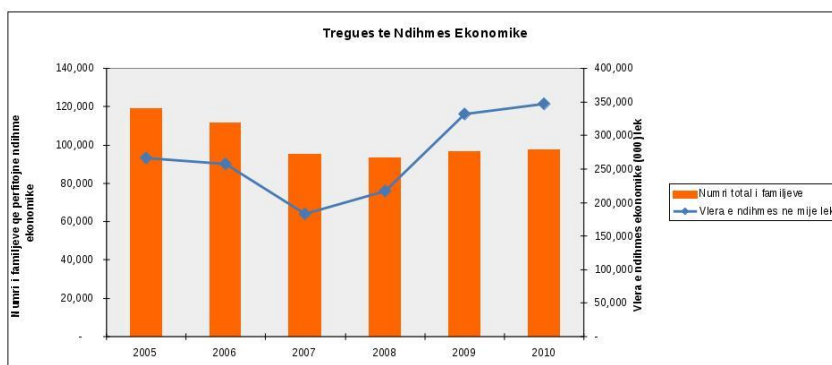


The government has created the necessary legal environment, in order that municipalities and communes take more responsibilities in conditioning the distribution of economic aid with relevant labor and services in community. The DCM provides for the criteria and procedures to be followed in conditioning economic aid with relevant labor and services to the community. With the implementation of this scheme, abusive cases of the economic aid have been discovered and subsequently set out.

**Table 1 Project Budget, the number of the family in NE , and the average benefit for person.**

Year	Funds In milione leke	Nr of the family in Asistence	The average monthly benefit for family Leke	The average monthly benefit for person Leke
2007	2600	114000	1890	406
2008	3600	93000	3226	693
2009	4800	85000	4706	1010
2010	5700	80000	5931	1274
2011	6800	74000	7686	1650
2012	7200	70000	8508	1827
2013	7600	70000	9115	1957

Burimi: Ministria e Punës, Çështjeve Sociale dhe Shanseve të Barabarta, 2012.



**Tab.2 The index of Economic assistance in Albania**

Open Data Albania have done a research on the number of the family that take economic assistance in Albania, based in INSTAT data and Ministry of labor, Social Affair and Equal opportunities.

As can be seen by the graphs in Albania during 2010 have benefited financial assistance 97,540 family, and the average financial assistance fund in all the country was 347.465 leke in one month.

The data show a decrease in the number of the families benefited from economic assistance compared with 2005 and 2006, but a growing trend during three last years. While the social assistance fund has been steadily increased beginning from 2007, and compared with 2009 this fund is increased with 5%.

Based on these data, results that during 2010 Shkodra district has the biggest number of the family in economic assistance, 15.433 family or 15.8% of all the family in assistance in Albania.

- Economic aid funds are allocated by the beginning of each year from the state budget to the relevant municipality/commune as conditioned grants.

- Local government units have the necessary legal basis to support poor families from sources such as local taxation budgets, setting on specific criteria.

In parallel with enlarging responsibilities of local government in identifying families in need the decentralisation process has been accompanied by an extension of limits of economic aid for specific social groups, such as:

- Parents of children born together as triplets, quadruplets, quintuplets, or more receive supplementary aid.
- Orphans from 18-25 years not under custody and unemployed orphans more than 25 years receive a special aid from the scheme.

The opinion of the Society of Municipalities and Communes has been taken into account while drafting the relevant legislation on social aid and services.

**Payment program for persons with disabilities** is based on the assessment of disability of persons. The disability is assessed from specialised medical commissions. Relevant funds for this purpose are transferred from the Ministry of Labour, Social Affairs and Equal Opportunities to the local government units, which carry out payments for these social categories.

Currently the number of persons with disabilities is 69 thousand, out of 38 thousand in 2003, which is an indication for a better social inclusion in the scheme. The scheme also includes treatment of 45 thousand labour invalids, bringing the total number of persons with disabilities covered by the scheme to 120 thousand persons, supported with transfers from the state budget. This category of persons represents 3.6% of the total population of the country.

**Residential and community services program** offers relevant services for children of persons with disabilities, youth, women and elderly. During 2007-2008 residential services were decentralized. Thus, 19 out of 26 residential services were transferred to local government units. Every year the Ministry of Labor, Social Services and Equal Opportunities transfers relevant funds for covering these services. In addition 43 community services in 8 regions were established under authority of local government.

**The cost and the coverage of the programs**

The NE Program is national wide and is covered by the state budget.

The economic assistance is a monthly salary for the families and is calculated on bases of the family members. The dynamic of reimbursement of the funds for the economic assistance and the number of the families benefiting from that is presented in the table no.1.

As it is seen starting from 2008 and up to 2013, the funds programmed for the social assistance is increased whereas the number of the families involved in this scheme decreases. This is because the evaluation of poverty rate is based on the Survey of Poverty LSMS of 2002, 2005, meantime we are expecting the results of 2008 from INSTAT. According LSMS- 2002 the absolute poverty population lived with less than 2 dollars per day making up the 25% of 820 thousand inhabitants.

In 2005 (LSMS) the level of poverty reduced to 18.5 % or about 592.000 inhabitants.

This means that 126 families were involved in NE scheme. Actually the number of peoples living with less than 2 dollars per day is 437.000 or at about 93.000 families.

The reduction of poverty is a result of the good management of the work of the municipalities and as a result of the incomes from the businesses, lands, stocks, and others. The establishment of the inspectorate of controlling these programs has assisted the reduction of poverty as well.

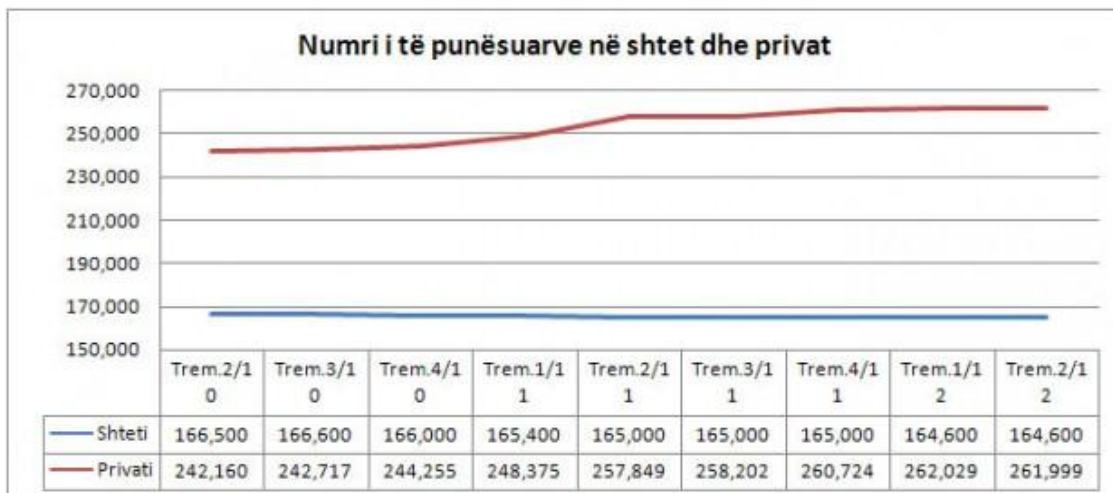
### 1.3. Unemployment in Albania.

The most recent official data of INSTAT, shows that in the fourth quarter the unemployment index in Albania was 13.29% , compared with 13.23 % that it was in the first quarter. Always referred to INSTAT, the number of the unemployment people in December 2011 was 142.950 or more than 900 people in the third quarter. In fact and the number of the employment people is increased with 2500, during the period October – December 2011.

But these increase is less than the increase in the labor force, which rise in 1 million 75 thousand people compared to one month ago that was 1 million e 72 thousand. These had done that the unemployment index, that is calculated as the ratio between the number of the unemployed people and the labor force, continue to increase.

Albania actually has 165 thousand people employed in the public sector and 260.7 thousand in the private sector non- agricultural. While the lion's share is held by the agricultural sector, where our government calculate every farmer that have in property a agricultural land, like employ. Consequently the agricultural sector employs actually 54.3% of all the employment people in Albania, a index, that is among the highest of the European Union and in many cases is interpreted with suspicion not only from the independent experts, but and from the European Union institutions. The tables below shows better the situation of unemployment in Albania.

**Tab. 3 The number of the employed in the public sector and in the private sector**



**Tab.4 The table below shows the difference between the population in working age, that there are employed and the unemployment**



	Popullsia në moshë pune	Të punësuar	Diferenca
2000	1,939,000	1,068,000	871,000
2001	1,773,000	919,810	853,190
2002	1,767,000	920,140	846,860
2003	1,826,000	926,000	900,000
2004	1,850,000	931,200	918,800
2005	2,003,000	932,100	1,070,900
2006	1,917,000	935,000	982,000
2007	2,101,000	939,000	1,162,000
2008	2,126,000	974,000	1,152,000
2009	2,146,000	899,000	1,247,000
2010	2,166,000	917,000	1,249,000

• Sipas Bankës së Shqipërisë – 3 Shkurt 2012



### Conclusions and further research

The empirical results demonstrate that the social work norm is more than just a theoretical construct and that there is every reason to consider norm-effects, not only in labor market economics, but in policy-making as well. Especially in constructing labor market concepts that are based on supplementing low-paid jobs with additional benefits, it is imperative to take account of such a norm, because it is clearly not the case that income is just income. All in all, however, norm-induced disutility caused by the failure to earn one's own income, is not the major reason why the unemployed are so unhappy. In this regard, the social work norm has only limited explanatory power, so that unemployment-induced unhappiness is obviously determined mainly by other factors. Therefore, it must be concluded that individuals are generally better off being employed rather than unemployed, even when in the former case the norm against living off public funds is violated. Yet, from a policy perspective, this major finding is certainly not sufficient to fully assess large-scale programs like the German Hartz concept, although it might be reason enough for the staunch proponents.

In fact, it is generally true for one individual, that it is better to be employed and subsidised by additional benefits, than it is to be unemployed. However, other relevant effects of instruments aimed at bringing unemployed individuals into subsidised employment must be considered as well.

First, it is important to note that not everyone who has a low-paid job and is eligible for social benefits would otherwise be unemployed. An increase in size of the low-wage sector will not thus produce only profiteers, but also people who are worse off. From the findings of this study, it can be concluded that such low-income earners would at least suffer from failing to conform to the social work norm. In addition, the regression results indicate changes in the impact of norm-violation, due to the implemented policies. In the economic literature, it is argued that various factors potentially determine norm strength, i.e. norms might change at least in the medium term. As described above, the determinant is located mainly in regional communities, but there are many other potential “norm senders” (Lindbeck and Nyberg, 2006, p. 1474), such as legislation. In the present paper, it is argued that social norms generally exist, but it is the level of conformity that changes, so that, at different periods of time (e.g. before and after significant legislative changes) or in different regions (as investigated in other studies) individuals have different motivations to follow such an informal rule and accordingly are sometimes more, and sometimes less concerned about norm-violation. The empirical results show that, since the implementation of the policy reforms, the significant disutility effect of living off other people has at least been reduced for the unemployed. Probably reinforced by the political debate, this reduction in normative pressure on the unemployed to earn their income from work, can certainly be linked to the policies designed to make benefit receipts more common, through promoting subsidised low-wage jobs. Since non-governmental institutions, such as unions, may also act as norm senders, it is interesting to note that, in the political debate in Germany, the argument has routinely been brought forward, that it is not right to have full-time workers in need of social benefits. The results indicate that, since it is being discussed publicly, the combination of full-time employment and benefit receipts has indeed a negative connotation, as if a self-fulfilling prophecy has come true.

Regarding the assessment of labor market policies, the identification of the various impacts on well-being is certainly important, but, in order to draw useful conclusions, it is necessary first to know which utility impacts are desirable and which are not. One might argue that, if people suffer from something, it should be opposed. Motivation, on the other hand, even if the result of dissatisfaction, could be regarded as socially beneficial, especially when it is about terminating unemployment and avoiding benefit receipts.<sup>20</sup> Social norms encouraging such behavior are attractive, at least from a fiscal point of view, when governments would otherwise have to spend large amounts of money to create identical incentives. In addition, research on intrinsic motivation has identified further problems of extrinsic pecuniary incentive schemes (see Frey and Jegen, 2001). Hence, there are good reasons for a society to foster social norms, although norm-violators may suffer from stigmatisation. On the other hand, norms may lose their relevance or power over time. For example, changing economic conditions may make it difficult or even impossible for people to comply with a particular social norm, so that adherence might even become obsolete.

Although hard to achieve in practice, ideally, there is considerable societal consensus as to the social norms that should prevail. Applied to the issue of labor market policies, there are two distinct paths. One is that wages are above the subsistence level and people are pressured by a broadly accepted social norm to earn their income from work. For the second path, where there is a significant low-wage sector, there is no real benefit from a social work norm as defined here. If a large low-wage sector is not regarded as a social problem, but as something that is inevitable or even desirable, then there is a need for concepts that combine low-paid employment and additional governmental support. In this context, Fehr and Falk (2002, p. 711) examine a “management of social norms” and discuss how norm-guided behaviour can be enforced. For instance, they argue in favour of clarity with regard to the messages conveyed by the implemented incentive scheme. Applied to the matter on hand, labour market policies should then all the more target the creation of jobs above subsistence levels, through, for example, implementing union-friendly legislation, insofar as this is the preferred path. The development of promising labour market models that consider such issues as norm-guided behaviour and stigmatisation is a task for economic researchers. In some cases, these aspects have already been considered, which will hopefully be expanded and extended by further theoretical and empirical research on labour market concepts.

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## MARKET PRO POOR APPROACHES (M4P) STRATEGIES TO STIMULATE RURAL DEVELOPMENT

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### **Abstract:**

*This paper aims to explain how strategies of M4P influence local products positioning and competitiveness including improvements of economic situation in rural areas.*

*The methodology used is Participatory Market Chain Approach (PMCA), which is a participatory R&D method for promoting pro-poor market chain innovation together with market chain actors and supporting R&D organizations. This methodology was first developed and applied in Peru and Bolivia by Papa Andina Initiative together with its local partners as a means to contribute to sustainable poverty reduction in rural potato producing areas.*

*Based on a structured and facilitated participatory process, PMCA gradually generates interest, trust and collaboration among market chain actors and supporting R&D organizations, as a mean to stimulate pro poor innovations. With its three 3-phase structure, PMCA has proven to be flexible and applicable in different contexts, having great impact potential in settings where crops grown by poor households are targeted and boosted through different type of innovations, including the development of new products, new technologies, and new institutions. In order to ensure optimal impact with tangible out-comes—adding value to both consumers and actors involved in the PMCA process—excellent process facilitation is required from R&D staff trained in the method and having good social skills, research and marketing knowledge.*

*At the end of this research work we found that development of Albanian brands may help producers to differentiate their local products, create competitive advantage in the market, arising from consumers demand toward these brands. As a final result of this research work a new local brand named “Albanian guarantee” was developed. This brand promotes Albanian products from different regions of the country through respective labels. Albanian Guarantee is a labeling system with clear rules for production and marketing, ensuring consumers to access high quality products from different regions of Albania. Albanian Guarantee helps consumers to access products that generate important income in rural areas of the country, thus contributing importantly to rural development and the safeguarding of typical values. Although, this research has been applied in Food and Agribusiness industry, we believe that these finding can be very useful for other industries that are base operations in local production.*

**Key words:** PMCA, rural development, competitiveness; research.

**JEL Classification:** O16.

### **1. INTRODUCTION**

Despite recent years of economic growth, poverty persists in Albania as a result of continuing low employment and low-income levels, particularly in rural mountain areas, and it reflects the unequal pattern of economic growth. Many small-scale farmers lack access to market outlets for their produce, particularly in mountain areas. Without outlets, farmers cannot increase their incomes and standards of living.

Their problems are compounded by a scarcity of market information, lack of compliance with food hygiene and safety standards and inadequacies in packaging and labeling, which make their products uncompetitive. Many farmers, asserting reactive, post-communist individualism, are skeptical of the potential benefits of more formal business collaboration, such as member-run marketing and trading associations (co-operative scar).

SASA (Sustainable Agriculture Support in Albania) is a development project financially supported by Swiss government and implemented by FiBL research institute in Switzerland through a local office in Albania. Main purpose of the project was to improve economic situation of rural population in the country. From 2001 to 2009 SASA project was implemented through 3 main stages. Last phase of SASA project, from 2009-2011 kept same goals and partners from previous stages, but it broadened focus from “pure” organic to organic and traditional products and shifted approach from production-oriented to market-oriented. Nevertheless, the biggest change comparing with previous stages of the project was introduction of new implementation methodology, PMCA (Participatory Market Chain Approach), which completely changed project’s organizational setting and roles of previous project’s actors. It enabled developmental and actor driven approach to the intervention limited a role of partners and FiBL to the back-stopping one and replaced classical PMU with PMCA Unit.

Lack of necessary infrastructure, small scale agribusiness sector, lack of marketing tools and policies have influenced on low prices received by local producers, non competitiveness, and limited export opportunities. One of the first issues that had to be considered was focusing on the products values transmitting tradition (Albanian consumers are very sensitive toward their tradition and history), typical elements, quality etc. Referring to the consumers’ preference, all these elements should be visualized using best marketing models and promoted to consumers. To achieve this, all rural actors had to work together according to one of the Market for poor (M4P) approach: PMCA methodology. As a result were developed two regional brands representing values of north and south Albania.

## 2. APPLIED METHODOLOGY

The Participatory Market Chain Approach (PMCA) is a participatory R&D method for promoting pro-poor market chain innovation together with market chain actors and supporting R&D organizations. It was first developed and applied in Peru and Bolivia by the Papa Andina Initiative together with its local partners as a means to contribute to sustainable poverty reduction in rural potato producing areas. Later it was applied in Uganda to validate its concepts and consolidate the methodological guidelines developed so far in the Andes. Currently it is being applied in Indonesia and Columbia.

Based on a structured and facilitated participatory process, PMCA gradually generates interest, trust and collaboration among market chain actors and supporting R&D organizations, as a mean to stimulate pro poor innovations (see figure below). With its 3-phase structure, PMCA has proven to be flexible and applicable in different contexts, having great impact potential in settings where crops grown by poor households are targeted and boosted through different type of innovations, including the development of new products, new technologies, and new institutions. In order to ensure optimal impact with tangible outcomes—adding value to both consumers and actors involved in the PMCA process—excellent process facilitation is required from R&D staff trained in the method and having good social skills, research and marketing knowledge.

Phase 1: Identification of actors and market opportunities

Phase 2: Analysis of market opportunities

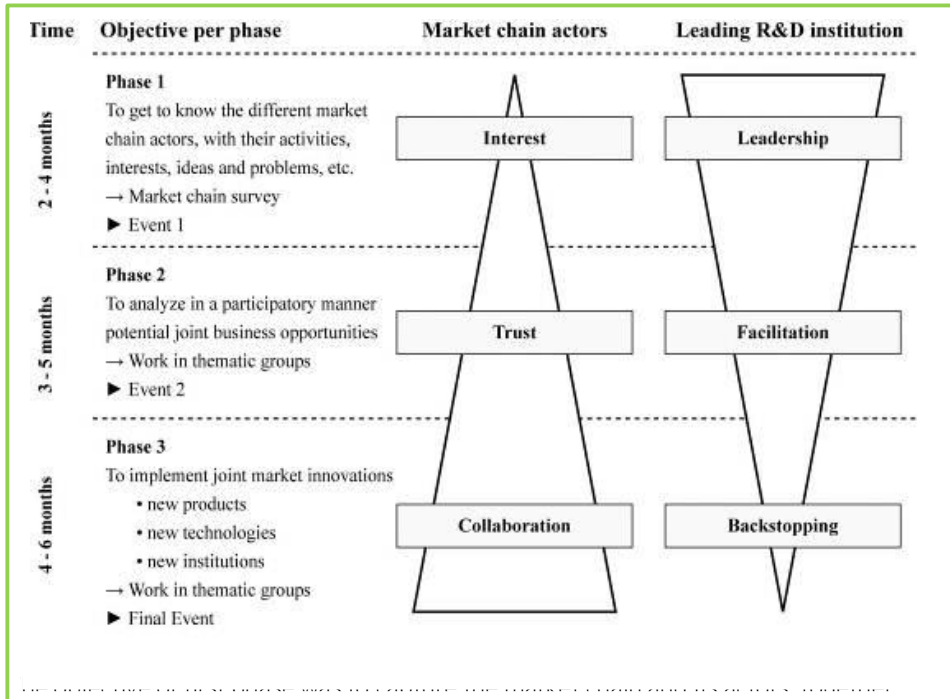
Phase 3: Implementation of joint innovations

During the first phase are identified main actors including traders, retailers, producers, development agencies and consumers. At the end of this phase a qualitative research study is presented to all actors. Research tools used include: face to face interviews, selection through impact filters, market chain sketch.

The second phase consists on tools such as rapid market appraisal, quantitative market research and focus groups research.

The third phase tools are related more with marketing concepts development and business plans.

**Figure 2.1** Participatory market chain approach methodology: Structure and objectives of the 3-phases of PMCA<sup>362</sup>



with their interests and problems, and to identify the market opportunities based on the interest of the stakeholders involved and interviewed. In order to achieve this, a rapid assessment of the market chain was conducted. As a first step taken was the identification of the crops, areas and labeling schemes. Results of this assessment have shown that on the domestic market the biggest impact on the objective achievement could generate vegetables and typical (traditional) products, while opportunity in the export would be highest for medical herbs and mushrooms. In addition, the findings from this activity are used to define which actors of the value chain should be interviewed. As a second step taken was the identification of actors to be involved in the interviewing process. The objective of conducting the interviews was to identify the market chain actors with their activity, interests and problems as well as identifying opportunities for each market chain. Adopted sample (39 interviewees list) consisted mainly of traders and processors since they are the nearest actors to the market, followed by producers and institutions supporting the agriculture and marketing development field. Sampling and survey took a regional character and was more general, in order to represent the Albanian market in whole. Results of the survey and Phase 1 in generally are presented on the final event, on which attended 79 representatives of the most important market chain actors, major stakeholders and partners, as well as of the governmental institutions, other projects and different development agencies that support agriculture and food-processing sectors. The main purpose of the gathering was to identify real market opportunities through joint brainstorming process and to create synergies among the actors for future thematic group work. It was result of the survey's main findings, which clearly opted for typical regional products as an opportunity on the domestic market and organic products as a main export opportunity. Because of that, it was suggested to create three Thematic Groups (Typical Products from North, Typical Products from South and Organic Export) for further development of above mentioned opportunities.

<sup>362</sup> Bernet T., Thiele G. and Zschocke T., 2006. Participatory Market Chain Approach (PMCA) – User Guide. International Potato Center (CIP) – Papa Andina, Lima, Peru

The objective of second phase was to discuss and analyze market opportunities in each Thematic Group (TG). There have been organized nine meetings for each Thematic Group, having a variable participation according to the specifics of each meeting. Out of total 49 actors involved in a work of North TG, an average number of meeting participants was 15, while of 60 members of South TG on the meetings participated average 19 actors. Since there are different products identified with market potential for north and south, thematic groups have been divided into smaller working groups, common market opportunity oriented. Issues discussed in the meetings relate mainly to identification of needs, problems and bottlenecks for each value chain; elaboration of a common label for north and south region respectively; elaboration of marketing concepts for different products; sharing information on market researches, promotion activities such as fairs, open days, focus groups and cost analysis effectuated by PMCA facilitators on demand of TG actors themselves and as a consequence of common decisions taken in respective groups. As a result of these performed activities, products with market potentials were selected coming down to a products' short list for each TG:

- *For North TG:* home-made pasta (jufka), goat cheese from typical goat, forest fruit (hazelnuts, chestnuts), honey, fruit jams, mushrooms, teas, dried fruits & vegetables, olives.
- *For South TG:* seasonal and winter vegetables, dairy products (cheese, butter, milk), olives and olive oil.
- *For both groups:* the concept of a traditional restaurant, offering traditional cooked dishes.

Through the work of the Exporters TG around 50 actors have been directly involved in PMCA process, but there are hundred farmers which have been affected from the process through other activities and from the increase of quantity of raw material demanded from the exporters. Organic Exports TG has in total 8 meetings discussing different opportunities common for the whole TG like preparations for Biofach 2010, promotional activities websites for the exporters, KASH fair and Summer Day in Elbasan presentations etc. Since this TG was also divided on different working groups based on market opportunities, other meetings are held based on specific opportunities analyzes like chestnuts, olive oil, medicinal herbs, special herbs etc.

On May 2010, PMCA held the second Final Event which was corresponding the second phase of PMCA methodology. During this event, participants have presented all analyzes and research conducted during this phase respectively for three thematic groups North, South and Organic Exports.

This phase was aimed to the implementation of market opportunities and innovations identified and analyzed in the previous phases. The objective of Phase 3 of the Participatory Market Chain Approach was to implement the work plan formulated in PMCA Phase 2, developing the proposed innovations proposed by each thematic group. These innovations are presented and launched in the Big Final Event 3. Through joint work of the PMCA team and respective Working Groups, have been developed concept documents related with specific products, which aimed to stimulate implementation of market innovation and opportunities by minimizing identified weakness through value chain. Other important activities held during second phase have been related with promotion of organic and Albanian typical products (KASH fair, Biofach, Summer Day etc). During the third phase about 160 actors (60 actors in North TG, 58 in South TG and 40 in Exporters TG) have been involved in different improvements in production and marketing of more than 26 products.

Main common issue for local thematic groups of North and South was drafting of Albanian Guarantee standard. Based on different surveys and researches conducted by the PMCA team during the phase 2 and 3, it was noticed high consumer preference toward Albanian typical products. During the Phase 2 are elaborated regional labels for North and South. On the phase 3, the efforts are concentrated more on the development of the technical standard Albanian Guarantee. In the working group have been involved national experts supported technically by the FiBL expertise.



Part of the common work of all thematic groups was the establishment of the new Healthy Corner in Mercator. In addition, the PMCA team itself has implemented another market innovation. As a new promotion and sales instrument was introduced a van that functioning as a mobile food shop in Tirana. The van was presented first during summer day event in Elbasan, on March 14, 2011 and resulted very attractive for consumers and media. Furthermore, promotional activities on events such as KASH fair in September 2010, Summer Day in Elbasan on March 2011, Biofach 2011, Fair in the USA Embassy during different times etc. have been of a great importance for PMCA actors regarding collection of relevant information, consumers preferences, market trends and demand etc. Findings generated through these activities are in the focus of PMCA and actors common work. Just on BioFach 2011 Total business contacts were approximately 138, and 35 of them are considered from Albanian companies as serious potential importers and expected financial impact is calculated on 450.000 Euros, based on the expected business contracts and agreements during the fair.

One of the most important events of the third phase was the Big Final Event held in April 15, 2011 in Tirana International Hotel. PMCA team invited about 98 persons, but it resulted that participation in event was much higher to 168 persons and institutions. The main objective of this event was to present the joint innovations resulting from the process to a wider public, with a important message that PMCA actors are real owners of all innovations.

Development of the Albanian guarantee standard with both labels Alpe Albania and Prodhime Jugu provided many opportunities for more than 160 actors all over Albania. Currently the branded products are sold in supermarkets chain (Mercator, Carrefour, etc), healthy food shops, widely promoted by governmental and development institutions, etc.

Label identification	Region	Products applied to the standards	Approved by the audit committee	Improvement in Packaging and Labeling
Prodhime Jugu	Saranda			
	Vlora	Cheese Fresh Fruits & Vegetables	Yes	Yes
	Lushnja	Olive oil	Yes	Yes
Alpe Albania	Dibra			
	Tropoja	Jufka (pasta homemade) Honey		
	Puka	Dried fruits	Yes	
	Kukes Shkoder	Patato	No	No

#### 4. Results

Main economic and quantitative results of PMCA application in Albania are shown below:

<b>Objectives Hierarchy</b>	<b>Indicators</b>	<b>Indicator's value 2011</b>
<b>Impact</b> <i>Improved economic situation of the population of rural and remote areas, where SASA is intervening, through environmental friendly production practices and market-oriented efforts that foster quality production of Albanian agricultural products for the</i>	- The economic situation of at least 1000 persons is directly or indirectly improved at the end of the project, thanks to SASA activities.	3700 direct actors, without household members and indirectly involved actors (370% of planned)

<i>domestic and export market.</i>		
<b>Outcome</b> <i>Commercial, technological and institutional innovations, all contributing to take advantage of existing and new market opportunities in the segment of quality production, including organic and regional products with corresponding labels, are triggered.</i>	- At least 50 different market chain actors and staff from R&D organizations are part of a successful participatory process that generates at least 5 different tangible innovations.	168 market chain actors (336% of planned)  19 tangible innovations

Important results of PMCA methodology implementation of are as well the following shifts:

- ü from the *production focused* to the *market focused* interventions
- ü from the “*sustainability of institutions*” to the “*sustainability of services*” request
- ü from the *donor/implementer driven* to the *actor driven* (PMCA) approach

As an **actor driven approach** to the implementation, the PMCA enabled a realistic needs assessment, identification of priorities, trough establishment of an informal platform for consultation, peer learning and co-operation between market chain actors. Having in mind that market skills and knowledge had been based mainly on the “market end” of chain, gain in a majority of cases during the education/working abroad, a participative and actor driven implementation method such PMCA is, enabled utilizing and further development of an existing knowledge base and its spreading all along a market chain. Majority of actors involved in PMCA implementation pointed out that the **main benefits** are:

- ü developed market models, which could be further replicated with or without donors’ support
- ü market and production innovations (labels, packaging, e tc.)
- ü established network/co-operation with other market chain actors
- ü appropriate form of a joint work (PMCA platform)
- ü new knowledge and skills, gained through a joint work
- ü necessary market services
- ü business development and income generation

## 5. CONCLUSIONS

Implementation of PMCA methodology can be considered in other contexts by grouping connected industries such as agriculture, eco tourism, environment etc, including establishment of new geographically closed (limited) brands but with a wider participation of actors. Referring to the results presented in this paper, such regional brands supported further developments of different regions and areas in Albania and this initiative can be strengthened involving new areas to increase their competitiveness and benefit out of potential synergies.

The SASA 2009-2011 was a case of the *PMCA implementation* in a field of agriculture and food-industry market, for the exit stage of an intervention with the aim to consolidate results of its previous stages, in a medium developed beneficiary country (candidate for EU), and it led to the significant impact made by a mid-sized action. Having in mind these findings, in a further practice of the PMCA application could be reasonable to test its efficiency and effectiveness for options listed in Table below. The case of the SASA 2009-2011 project gives a ground to establish the hypothesis that the well applied PMCA based method of a project implementation guaranties not just a result, but also an impact. All listed testing should be conducted in order to clear whether it guaranties “just” results or an impact too.

Sectors	Project cycle stages	Contexts (countries/regions)	Ranges of projects
<ul style="list-style-type: none"> <li>ü PAR</li> <li>ü education/VAT</li> <li>ü health</li> <li>ü local development</li> <li>ü development of different economy branches, etc.</li> </ul>	<ul style="list-style-type: none"> <li>ü project development</li> <li>ü project implementation</li> <li>ü different stages of the implementation</li> </ul>	<ul style="list-style-type: none"> <li>ü different development frameworks</li> <li>ü priorities</li> <li>ü economy structures</li> <li>ü institutional and legal frameworks, etc.</li> </ul>	<ul style="list-style-type: none"> <li>ü different duration</li> <li>ü different total amounts</li> </ul>

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## EXPORT PERFORMANCE AND COMPETITIVENESS IN THE WESTERN BALKAN ECONOMIES: THE CASE OF ALBANIA

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### **Abstract:**

*Sustaining faster growth and reducing unemployment in the small open economies depends on improving export performance. Improving export performance can also help preserve macroeconomic stability by closing the current account gap to avoid losing reserves and to contain the growth of external debt. Improving export performance requires enhancing competitiveness. In this paper we analyse the competitiveness of the Western Balkan economies, especially in Albania. During the transition process, the export structure of the Balkan economies has undergone significant structural changes. The Western Balkans is cost competitive and has EU proximity advantages. While cost competitiveness as a source of differentiation might improve short-term export performance, sustained improvements require enhanced productivity and resources reallocation to more dynamic sectors, which depends on reforms to improve the business environment. The other aim of this paper is to analyse the connection of the competitiveness with the performance of exports in Albania using various indicators. Albanian exports were highly concentrated in structure (products and geographic markets) and around labor intensive, low value added inward processing products and raw materials. The import coverage index has continuously a low value reflecting a low competitiveness level of the country's exports. Finally we recommend that stable institutional setup, structural reforms, and targeted FDI are the internal supply capacity factors that will lead to increased export performance in the Balkan economies.*

**Key Words:** *export performance, competitiveness, foreign/EU market access, internal supply capacity factors, structural reforms.*

**JEL Classification:** *F13, F15, F43, F63.*

### **1. Introduction**

Export performance and competitiveness are often seen as synonymous. Just as a firm's competitiveness can be measured by its participation in the market or by growth of its sales, the competitiveness of a country is often identified with the performance of its exports. Yet, identifying a nation's competitiveness in this way is unsatisfactory because it is not countries but firms that compete. Having said that, it remains true that the dynamism and composition of exports may help explain the conditions under which firms operate and the difficulties that they confront.

The Western Balkan economies have recorded a relatively high growth rate of exports which has been accompanied by increasing market shares abroad, by the dominance of the EU-15 as the main market, and by considerable changes in the structure of exports in favor of goods with higher value added.

In fact the European and regional integration processes has significantly contributed also to macroeconomic stabilization, trade openness, increased flow of foreign direct investment, improved legal and institutional framework that have been key drivers of economic growth of the Balkan states during the last decade. The purpose of this paper is to analyse the Balkan economies' export competitiveness through foreign trade performance stressing on exports diversification, structural divergences with intra-EU import structure, their technological complexity and factor content. This analysis is made especially for Albania. Based on the relevant theoretical concepts we distinguish between market access and the supply capacity determinants of export performance. The paper is structured as follows. Section 1 examines the determinants of the Balkan economies' export performance and competitiveness. In Section 2, we analyse the export performance and competitiveness of Albanian products and the last section presents the conclusions and recommendations. The first recommendations for the Balkan economies is that future growth will need to be driven more by investment and improvements in productivity that enhance competitiveness and productive capacity, and less by the externally financed consumption and investment in real estate and other bubble assets that characterized the pre-2009 period. The second recommendation is that there remains in most of the Western Balkans (WB) a lengthy unfinished agenda of structural reforms. These urgently need to be addressed in order to take advantage of the access to markets, and to FDI, bank finance and remittances that the integration-based growth model offers.

## 2. The determinants of export performance and competitiveness in Western Balkan economies

The WB began to construct a market economy in the early 1990s, after the fall of the communist system. Early reforms were very difficult and led to a significant decline in production, created serious difficulties for the societies. In spite of this, and despite different pace at which the reforms had been introduced in various countries, by the end of the 20<sup>th</sup> century all South Eastern Europe (SEE) countries entered the path of the economic growth. Moreover, various paths of the transition led to the creation of various models of market economy in the SEE countries, with various prospects for future growth.

Based on economic theory and empirical research, factors determining the speed of convergence of transition economies with EU are: initial conditions, success of structural reforms, and macroeconomic stability (Fischer & Sahay, 2000). In the later phases of transition, determinants of economic growth of less developed countries are more or less the same as in the most developed economies and are related to quality of human and fixed capital in the broadest sense.

In the period 2000-2010, WB countries have significantly reduced the development gap in terms of EU 27 average in terms of GDP measured by purchasing parity standard (Table 1). Although in less favorable conditions, macroeconomic convergence of WB countries was comparable to new EU member states (NMS 12). Confirming economic theory, less developed countries in initial transition phase have a potential for higher growth, and that is the factor behind a rapid "catching-up" process in Albania and Montenegro. However, despite a low base, Macedonia and Bosnia and Herzegovina have recorded lower levels of progress.

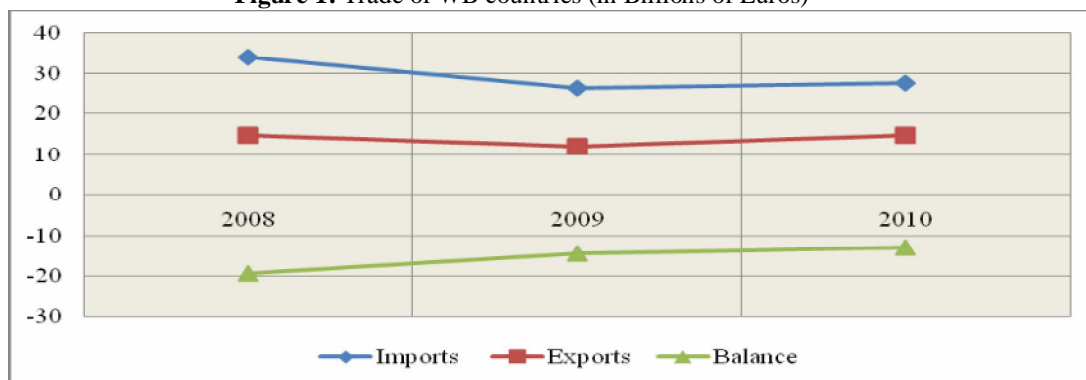
**Table 1:** GDP PPP per capita, EU 27 =100

	2000	2005	2010	Index 2010/2000	Average annual reduction of development gap, in terms of EU 27 average GDP
Albania	18	22	29	161,1	1,1
Bosnia and Herzegovina	21	23	28	133,3	0,7
Croatia	49	56	62	126,5	1,3
Macedonia	27	28	34	125,9	0,7
Montenegro	29	31	43	148,3	1,4
Serbia	32	32	43	134,4	1,1
Average WB countries	29	32	40	138,3	1,1
NMS-12	45	52	61	135,6	1,6

Source: WIIW (2010).

All these countries face the challenge of more active inclusion in the European integration process, and one of the key factors in this path is the improvement in trade patterns and export competitiveness. Trade flows of the WB countries have been increased continually, regardless the interruptions by the regional conflicts and the sanctions during the '90s. The biggest increase of the total exports and imports has happened after the year 2000, during the period of political stability.

**Figure 1:** Trade of WB countries (in Billions of Euros)



Source: IMF (Direction of Trade Statistics - DoTS)

The import coverage ratio from exports is still low in Balkans (less than 60%). The exports of the goods remain very low in the majority of the countries, being accompanied even with high rates of unemployment. Thus, regardless the last good increase, the capacity of exports and trade in WB are far away their potential (Broadman, 2005). WB have to follow a long way to achieve the potential of their exports and the performance of countries such as Slovakia. Finally, the steady increase for the small countries of WB asks a strong increase in the net exports.

The current account deficits of the countries of SEE are continually worsening since 2000 (Table 2), by increasing problems about macroeconomic stability. Currently, trade deficits are covered in several countries by large flows of remittances (in Albania, Montenegro, Kosovo, etc.). Other countries still rely on inflows of concessional aid, including especially Bosnia-Herzegovina which according to some observers has become an aid-dependent economy (Barlett, 2008).

**Table 2:** Balance of current account for SEE countries (in % to GDP)

Countries	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Albania</b>	-4.7	-7.4	-9.5	-7.0	-5.8	-8.7	-11.3	-10.6	-15.1	-13.5	-11.6	-13.2
<b>Bosnia &amp; Herzegovina</b>	-16.4	-	-	-	-	-16.8	-8.0	-12.2	-14.1	-6.3	-6.1	-8.3
<b>Bulgaria</b>	-5.6	-5.9	-2.0	-5.1	-6.8	-12.2	-17.9	-25.4	-25.2	-8.9	-1.3	1.9
<b>Macedonia</b>	-1.9	-7.1	-9.5	-4.0	-8.4	-2.7	-0.9	-7.5	-12.7	-6.8	-2.2	-2.8
<b>Montenegro</b>	-4.5	-	-	-6.8	-7.2	-8.6	-24.7	-29.4	-33.6	-29.6	-24.6	-19.4
<b>Rumania</b>	-3.6	-5.8	-3.4	-5.8	-8.4	-10.2	-11.8	-14.4	-12.3	-4.2	-4.5	-4.2
<b>Serbia</b>	-2.2	-2.5	-4.3	-7.8	-	-8.7	-10.1	-15.7	-17.2	-7.1	-7.2	-9.1
<b>Croatia</b>	-2.5	-3.2	-7.5	-6.3	-4.4	-5.5	-6.9	-7.5	-9.4	-5.0	-1.0	0.9
<b>Average</b>	-5.6	-8.2	-8.6	-8.0	-9.6	-9.7	-12.1	-16.4	-18.7	-10.2	-7.3	-6.8

Source: IMF, *World Economic Outlook*, 2010, 2011, 2012.

Except this, many privatizations have been fulfilled and the financing of the deficits from the direct foreign investments and the remittances cannot continue constantly. So, the environment for the steady export-led growth is expected to become more difficult for the Balkan countries. For these reasons, the constant increase cannot be based on grants, but on the structural reforms as well as on the possibilities for a deep integration.

The weak performance of the exports in the Balkan countries can be attributed to the conflicts and sanctions, as well as to the late transition in some countries. The loss of the markets of the Republics of the former Yugoslavia, which followed the break-up of Yugoslavia, became harsh by the effects of the conflicts, by economic sanctions, and by the destruction of the infrastructure in 1999. This divided decisively the trade and economic relations between neighbours of the former Yugoslavia and their main trade partners, as well as the international networks of production and distribution. These effects were combined by the late transition and the weak economic management in some countries, by being accompanied by the increase of governmental interventions in the market (e.g. by means of the prices and exchanges control). The absence of the oriented market structures, protectionism, oppressive regulations and taxation prohibited the development and performance of export - oriented industries (Kathuria, 2008).

The experience of EU8 countries demonstrates that an enlargement of the goods exports can be necessary for the creation of jobs, but it needs to be accompanied by the services sector modernization. The services liberalization is necessary not only to improve the increase of the services but also to increase the competition and efficiency of the productive sector and it also helps its faster integration with the international production and distribution chains.

An important factor that has affected exports of Balkan countries is improved access of these economies to EU markets. The liberal access to EU markets, inside the network of Stabilization Association Process (SAP), made that the exports of the WB increased towards the EU market. Thus, EU become the most important trade partner of these countries, as it can be seen by the Table 3.

**Table 3:** Trade of WB countries with EU (in million Euros)

Period	Imports	Variation (%, Y-O-Y)	EU Share of total imports (%)	Exports	Variation (%, Y-O-Y)	EU Share of total exports (%)	Balance	Trade
2007	19635	10.1	65.5	9379	9.4	67.2	-10256	29015
2008	22457	14.4	65.9	9827	4.8	66.4	-12630	32284
2009	16782	-25.3	63.6	7591	-22.8	63.3	-9191	24373
2010	16921	0.8	61.3	9531	25.6	64.5	-7390	26452

Source: IMF (DoTS), 2011.

Whereas, the importance of the trade within WB region in the trade flows varies between countries and reflects the past inheritance. In a study made by IMF (2005) was emphasized that there are only a few main lines of trade flows between the countries of the region. Thus, the regional market is the most important for the domestic exporters of former Yugoslavia countries. Regional trade of WB is generally more balanced and the overstocks of the trade account from the trade with the other region countries, serve to compensate the imbalances in the trade with the other trade partners: EU and the third countries. However, for WB countries, regional markets as an alternative toward EU markets and the other developed countries present only one solution “the second best”, they contribute for the achievement of a more balanced trade balance.

In his interpretation of the achieved results from trade liberalisation in the region of SEE, Gligorov (2008) is very careful when he emphasizes that the movements in the free trade till now, can not be attributed only to the free trade agreements. They have to do with the general increase of international policies, revival of the trade ties which were almost fully interrupted, and with the improvement of the statistical evidences.

Another important factor that has affected the export performance of WB is structural change in exports. Since the beginning of the transition process, the export structure of the Balkan economies has undergone significant structural changes in terms of an increasing share of medium and high-skill and technology-intensive manufactures and the corresponding decrease in the share of primary commodities, labor-intensive and resource-based products, and low-skill and technology-intensive manufactures. But these structural changes have moved slowly and there are wide variations among countries. Albania is the country which registers the lower part of exports with skilled labor and capital intensive (about 10%), while the other countries have this ratio between 33-46% of total exports (Table 4).



**Table 4:** Export factor intensity from SEE countries to world markets

Country	Change rates 1996-2005 (in% )				Share of skilled-labour & capital products	Skilled-labour & capital change	Skilled-labour & capital change	Share of unskilled & natural-resource products
	Natural-resource-intensive products	Unskilled-labor products	Capital-intensive	skilled-labor (SL)-intensive products	2005	1996-05	2000-05	2005
Albania	-10.5	7.2	1.4	1.9	10.9	3.3	-1.3	89.1
B&H	-9.6	3.9	9.9	-4.2	33.2	5.7	12.3	66.8
Bulgaria	0.1	8.1	-7.6	-0.7	34.2	-8.3	3.1	65.8
Croatia	2.0	-7.7	1.5	4.2	39.3	5.8	4.3	60.7
Macedonia	-9.0	-3.9	-5.3	18.2	35.2	12.9	-0.9	64.8
Rumania	-5.5	-0.5	2.3	3.7	42.9	6.0	9.8	57.1
Serbia&M.negro	3.3	1.2	-21.9	17.5	46.8	-4.4	10.8	53.2
Western Balkan	-0.1	-4.6	-4.2	8.9	39.0	4.7	6.4	61.0
SEE	-3.9	1.2	-2.2	5.0	40.0	2.8	7.5	60.0
EU-8	-7.5	-8.1	8.8	6.8	67.2	15.6	5.4	32.8

Source: The calculations based on UN COMTRADE database (World Bank, 2008, Kathuria)

With respect to merchandise imports, the restructuring has been stronger and homogeneous. WB is shifting toward more SL-intensive and CI imports, which account for 56.6 percent of total exports in 2005 by increasing with about 9 versus the year 1996 (World Bank, 2008). Nevertheless, the share of capital-goods imports remains much lower than that of EU8 countries (67.3 percent). By contrast, the high concentration of exports in unskilled-labor and natural-resource-intensive products puts future export growth prospects at risk in some WB countries. As a result, the actual structure of exports of WB countries seems neither steady nor desirable for the long-run period. For this reason it is necessary the encouragement emergency of export sectors with skilled labor and capital-intensive products. The experience of the more developed Central and Eastern Europe countries suggests among others the need for the increase of FDIs, which will contribute for a deeper integration with the EU markets in more sophisticated levels.

Another characteristic of export products of WP countries is that they have a trade structure almost similar and a low complementarity (Grupe & Kušija 2005). The WB have the relatively similar factor stock and so similar comparative advantages. Thus, these countries compete with each-other with the exports towards the region and third countries, especially towards EU market. Thus, taking into consideration the low elasticity of demand in these markets, the development strategies should be focused on the *improvement of production structures and product differentiation*.

The biggest impediment to achieve the free trade potential in WP is the existence of high non-tariff barriers, including the complex regulation of the product and standards, rules of origin, certificates and the bureaucratic custom procedures.

The increasing tendency of the skilled labor and capital intensive imports and exports, shows that bilateral FTAs seem to have contributed in the trade diversification (Gligorov, 2008). These tendencies are only in their beginnings, and it is not sure that in what amount they will develop. Such a development is expected theoretically, and so the stimulation of the free trade by means of CEFTA can ensure the diversification of the export sector of all the member countries.

WB countries have the potential to exploit the new possibilities for the development of the production, knowing that their position is in the centre of the transit passage between EU and Eastern Europe, Turkey and Middle East. A more integrated market of WB can help to withdraw the FDIs. Apart from this, each country should improve its policies and the climate of investments in a focused way with priorities, but the priorities should differ for each country.

Some common obligations can also be put. WB countries should be better prepared for the future increase of the firms and the unpreventable increasing competition from the countries with low wages. So, in order to develop competitive production structures, the WB economies need to turn away from low-factor-costs production, move up their skills and technology to sustain rising wages and greater economies of scale and scope, and develop products for customers in the increasing WB market (UNCTAD, 2002).

Achieving regional integration, beyond merchandise trade liberalization, requires government actions that reduce the market-segmentation caused by domestic regulatory policies. The benefits of a deeper integration lie in the creation of a single economic space and include greater contestability, a larger market, greater economies of scale – all evidenced in intra-regional supply chains, higher FDI, increased efficiency of the most important sectors and increased intra-regional trade (Kathuria, 2008).

### 3. The export performance and competitiveness in Albania

During the transition period the Albania's foreign trade growth, except for certain points in time, has been quite higher than the GDP growth, as shown in Table 1.

Table 5: Albania's macro-trade indicators

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Real GDP growth rates, (in %)</b>	7.9	4.2	5.8	5.7	5.7	5.4	5.9	7.7	3.3	3.9	3.0
<b>Trade flows (exp+imp) growth rates, (in %)</b>	22.7	8.5	9.9	6.1	9.8	15.2	26.3	16.2	-3.1	20.0	15.6
<b>Trade Deficit/GDP (in %)</b>	25.2	26.1	24.6	23.0	23.9	25.0	29.0	30.0	28.7	25.7	26.4
<b>Import coverage ratio, (Exp/imp) in %</b>	22.9	22.2	24.2	26.5	25.3	26.0	25.7	25.6	24.0	33.5	36.3
<b>Trade openness index*, in%</b>	40.3	40.9	40.3	39.5	40.0	42.6	49.0	50.7	46.7	51.6	56.4

\*measured as a ratio of trade flows to nominal GDP, expressed in ALL.

Source: Ministry of Finance, INSTAT, METE, Bank of Albania and ACIT's database.

But, despite the good progress in tariff liberalization, Albania's trade openness has been relatively low, with an openness index reaching around 56 percent in 2011 (Table 1). Also, the import coverage index (Exp/Imp ratio) has continuously a low value for the whole 1993-2011 period and reflects a low competitiveness level of the country's exports.

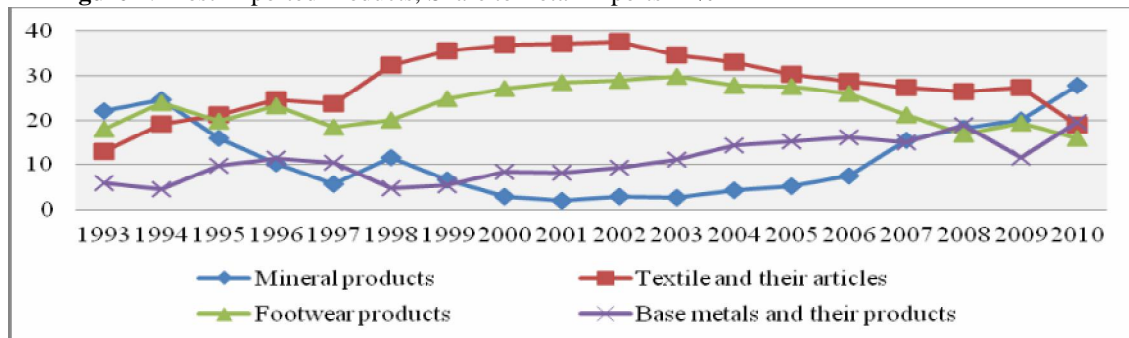
A quite high and endemic trade deficit (Table 5) makes the macroeconomic situation and developments in the country fragile, especially in light of the economic crises. The main financing source for imports during the whole period of transition has been emigrants' remittances (Bank of Albania, 2009). Even for 2011 – 2012 there is a deterioration of the foreign balance, because of the decrease of the remittances, exports etc. Such factors, as well as the internal factors (as policy inconstancy) are expected to influence negatively the budget deficit and the public debt.

The gap between exports and imports highly depends on the respective growth rates. A structural analysis could help in exploring the performance of exports, and defining potential sectors that can contribute to a faster growth of exports.

Generally, exports were characterized by a strong and steady positive trend from 2002, but as exports were highly concentrated in structure (products and geographic markets), they appeared highly vulnerable from the crisis that hit the global economy in 2009. This high concentration around labor intensive, low value added inward processing products and raw materials have transmitted quickly the contracting world demand effect on Albanian export flows. With the recovery of the main sectors in European partners of Albania, export flows started increasing since the end of 2009 and continued a very positive trend during 2010 and kept positive increase figures during 2011 (although with less increase as compared to 2010).

The product-group of textile and their articles even though it is in the main category, as it is shown in the Figure 2, shows a lower norm of increase compared with the other sectors like minerals, the base metals etc. Their lower increase reflects also the effects of competition coming to Europe from China and India. The exported 'value added' from these sectors has been increasing but slowly, due to the unexploited possibilities of increasing the value chain in inward processing industries. Exports are concentrated on four product-groups (Figure 2), minerals, textile and their articles, footwear etc, and base metals and their articles, together accounting more than 80 percent of the country's total exports. Compared with the other countries in region, the variety of export items remained the lowest in Albania. So, only ten exported goods for 2011 account for 47 percent of value of overall exports (ACIT, 2012).

**Figure 2:** Most Exported Products, Share to Total Exports in %



Source: ACIT database

Albania's exports not only cover a relatively small part of imports, but also suffer from a relatively high fragility. They are highly related with inward processing industries like apparel and shoes industries where the comparative advantage is mostly based on low wages being so not sustainable. Exports of mining products and other raw materials are highly dependent on world price fluctuations, while export of energy is highly related with the weather conditions.

Most of economists suggest that the import substitution policy can be favorable in the initial stage of economic development in the transition countries. But, in the next stage of development it is imperative export orientation and promotion policy. There is consensus among economists that opening up the economies for export-led-growth through trade liberalization is a crucial factor among others, which significantly influenced the growth performance of China and other East Asian countries (Sachs & Warner, 1995, Frankel & Romer, 1999).

But, the low base of exports in Albania has not allowed the higher growth to translate in a decreasing trade deficit. Narrowing the gap between imports and exports can potentially come from both sides through 'restricting' imports (by using the import substitution possibilities for the country) and a faster increase of exports, considering the latter as a strategic and a longer term approach.

The big dimensions of import compared with export seem to legitimate such position in Albania. Emigration remittances and other revenues have conditioned a steady high level of imported goods demand. This demand cannot be limited only with limiting policy. The "substitution" process of imports was not followed by decreasing of imports' volumes, but at contrary, it increased continuously. Beside domestic production growth, the weight of imported capital goods increased also. Thus, the "import substitution" is happening through their "growth". The low level of openness of the economy does not induce for imports limitation. The solution lies not in the limitation of imports, even through "substitution" of it.

It must be noted, however that Albania competes against other countries in the region or even worldwide, some of which have similar natural resources, or offer similarly low labor costs, have higher labor productivity to offer or have better infrastructure. Also, some these countries have larger internal markets in which emerging suppliers can gain experience.

The EU market is highly competitive and very demanding with regard to quality, reliability and efficiency of supply. Nevertheless, these markets are also changing, and Albanian exporters will have to adapt to the new market conditions and the international competition in these markets as well. Albanian exporters would face also the challenge of greater competition in the European market as a result of Stabilization-Association Agreement and in the regional market of Central European Free Trade Area (CEFTA).

That's why the incorporation of the export competitiveness issue in the overall development strategy is most important. Improved export firms performance consists not only of increasing market shares but also of diversifying the export basket and sustaining higher rates of export growth over time. Albania should focus on how to achieve a long-term competitiveness, which points the ability of domestic firms to adjust to the changes in the international markets over time in line with international standards.

The export promoting strategy defines the export promotion objectives and roles of the main stakeholders involved (business community, public and private organizations and government). But, it is imperative to implement seriously this strategy. All stakeholders need to cooperate and collaborate in order to turn benefit from complementary approaches and synergy effects. Thus, the functional linkages between contributions of the government, public and private organizations, business community and donor organizations will be decisive for the success of the strategy.

The achievement of this objective needs, first of all, support by policies that have as object the deepening of structural reforms and restructuring processes. Here institutional reforms are of primarily importance. Specifically oriented policies towards encouragement of exports would be successful only if they consider and support the activation of trade instruments at the measure that these market instruments were created and functioned.

#### 4. Conclusions and recommendations

The liberal access to EU markets, inside the network of Stabilization Association Process (SAP), made that the exports of the WB increased towards the EU market: EU become the most important trade partner of these countries. Regional trade of WB is generally more balanced and the overstocks of the trade account from the trade with the other region countries, serve to compensate the imbalances in the trade with the other trade partners: EU and the third countries.

Since the beginning of the transition process, the export structure of the Balkan economies has undergone significant structural changes in terms of an increasing share of medium and high-skill and technology-intensive manufactures and the corresponding decrease in the share of primary commodities, labor-intensive and resource-based products, and low-skill and technology-intensive manufactures. But these structural changes have moved slowly and there are wide variations among countries. The actual structure of exports of WB countries (the high concentration of exports in unskilled-labor and natural-resource-intensive products) seems neither steady nor desirable for the long-run period. It is necessary the encouragement emergency of export sectors with skilled labor and capital-intensive products.

Another characteristic of export products of WP countries is that they have a trade structure almost similar and a low complementarity: these economies have the relatively similar factor stock and so similar comparative advantages. Taking into consideration the low elasticity of demand in these markets, the development strategies should be focused on the *improvement of production structures and product differentiation*.

The Western Balkans is cost competitive and has EU proximity advantages. Cost competitiveness as a source of differentiation is not sustainable. Cost levels are increasing gradually in some sectors, negatively impacting margins and potentially eroding market share. Limited access to finance and a lack of strategies for reinvesting in technology and human capital represent a risk for the future.

To sustain competitiveness, the Western Balkans needs to move up the value chain: first, by differentiating through value-added services and innovation; and second, by further leveraging the region's proximity to the EU market. In moving up the value chain, major challenges should be addressed in three areas: sector specific policies, human capital, and innovation.

During the transition period the Albania's foreign trade growth, except for certain points in time, has been quite higher than the GDP growth. But, Albania's trade openness has been relatively low, and the import coverage index has continuously a low value reflecting a low competitiveness level of the country's exports. Albanian exports were highly concentrated in structure (products and geographic markets) and around labor intensive, low value added inward processing products and raw materials. The exported 'value added' has been increasing but slowly, due to the unexploited possibilities of increasing the value chain in inward processing industries. The low base of exports in Albania has not allowed the higher growth to translate in a decreasing trade deficit.

Albania should focus on how to achieve a long-term competitiveness, which points the ability of domestic firms to adjust to the changes in the international markets over time in line with international standards. For strengthening competitiveness and broadening the sources of growth underlined the need to continue and intensify structural reforms:

**First**, greater orientation of Albania's economy to export and overall higher competitiveness of our products in international and domestic markets dictate the need for continued structural reforms at macro- and microeconomic levels. This means further and more rapid improvements of the business environment and investor protection to increase domestic and foreign investment, to raise productivity and to help Albania's exports to climb up the value-added ladder. An important role in the increase of productivity would play the investments in the human capital, governance, the attraction of more advanced technologies, in infrastructure and in the increase of managing skills of private business.

**Secondly**, macroeconomic stability consolidation requires more work in the future. **Thirdly**, ensuring the country's financial stability requires coordinated action by all supervisory and regulatory institutions, and a greater attention by private agents of the market. A sustainable financial system, oriented to new long-term horizons and prudential to risks, serves to channel savings into the most competitive sectors of the economy.

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**REFLECTIONS ABOUT A LARGE STUDENT ENGAGEMENT AND INVOLVEMENT IN THE SOCIETY POLITICS**

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**Abstract:**

*Students will be the leaders of future changes, not only as individuals but also through their membership in different groups. Encouraged by ideas and experiences from foreign universities, from different initiatives for an effective leadership development programme, in this presentation we suggest several recommendations for changes in order to build a more active role of students in our university. Our faculty, by its own interdisciplinary nature, can be the promoter of a better stimulating environment, for the orientation and management of students' interests from all disciplines. Based on new visions and positive experiences from other academic institutions in the world, students will be motivated for more active engagement and collaboration at a university level. Student involvement in sensibilization campaigns, in community projects and in leadership development programmes will contribute to public politics and to the citizenship of tomorrow. These kinds of activities will be very valuable for the student curricular and extracurricular activities, for their future career, for project management skills and for expanding their network of social and professional contacts. The formation of critical and creative citizens brings progress to the whole society. Creating a new spirit of engagement will enable everyone to see him/herself as a responsible actor in the collective life- an essential value of democratic civilizations. These are some aspects of our presentation in this conference that will be accompanied by actual analyses and reflections from contemporary European experiences.*

**Key words:** engagement, civic and social responsibility, development

**JEL Classification:** O1.

**Introduction**

The student's profession is a metaphoric word. It is not referred to 'a profession' like we are always used to in the everyday life, it is referred to a professional activity. To be a student is more a temporary profession, so a temporary social status. It is not sufficient to be enrolled in the university, or to follow the lessons/seminars, but it is extremely important to do intellectual and research activities. To become a student needs basic knowledge, to be aware of what to do.

Engagement is referred to the time, energy and resources that students dedicate to the designed activities to enhance learning at the university. There are studies about the sociology of student's world, their ways of living, and their cultural approaches (where we can find issues of their associative life). There are other studies about the institutional and functioning university issues. In this paper, we would mention different forms of organized student engagement and two models of student engagement, student experience in a national level and what are the improvements to follow. We will present empirical evidence and will try to monitor and promote community engagement to have a clear picture of the situation.

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Student engagement in university or extra-university activities; their form of expressions; the analyse of their motivations; the results of what they will achieve; to better understand the meaning of the university and of the society as a whole (in a global perspective) have become during last years an object of study for many researchers. In different contexts and from different authors we can find a lot of definitions regarding student engagement. Hu & Kuh (2001) state that student engagement is about the quality of individual efforts to educative purposes; in strengthening and involving them in the process of shaping learning experience. Student engagement is referred also to the optimization of students' experience by developing their own performance and the institution reputation as well. Engagement can be seen also in all the connections that universities can have with other partners like society, business and government.

The word engagement is used to describe the behaviours and attitudes of student which reach and attempt to have high level experiences during their graduation period. The fact is that student engagement is not a regional phenomenon, and it does not happen without a defined institutional strategy. The university engagement programme could be a model that our university, especially our faculty can follow. We can mention some activities that can be considered as student university engagement like: disseminating information, public relations, spreading academic findings, which can position the university as a cultural influencing entity. Other ways of involving students in activities can be; participating in artistic groups, media events, artistic shows for the community, manifestations, protests, awareness campaigns and following their peers in different countries of the world like France, Italy, England, Greece, USA, and Australia. Student engagement should be a distinct and specific issue in the university, and this can be done by having a single and unite concept about students' public involvement. Activation in civil and social participation is an important issue for our society. The degree of society development depends on the engagement and participation of its students in society politics.

### **Students' engagement: models and dimensions**

To become active citizens in a democratic society is crucial to involve student in public life. Student engagement can be classified into two main categories: a) extra-university engagement and b) university engagement<sup>365</sup>. The first category of engagement does not have any direct connection with the structure, content, finality and study conditions. The second category of engagement shows an area of students' representation; shows a discipline protection and further development. The student participation can be seen in a local, national and European view, where each of these engagements is important and independent from the others. Students are engaged in university elections, being parts of academic structures, but even in different student associations<sup>366</sup>.

According to different authors we can mention two models which represent different educative ideologies about the student engagement. The first one is Market Model of Student Engagement (MMSE) and the second one is Developmental Model of Student engagement (DMSE)<sup>367</sup>.

The first model allocates the students primarily as consumers in the university education and it is based on the neoliberal point of view of the marketing of education. As this model states student engagement is focused on the rights of the consumer, by enhancing his institutional position in the market. The second model considers the students as partners in a learning community, and it is based on 'constructivists' concepts of learning like the co-creation of knowledge from teachers to students.

This new perspective gives more priority to the students' enhancement and development, by pointing in the quality of learning, personal and social rewards that can derive from student engagement to the community. For students engagement dimensions we can mention the individualist versus the political dimension.

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<sup>365</sup> Robi Morder, Les engagements extra-universitaires des diants en France

<sup>366</sup> SIFE Albania

<sup>367</sup> Trwoler, V. Framework for action: enhancing student engagement at the institutional level.



The individualist dimension: The student is considered as a social and economic individual who should take the best from the university studies and who should become who wants by giving the best he/she can. We are not analyzing here the concept of human capital investment<sup>368</sup>; but the student should guarantee his future during the university studies by gaining social capital. Students should react now and take a Political dimension which is more important than individual calculus, does not take into consideration all related externalities. The student now is considered as a political individual who represents a specific aging class, whom gained a social position in the society. He has become already integrated into political discussions, programmes and actions. The student should make collective and political choices, which means that everybody is involved and that there are direct/indirect consequences in the whole society. This political responsibility, which students are free not to use, passes through engagement or support for students' movements.

### Albanian and foreign examples

To have a specific context on institutional practices is necessary to understand national systems which have good example in engagement. A high education system it is not only composed by national rules and policies, but also by the culture and agreements which form what are the accepted practices and goals. Student should have a big desire to get engaged in social issues. They should be volunteers like other citizens and take part in community activities.

Thousands of students in French universities demonstrated in 2006 against educational policies and work contracts by having a constructive and deep effect. We can mention the University of Oxford in UK where the students' campaigns against scientific testing on animals have raise big ethical issues on researches and have stimulate constructive debates through different involved actors<sup>369</sup>.

Different national systems with high reputation on effectively exchange of knowledge among universities and society can be used as model and reference for changes and improvements.

- Germany we can find well-developed knowledge exchange in a national level in ecology. We can find intermediary organizations and centres which have created a shadow effect by discouraging other types of engagement.
- Finland has developed a model for creating universities in the periphery, by having inter-universities like federal colleges. This was of big help for professors to find a place where to do research.
- The Netherlands universities have always served for social precise goals since the 1890. During the last years they are having a focus in the national spatial strategy.
- Canada the government has provided a formal support to double the research funding for the universities if they can prove that can triple the society impact.
- Australia universities are encouraged to make opposition for the government by making management policies.

If students are involved in community service they are more likely successful than non-engaged students<sup>370</sup>. The university experience is enhanced by this student involvement in community service, and these activities may help these students to see themselves with a greater academic and professional potential<sup>371</sup>. Student engagement during their university studies helps them to occupy the free time in a more active way. Through engagement they achieve an experience and a background that only educational issues cannot provide. They live passionately, feeling themselves helpful and by making more practice and gaining another self-assessment. Engaging student at the university allows them to have contacts not only in the present but in the future as well. We can find also in their motivations to be engaged with community services at the university period selfish and altruistic reasons.

<sup>368</sup> Gary Becker states that there can be differences in payment as there are differences in the individual productivity arises from differences in education

<sup>369</sup> F.Gjini, Ideja e komunitarizmit me studentet dhe edukimi i nje humanizmi te ri

<sup>370</sup> Ting (2000); Ting & Robinson (1998); Furco & Root ( 2010)

<sup>371</sup> Johnson et al (1998)

Performing in active civic groups means not only personal satisfaction, but even confronting difficult situations. We should admit the existence of challenges in this engagement. We can mention here limited budget resources, environmental indifference, lack of energy and ideas. These factors are sometimes restrictive for an active social life. First year students may face more of these obstacles who still do not feel very orientated.

In our universities in Albania does not exist a scholarship programme regarding student engagement. This could be a great motivation for students to be involved in public activities. While the field is growing and there are publications regarding this issue, the public engagement field itself remains still small. We cannot find any newspaper or publication that students can use. Civic engagement for students and social responsibility occupies a low profile in the public domain. A specific challenge can be 'popularization' of the research findings so that the universities become associated in the public eye with civic engagement, development and social responsibility<sup>372</sup>.

Another aspect that the Albanian context misses is a youth forum, dedicated to like-minded youth people who share similar interests and attempt to strength inter cultural relations within a university. Students should organize these activities in order to support the faculty goals, by giving them guidance on planning, developing and executing leadership initiatives for a constructive influence in the civil society. Our faculty staff should also outline how to help these students to realize these activities through its network, resources and partners. It is evident for all that big changes are happening, changes in social relations and profound changes in values. But whatever change happens; one thing is sure: it will affect and influence our universities, and the universities should play their role in helping in the formulation of new society concepts by having a different perspective on their issues<sup>373</sup>.

Wenger has developed the idea of 'communities of practice' (CoP) by pointing out the importance of small interaction of the interpersonal community of people by working together to solve problems. It is clear that effective engagement requires cooperation through exchanging ideas between partners, requires co-learning processes and sometimes joint research<sup>374</sup>.

### Conclusions and future recommendation

The development of a society depends primarily by the engagement and participation of youth people in society politics.

Student engagement has a big impact in the outside world of the university; from local communities to global communities.

Engagement concerns with all possible ways that universities and its own students can contribute in local, social and global issues (environment sustainability issues; health and poverty) from participating in public debates in performing in artistic shows, in researches and formal programmes.

This paper stated out not only the related problems with student non-engagement but also here we presented ways, visions and possible solutions how to solve and how to fight against injustices and for the whole society development. The reasons to be non-engaged students are numerous. Study time, family, friends and entertainment take a lot of time, so it remains no time for other things that we do not know and for the society as a whole.

There are selfish and altruistic reasons that motivates student engagement in community services. But we can mention a lot of challenges that our students face when try to get involved and contribute in community service.

<sup>372</sup> Piyushi Kotecha, 2010

<sup>373</sup> Dobrée, 1943

<sup>374</sup> Community of practice (CoP) is, according to cognitive anthropologists Jean Lave and Etienne Wenger, a group of people who share a craft and/or a profession. The group can evolve naturally because of the members' common interest in a particular domain or area, or it can be created specifically with the goal of gaining knowledge related to their field. It is through the process of sharing information and experiences with

the group that the members learn from each other, and have an opportunity to develop themselves personally and professionally-[www.wikipedia.org](http://www.wikipedia.org)

Factors like lack of energy/ideas, limited budget resources, environmental indifference, are restrictive for an active social life. In addition we can mention that it does not exist any scholarship programme regarding student engagement or a youth forum dedicated to youth people.

If students are involved in community service they are more likely successful than non-engaged students. The university experience is enhanced by student involvement in community service, and activities like that may help students to see themselves with a greater academic and professional potential. Our faculty staff should outline how to help these students to realize these activities through its networks, resources and partners. During last years Albania as many Balkan countries is having a difficult situation regarding unemployment and future perspective. Youth seems to be satisfied with entertainment but still are experiencing uncertainty about their professional future. They should act with more solidarity, to work more as volunteers and to create new student's association. To be more involved in public life will be a challenge for these students.

Everything is possible if student can take under their responsibility this process.

Youth and students particularly, should pass from the desire to act, to the interest manifestation for forms and values of engagement, so to contribute actively as citizens of tomorrow.

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**SUSTAINABLE TOURISM AND RECENT ECONOMIC CRISIS (ALBANIA CASE)**

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**Abstract:**

*In many countries around the world, the tourism sector is considered as much more important than even the production one, seen on both, the economic and social aspects. Albania is regarded as an unknown tourist destination in Europe, but it still provides a lot of precious and rare secrets of nature and also the cultural heritage. Sustainable Tourism development has to be taken under consideration from strategy design to its implementation. The main aim of this paper is to define the role of sustainable tourism and its impact to the current economic crisis in Albania and at the same time to evaluate the measures for the future development.*

*Finally, this paper provides some conclusions and recommendations for the phenomenon treated.*

**Key words:** *Tourism, sustainable development, economic crisis, economic development, Albania.*

**JEL Classification:** *M39.*

**1. Introduction**

*“Successful problem solving requires finding the right solution to the right problem. We fail more often because we solve the wrong problem than because we get the wrong solution to the right problem”*

Russell Ackoff 1974

In the last decades, tourism is one of the main branches of the Albanian economy. Before '90-ies, tourism in Albania has not been developed due to the lack of income and the necessary infrastructure. After '90-ies, tourism grew rapidly. Many foreign and Albanian investors discovered that tourism in Albania could be the main source of their profits.

Tourism has an impact, not significant in absolute value, but at an increase rate through years, in the employment phenomena. It is important to emphasize, that, the impact of tourism in the GDP (11%), it is not yet included in the main national statistical sources, which is the most representative indicator of the tourism contribution.

The aim of this paper is to define the role of sustainable tourism to the economic development in Albania during the global economic crises, also to find out the measures we have to undertake for a sustainable development.

**2. The role of sustainable tourism in Albania economic development**

Tourism constitutes an excellent potential, a catalyst towards the economic growth and therefore, it is a key sector in the macroeconomic level. Tourism has been increasing with great strides over recent years, contributing over 2.4 billion dollars in 2009 and is expected to grow by 4% in 2011, based on statistics of the World Council of Travel and Tourism.

Over 200.000 Albanian peoples are employed in the tourist business and this number increased in 2010-2011, despite the effects of global crisis in the tourism industry.

"Tourism in Albania is at a critical point of development"<sup>375</sup>. Decisions made today are important for growth and protection of the rich natural, cultural and historical resources of Albania".

Tourism, a fast growing industry that produces income, job step, increases welfare host countries, is considered as a bridge that brings cultures side by side, as the building of people with different cultures and religions of containers encourages understanding and gives pleasure.

The main question is: Is it really important to develop tourism sector in Albania and which is the benefit from this? The answer will be: Yes, because we are competitive regarding the other countries. Albania is a beautiful and attractive country. It has a wide range of historical attractions and cultural and natural resources are of great interest to international tourists. The country is safe, people are welcoming and friendly. What is most important, the country is still "authentic." It remains largely untouched by foreign influence. In this respect, Albania is unique in its kind and offers a wide spectrum of investment opportunities in tourism. It is crossed by a 362 km long coastline and has inherited over 2000 objects declared cultural monuments which are three of humanity's global wealth protected by UNESCO (Butrint, Berat, Gjirokastra).

Albania has outdoor and favorable climate for the development of a diversified and perennial tourism. In Albania there are actually about 630 hotels with a capacity of 25 000 beds and if we include family tourism, accommodation capacities go to 35 000 beds. Overall standards at the level of classification are the "three stars", but there are hotels such as Sheraton and "4 Stars" level hotels. Across the country, over 150 travel agencies conduct their business.

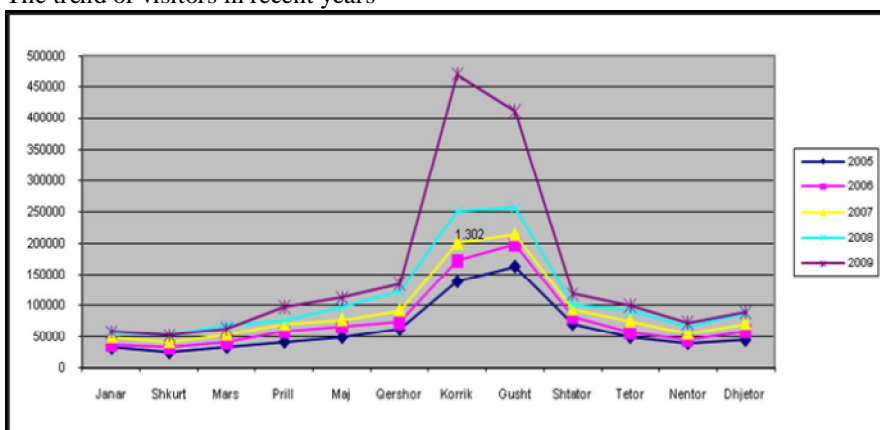
Albanian Government considers the development of tourism as an unquestioned advantage and therefore it has undertaken measures for promoting and facilitating foreign investment in this area legally and for infrastructure in general, in a continuous and uninterrupted way.

In recent years the number of visitors in Albania has been at an upward trend which is expressed as the number of visitors, as well as the amount of income from tourism.

In the period January to December 2009, 456 thousand foreign visitors have entered over the same period last year. In this period, the number of foreign visitors has been increased by 34% compared to 2008 and compared to 2005 the increase is nearly 2.4 times more.

In the period January to June 2010, 26.908 foreign visitors more have entered over the same period last year.

The trend of visitors in recent years



Source: Bank of Albania

<sup>375</sup> Xhozef Uilliams, USAID Mission Director, in Seminar on Sustainable Tourism supported by USAID

### 3. SMEs tourism sector

SMEs tourism sector, is considered the most faithful and safest for all foreign investors who want to invest their money in Albania. The Albanian government and society has the sustainable development of tourism sector as a priority, and this is a very important condition for all investors. Investor's opportunities to succeed in this business are tremendous considering numerous options without resorting to offering the Albanian territory.

The situation is analyzed by conducting a questionnaire to Albanian businessmen's and assessing their point of view. Finally, this study directs with conviction investors in the field of tourism-SMEs due to the foreground and the possibilities offered by this sector.

SMEs are considered the engine of development for Albania and a source of welfare as society invests in them, but taking and a greater control over their business.

### 4. Sustainable tourism and the impact of crisis

The income from tourism sector in recent years has risen. Tourism is becoming the main supplier of the economy's income and it is one of the sectors where the economic growth will be focused in the future. The last two years, our country has been raised significantly in the classification in terms of foreign currency inflows into the economy from abroad. Monetary derived values spent the export's income, remittances and income from direct investments.

The performance of tourism sector in our country has been totally different from that of neighbor countries, where this sector has undergone significant drop (dramatically) during 2009.

Emigrants and tourism sector are the ones who so far have saved Albanian economy. Jobs would have been much worse than before the crisis, taking into account only the trade balance. In fact, the money entering the country and those that are coming out, include other elements, such as income arising from emigration and income from tourism. Both these items have contributed substantially to improving the situation. Current transfers as every year take the form from flows of emigrants. These represent the main source of financing the deficit in trade of goods and services. The contribution of these remittances in alleviating the trade deficit is estimated at about 40 percent. However, remittances are falling, while foreign tourists themselves have not enough money in advance to be spent on unconventional places like Albania.

The effects of the crisis will be felt by reduced inflows of money from immigrants who will come from the reduction of unemployment and the pace of exports. This will certainly affect the recession of the economy, but considering the fact that about 70 percent of financial income of the population goes to private consumption, this factor will not have any major impact, as personal consumption will exist and above all, consumers will give up luxury items and then will reduce consumption.

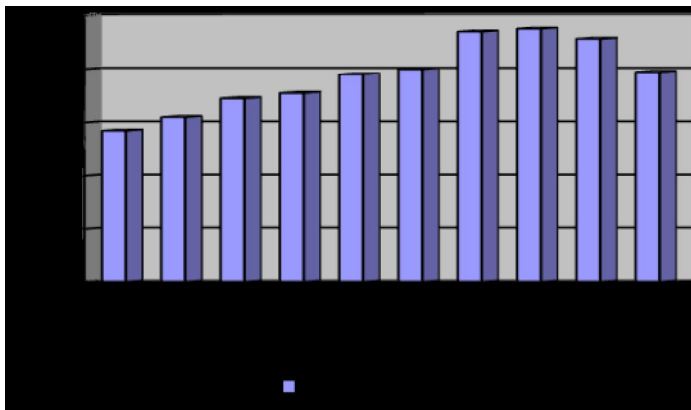
Today, at the time of global crisis particularly sensitive branches, such as tourism, have stagnated and significant decrease. Initially, the question is: have anti-crisis programs been approved or implemented the necessary?

Until recently, for such reasons situations corresponding to different social, political, monopolistic, many countries did not want to accept the situation created by the global crisis, saying there is no crisis or the government has taken appropriate action. Thus, the global challenge changed or significantly destroyed the economic structure of world's most powerful systems. Therefore, Microsystems of transition countries such as Albania can not be compared with global macro system traditionally developed. Albania certainly is not in terms of year-end 1996 and early 1997-the year when the "crisis of usury" was turned into proper economic crisis by resulting a decline of 7 percent of GDP, increased at 42 percent inflation and worsening other macroeconomic indicators. But this should not make us overlook the consequences of global crisis on our country. Albania is not immunized from the effects of global crisis, despite of the weak links integrated with U.S. and world economy in general. It's enough to mention the fact that over 3 / 4 of the foreign trade conducts with EU countries. A variety of data show that the crisis has begun to affect in a sensitive way, to a range of indicators such as: In decrease-rhythms of remittances, in decrease of the saving deposit rates, in decrease of the rates of export-import, etc.

**5. Albanians remittances and their trend**

There is no doubt that moving the most painful consequences of the Greek crisis is gradually closing the tap of remittances of migrants remittances hit hard by the crisis. "Finally what is important, in Greece there are over 700,000 Albanians, who for years have contributed to remittances, remittances which, as was shown in 2009 have fallen sharply around 30%. Migrants are the first affected in their work, especially in construction and tourism.

**Inflow of remittances in Albania (million euros)**

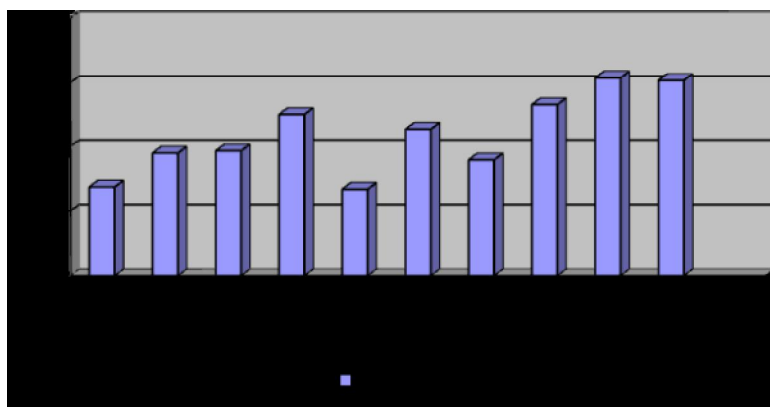


Source of

data: Bank of Albania

The volume of remittances depends on the number of immigrants from the country of migration, on revenues that provide it, the level of ties with their families, from facilities in sending money, political stability etc... During the 10 years 1993-2002, we have entered 4367 billion USD in total, 437 million USD on average per year:

**Inflow of remittances in Albania (million Dollars)**



Source of data:

Bank of Albania

At the next 6 years, 2003-2008, emigrants have entered a total of 5.161 billion euros, or 860 million euros on average per year, as follows:

Year	2004	2005	2006	2007	2008	2009	2010
Remittances	718.8	826.3	927.6	936.5	947.0	802.0	789

The growth of rhythms in the years 1994-1996 was due to the increase of immigrants in European countries, particularly in Greece and Italy, while the decline in 1997 as a result of the collapse of pyramid schemes, which lost about 2 billion USD. In that year, as is known not only shook the financial system but also economic, political and social, in its entirety.

Remittance volume in 2008 fell to 802 million euros, 145 million less than in 2007. This level was even lower than in 2004. This trend is explained not only by world experience that shows that the level of remittances reaches a peak after about 14-15 years and after this coming fall, but mainly with the effects of global financial crisis.

This fact and delays in taking protective measures of their savings in their homeland, especially in the beginning of the crisis, also impacted negatively the contraction of remittances. The same declining situation arises in the years 2009 -2010 as well.

The consequences of the collapse of remittances will be shown considerably to the increase of poverty, reduction of imports, deterioration of macroeconomic indicators, lower private savings and investment.

## 6. Conclusions

Tourism sector is seen as the most important branch for sustainable economic development, which should focus the energies of society to create an economic sector based on long-term development plans that harmonize and reveal the opportunities.

Tourism is considered as a priority branch by the government, which is interfering in the development of the country's infrastructure, but also in legal and institutional framework, to promote investment in tourism but also to attract tourists, whose number is worth mentioning that is growing by year to year.

The choice of an economic development based on tourism should definitely bring a management model to maintain and evaluate cultural and natural properties as a premise of economic development.

Bearing in mind the current conditions, the economy researchers of our country suggest a drafting of an anti-crisis measures package for coping with the consequences, which are being felt in tourism.

Given that the problem is complex and combined, requires a broader participation of stakeholder's politics, financial and banking institutions, organizations and employers' associations (unions) of employers (business), university circles, research institutes etc... In compiling this "anti-crisis package" we should "imitate" rationally the practices of EU countries and carefully evaluate the advice of specialized institutions such as IMF and World Bank etc.

In this period, government spending should be reduced, even by reviewing the annual budget indicators and to restore institutional cooperation with the IMF

This will create conditions to attract "soft" credit, as well as opportunities for the most appropriate fiscal policy in times of crisis.

Only in this way, comprehensive cooperation and effort will be able to minimize the effects of global crisis over the whole economy in general and on the living level of each citizen in particular.

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## SECTION XI: TOURISM MANAGEMENT

### IMPACT OF SPORT TOURISM SERVICES IN ALBANIA

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#### **Abstract:**

*Sport Tourism is an emerging field in our country. The main scope of this case study was to observe sports and recreational activities offered by hotels and tourist resorts. Services of Sport Tourism are more widespread in the coastal part, where the main tourism hotels and resorts of Albania are established. The research methodology of this study was descriptive, based on questionnaires and interviews. The data gathering was based into 2 perspectives: a) sport tourism service from the customer point of view, b) sport tourism offers from the manager's point of view. The selection of data was based on a random sample of eleven hotels located in the coastal part from Vlora to Saranda, three hotels in Korca and Pogradec and two hotels in Tropoja. The data was combined into two questionnaires. Interviews were conducted in order to collect information from managers for the the short term and long term planning of Sport Tourism offers. Statistical analyses results showed an evident increase of the Sport Tourism Offer and Request. This case study results outlined: a) Businesses of Sport Tourism are present in the Albanian market and sport products offer is expanding in the recent years, based on customer request. b) Analyzing customer needs and marketing of sport products by promoting sports and recreational activities during tourists' visits is very important for the present and future of sport tourism, c) Sport Package Offer has demonstrated a growing impact and plays an important role in the tourism field outcome.*

**Key Terms:** Sport Tourism, Sports and leisure activities, Tourist Accommodations.

**JEL Classification:** M10.

#### **1. Introduction**

##### **1.1 Research Background**

Sport Tourism has become an emerging field in Albania. The main scope of this case study was to observe sports and recreational activities offered by hotels and tourist resorts. Services of Sport Tourism are more widespread in the coastal part, where the main tourism hotels and resorts of Albania are established. There are a number of benefits by offering sport and leisure activities for both customer and the host destination. On a large scale it improves quality of service and generates income both on nationally and privately.

Main objectives of this empirical research were:

1. Provide information about accessible sport and leisure infrastructure of the hotels
2. Determine participants perception of sport and leisure services offered
3. Uncover the perceptions of hotel managers towards sport tourism

##### **1.2 Literature Review**

The economic, social and cultural impact of sport and leisure on tourism has been investigated in several works [1], [2], [3]. Standeven & de Knop (1999) research highlighted “a strong symbiotic relationship” between sport and tourism by providing economic and social benefits. A review of recent works on the field of tourism and sport tourism [5], [6], [7], [8], [9], [10] investigated various perspectives of the field.

## 2 Research Methods

The research methodology of this study was descriptive, based on questionnaires and interviews. Data gathering process was based into two perspectives:

1. Sport and leisure tourism service from the customer point of view (based on hotels managers perceptions)
2. Sport tourism offers from the manager’s point of view (based on customers perceptions)

The selection of data was based on a random sample of eleven hotels located in the coastal part from Vlora to Saranda, three hotels in Korca and Pogradec and two hotels in Tropoja. Questionnaires and Interviews development was based on literature review [11], [12], [13], [14], [15], [16] :

- a) Identification and evaluation of sports and leisure activities currently offered
- b) Short term planning for sports and leisure activities
- c) Long term planning related to sports and leisure activities

Interviews were conducted individually with hotel’s managers. These qualitative sources were used to identify current access of sport services and discuss for future improvements in the field.

## 3 Results

Perception of service quality level was evaluated on a four dimensions basis: Tangibility, Responsiveness, Assurance and Reliability. Scores were measured on a five-point Likert scale from 1 to 5 (1= strongly disagree, 2= disagree, 3= neutral, 4= agree, 5= strongly agree).

### 3.1 Descriptive Analyses

Descriptive analyses was conducted in order to evaluate quality of the services offered based on customers perception. These results are summarized in Table 1.

	Mean	St. Deviation
<b>Tangible</b>		
1. Equipment were clean and worked properly without causing breakdowns	4.02	0.71
2. Equipment were up to date	3.84	1.09
<b>Assurance</b>		
3. Staff was supportive by providing physical safe	3.88	1.02
4. Staff explained clearly safety instructions	3.89	0.99

Responsiveness		
5. Staff had good communication skills	3.96	0.79
6. Staff was polite and professional	4.11	0.71
Reliability		
7. Services were provided as you were promised	4.04	0.92

Twelve out of sixteen managers reported that income related with sport and leisure services was lower than 10% of their total income. Four out of sixteen managers reported that income related with sport and leisure services was greater than 10% of their total income.

### 3.2 Qualitative data analyses

Qualitative data analyses of the interviews conducted with hotels managers outlined that offering sport and leisure activities can bring to:

- Encouraging visitors to stay longer
- Allows local people an opportunity for economic and educational growth
- Stimulating visitors to travel to a particular destination;
- Offering media coverage and promotional opportunities for a destination
- Facilitating repeat visitation.

A conceptual framework of the questionnaires and interviews development is presented below (Figure 1).

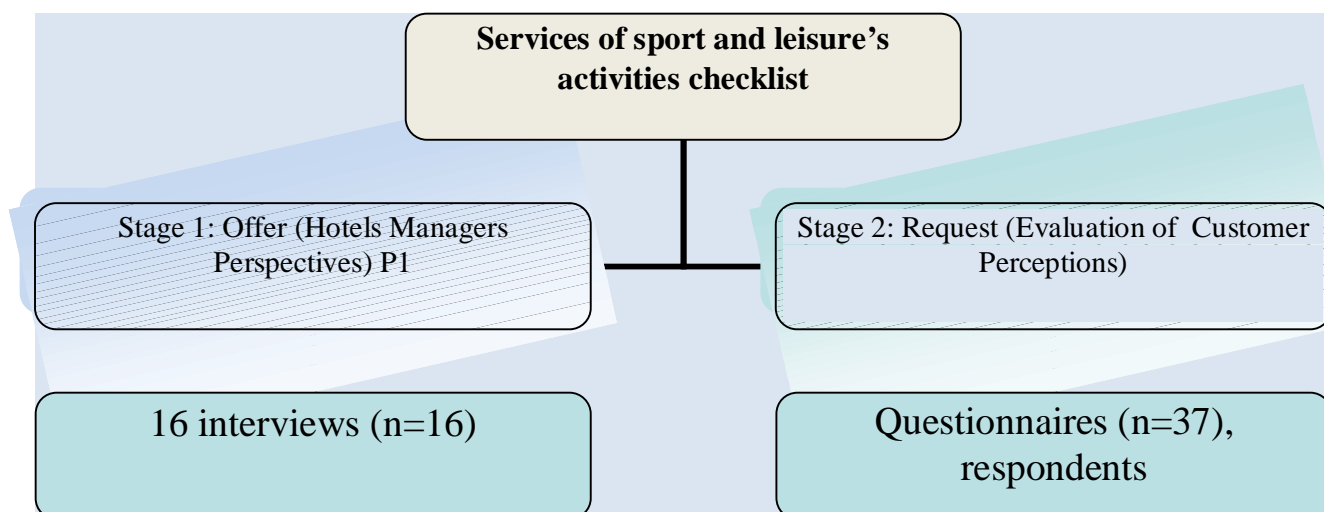


Figure 1: Conceptual data gathering framework

A summary checklist of the sports and leisure activities offered from the selected hotels is presented in Table 1.

Table 1: Summary of sport and leisure activities offered during hotel accommodation

<b>VLORA , SARANDA</b>	
Swimming	Boating
Surfing	Basketball
Canoeing	Tennis
Parasailing	Diving
Jet skiing	Football
Fishing	Diving
Beach Volley	SPA
Parachuting	
<b>TIRANA</b>	
Football (mini)	Tennis
Dancing	Boxing
Bowling	Body Building
Fitness	Basketball
Aerobics (Zumba)	Cycling
Football	Fitness
Horse-riding	Yoga, Pilates
Basketball	SPA
Volleyball	Climbing
<b>KORCA</b>	
Basketball	Tennis
Skiing	Horse-riding
Climbing	Volleyball
<b>TROPOJA</b>	
Climbing	Tennis
Volleyball	Basketball
Horse-riding	Shooting
	Skiing

#### 4 CONCLUSIONS

This research has provided an empirical understanding of sport and leisure tourism in Albania. This case study results pointed out several milestones:

- Businesses of Sport Tourism are present in the Albanian market and sport products offer is expanding in the recent years, based on customer request.
- Analyzing customer needs and marketing of sport products by promoting sports and recreational activities during tourists' visits is very important for the present and future of sport tourism.
- Sport package offer has demonstrated a growing impact and plays an important role in the tourism field outcome.
- Businesses are looking forward to professional animators and instructors in order to improve quality of service.

Research results outlined that sports and recreational activities is a fast growing sector in the tourism field in our country. Combination of promotion of a sport event with promotion of a destination can bring to economic gain. Moreover, the hotel managers should ensure that service quality dimensions are considered to improve the level of service quality at sport and leisure events and activities.

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## MANAGING REGIONAL DEVELOPMENT: EMPIRICAL EVIDENCE ON TOURISM CONTRIBUTION

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### **Abstract:**

*Tourism is one of the greatest sources of economic growth and is detected by many undeveloped and developing countries as the only way-out for economic prosperity. This study argues the inevitable relationship between tourism and regional development with an aim to investigate the potential of successful contribution of tourism to regional development in the south-west part of Macedonia. In particular, it makes an attempt to explore and compare the NUTS3 regions from the perspective of tourism potentials for regional development. This empirical evidence reports on analyses based on stylized facts obtained from secondary data. The outcomes point to the fact that the South-West planning region is the leading statistical region in Macedonia when referring tourism and regional development issues. Yet, despite its enormous potentials, tourism still has not reached its peak point. So, the paper strongly recommends this evidence as a good example for boosting regional development through tourism application. Furthermore, it urges the need for identifying effective framework for mitigating the up-to-date modest results and creating sound public policies. Additionally, the contribution of this paper lies in the fact that it enriches the poorly-developed empirical academic work within this scientific area in Macedonia.*

**Keywords:** *Tourism; Regional development; South-West planning region; Macedonia.*

**JEL Classification:** L83, R11, R58, H76.

### • **Introduction**

Tourism has emerged as important factor for regional development. It has a major economic and social impact at regional and local levels, particularly in the areas where tourism activities take place. Hence, some regions were highly positively influenced by tourism impacts, like mainly coastal (Emilia-Romagna, Italy), mountainous (Valais, Switzerland), urban and historic (Ile-de-France, France) or regions with exceptional natural resources (Quebec, Canada and Arizona, USA). Additionally, regions with different profiles can also benefit from the growth of tourism. In this line, they can be rural, promoting green tourism, leisure and nature activities (Queensland, Australia), very remote, (Greenland, Denmark) or regions undergoing industrial restructuring (Nord-Pas-de-Calais, France).

The regional development of tourism can trigger general economic growth by creating new dynamic. It can also contribute to better land use planning by countering rapid urbanization in developed countries and by attracting populations to new regions where tourism is developing. However, some guidelines for development must be laid down in order to preserve resources, ensure complementarity between areas and define tourism poles. Yet, tourism development in the underdeveloped areas enables development of the periphery, retaining the population in the homeland, infrastructure is improved as well as all other activities which contribute to prosperity of the region and a country.

Like many countries, Macedonia has been affected by growing regional inequalities during transition. Pre-existing regional inequalities have intensified during the transition process and have been exacerbated by non-economic factors. Per capita income in the capital city of Skopje is far above the rest of the country and became the main pole of development. While the other regions have secondary towns that are poles for their development, none can compete with the capital. Consequently, this kind of mono centric pattern of development underpinned huge differences in the quality of life among the other regions.

Although regional policies have been put in place over the years and a process of decentralization has been applied since the end of 2001 conflict, they have as yet not addressed these fundamental inequalities. In recent years eight planning regions have been defined, each with own specific characteristics and development problems. In that line, the Law on Equal Regional Development, set in 2007, laid the foundation for a regional policy that conforms to EU standards and foresees resolving the problem of delayed development of some regions in an institutional manner. For that purpose, a Council for Equal Development has been established with a mandate to coordinate regional development policy. Moreover, a Council for the Development of the Planning Regions has been established as a body responsible for policy implementation in each planning region. The former Agency for Economically Underdeveloped Areas was transformed into the Regional Development Bureau. Additionally, the National Strategy for Sustainable Development and National Strategy for Regional Development [1], [2] offered possibilities for revitalization of numerous deserted areas in Macedonia. Furthermore, recently revised National Strategy of Tourism Development [3] gives recommendations for tourism development and identifies five strategic clusters as a framework to Macedonian tourism development.

The objective of this paper is to disentangle tourism influence on regional development of Macedonia in terms of basic economic parameters and tourism indicators. In order to achieve that goal, the paper addresses the case of the South-West planning region as the best practice and the leading statistical region when referring tourism development. It is reach on recommendations for this region as a good example for boosting regional development through tourism application. Furthermore, it urges the need for identifying effective framework for mitigating the up-to-date modest results and creating sound public policies. Additionally, the contribution of this paper lies in the fact that it enriches the poorly-developed empirical academic work within this scientific area in Macedonia, with certain exceptions [4].

## 2. Literature review

The concept of regional development includes on one hand, the dynamics of development of specific areas, primarily understood as a regional economic development of those areas, but also regional traffic, population or environmental development. There is a large body of literature which main thesis are that regional development must be based on the exploitation of best potentials of the regions environmental features, and sustainable development must be based on reasonable regional development.

In this respect, the conventional thinking about the relationship between tourism and regional development is present in the most studies [5], [6], [7]. Other researchers investigate the local, place-based factors that influence tourism development, and ask why some tourism areas develop more than others [8]. Likewise, a focus is put specifically on the less developed world and by arising many assumptions about the role of tourism in development and, in particular, highlighting the dilemmas faced by destinations seeking to achieve development through tourism [9], [10]. Some authors even endeavor to a critical approach within a multi-disciplinary framework to relook at the complex phenomenon of tourism development [11], [12]. In the last twenty years, large regional differences in the quality of life have emerged within many transition economies [13].

Tourism is seen as a 'sunrise' industry that is labor intensive and therefore offers the potential to be a substantial source of employment. In short, much attention has been directed to tourism's economic potential [14], [15], [16]. Due to the relationship between food and tourism, some authors underscore the significant opportunity for product development as a means to rural diversification [17]. Others examine the contemporary issues and reasons for tourism development as a strategy for urban revitalization [18] as well as for providing the basis for a better informed integration of tourism in regional development strategies [19]. Moreover, some discussions are towards various policy innovations as activities by regions in terms of tourism development considering continuous growth within the sector [20].



Additionally, as tourism and regional development are closely linked, regions and local authorities play a key role in the formulation of policy and the organization and development of tourism [21].

### 3. NUTS classification

In 2007, under the imperative to harmonize its laws with the EU, Macedonia adopted the Nomenclature of Territorial Units for Statistics (NUTS 3 level) and created eight statistical regions: Vardar, East, South-West, South-East, Pelagonija, Polog, North-East and Skopje. These regions serve as main units for development planning. Moreover, they have been assigned the role of planning regions entitled for planning process and implementation of a consistent regional development policy and for harmonization with EU regional policy. Each of the planning regions has a Centre for development established for the purposes of carrying out professional tasks relevant for the development of that particular region.

The experience of the Central and Eastern European countries show that there is no obligation under the EU law to align NUTS units to the existing administrative organization of the country. However, “for practical reasons regarding data availability, the design of the statistical units follows the borders of the existing administrative units, and it is usually revised following an administrative reform in the respective country” [22: 182].

### 4. Methodology

The paper makes an attempt to document different views and paradigms on tourism development in an in-depth manner. So, the objective of this research is to give an overview of tourism importance as a source of economic development in the south-west part of Macedonia. In order to fulfill its main aim, the paper is reach on different types of analyses mostly based on available sources of secondary data, being reach on stylized facts.

Yet, despite the enormous potentials, tourism in the South-West planning region in Macedonia, still has not reached its peak point. On one hand, this empirical evidence underscores a good example of tourism application in regional development, but on the other, points out the necessity of undertaking governmental measures and initiatives for enhancing tourism contribution to the regional development.

### 5. Analysis, results and discussion

Generally, the paper addresses the issues of tourism flows, accommodation capacities, as well as tourism potentials of South-West planning region. For this purpose, the analyses are based generally on official sources of secondary data spreading over the sample period 2004-2011. The research findings point out that the South-West planning region is the leading statistical region in Macedonia when referring tourism and regional development issues.

#### 5.1. Tourism flows

The planning regions were created for regional development planning and for realization measures and instruments for promoting balanced regional development. With regards to tourism development, the data point to South-West planning region as the leading statistical region in Macedonia.

Table 1 describes tourist arrivals within the sample period 2004-2011. It is noticeable that the South-West planning region is by far absolutely dominant in terms of tourist arrivals in comparison to other planning regions in Macedonia. In 2009, 170 127 domestic tourists visited the South-West planning region, thus representing 52% of total domestic tourism demand. Similar positive conclusion can be underlined when referring to international tourism demand, when the region was visited by 87 353 foreign tourists representing one-third of the total foreign tourists in Macedonia.

Speaking generally, this region participates with 40-50% or nearly one-half of the total tourist arrivals in Macedonia. This fact indicates that the South-West region is the leader in tourism development and may serve as a good example for other planning regions.

Table 1. Tourist arrivals by statistical regions in Macedonia, 2004-2011

Region/year	2004	2005	2006	2007	2008	2009	2010	2011
Vardar	8 334	7 564	8 173	8 419	7 799	9 448	10 572	12 086
East	9 865	9 377	12 069	10 813	13 739	12 680	13 054	13 615
South-West	222 950	236 434	233 218	255 257	276 669	257 480	234 665	249 746
South-East	44 094	61 851	58 577	66 043	84 031	90 998	84 856	108 555
Pelagonija	56 710	58 553	51 970	51 715	63 325	50 740	69 712	76 469
Polog	22 679	20 555	21 890	17 188	19 153	31 596	31 828	29 153
North-East	3 373	3 672	2 433	3 657	3 395	3 560	3 098	3 803
Skopje	97 010	111 700	111 143	123 120	138 209	131 268	138 456	154163
Total	465 015	509 706	499 473	536212	605 320	587 770	586 241	647 568

Source: Authors' own calculations based on: State Statistical Office (various years) [23], [24].

The South-West planning region has once again the leading role when analyzing tourist nights spent for the period 2004-2011. Namely, Table 2 performs that two-thirds of the total tourist nights spent are registered within this region i.e. 58-67% of the tourist nights spent are noted within the past eight years. This fact is not a surprise since it is in a direct correlation to the previously analysis outcome in terms of tourist arrivals. It can be concluded that the South-West planning region still has the biggest piece of the cake, although a downward trend is noted from 2008-2010 as a consequence to the world financial crisis.

The analyzed data perform that even 71% of total domestic nights spent and 43% of total foreign nights spent are registered in the South-West region. The last available official statistical data addressing 2011 indicate that 56% of the total tourist nights spent are recorded in the South-West planning region.

Table 2. Tourist nights spent by statistical regions in Macedonia, 2004-2011

Region/year	2004	2005	2006	2007	2008	2009	2010	2011
Vardar	17 772	15 803	16 880	15 530	13 861	17 228	20 137	21 139
East	26 406	19 909	28 989	21 694	28 449	27 509	25 687	28 852
South-West	1170481	1288135	1244487	1351806	1452205	1326192	1168824	1 209 187
South-East	233 738	208 858	218 077	211 619	260 351	277 030	262 787	312 377
Pelagonija	176 930	178 814	155 461	152 726	171 928	139 699	170 354	208 918
Polog	53 450	50 476	53 824	37 986	45 345	61 146	61 455	54 787
North-East	5 684	6 066	4 003	5 677	5 130	6 247	5 628	6 807
Skopje	180 973	201 980	195 674	222 674	258 251	246 555	305 345	330 967
Total	1865434	1970041	1917395	2019712	2235520	2101606	2020217	2 173 034

Source: Authors' own calculations based on: State Statistical Office (various years) [23], [24].

Chart 1 represents tourist arrivals and tourist nights spent in the South-West statistical region in Macedonia for the observed period. It is noticeable that the peak point for both variables was reached in 2008, being followed by sharp decrease in 2009 and 2010. Namely, due to the world economic crisis, the up-ward trend was replaced with negative results. Yet, first positive impulses are noted in 2011 with modest, but encouraging recovery.

Chart 1. Tourist flows in South-West planning region, 2004-2011

Sustainability of tourism as a leading accelerator for development in the South-West planning region is supported by another positive finding. Namely, this region is well-established as a leading tourist center in Macedonia since it fulfills the highest average length of stay. So, between 2004 and 2011, the average length of stay is between 5 and 5.4 days. When compared with the average of Macedonia which is 3.4 to 4.2 days, it is 1.5 times higher. Thus, one must respect tourism results of the South-West region and appoints tourism as the strategic priority areas for regional development.

## 5.2. Accommodation capacity

The analysis of the accommodation capacity is important since it argues the (in)appropriateness of tourism accommodation supply. In this respect, it is noted that the comparative analysis of the estimated values regarding the number of needed hotel beds with the existing ones, points to an over dimension of hotel accommodation capacities in Macedonia [25].

Table 4. Accommodation capacity by statistical regions in Macedonia, 2008-2011

Region/year	2008		2009		2010		2011	
	Number of rooms	Number of beds	Number of rooms	Number of beds	Number of rooms	Number of beds	Number of rooms	Number of beds
Vardar	550	1 504	508	1 360	554	1 496	589	1 701
East	588	1 729	598	1 718	533	1 591	544	1 606
South-West	16 154	41 703	16 369	42 103	16 013	41 458	16 033	41 454
South-East	2 095	5 893	2 152	5 750	2 105	5 714	2 277	6 069
Pelagonija	3 053	8 993	3 102	8 999	3 390	10 229	3 330	10 165
Polog	1 020	3 046	1 080	3 182	1 011	3 057	1 018	3 058
North-East	291	800	297	805	292	633	302	645
Skopje	2 201	5 429	2 284	5 644	2 291	4 914	2 355	5 039
Total	25 952	69 097	23 390	69 561	26 189	69 102	26 448	69 737

Source: Authors' own calculations based on: State Statistical Office (various years) [23], [24].

The issue of accommodation capacity is addressed with an aim to lead us to concluding remarks weather key actors which are responsible for tourism policy, should carry out measures and activities for enhancing tourism competitiveness in the South-West planning region. Table 4 gives an overview of the accommodation capacity in all eight statistical planning regions in Macedonia for the past four years (2008-2011). On average, during the sample period, the South-West region accounts for 63% of the total number of rooms in Macedonia and 60% of the total number of beds. However, the limited data regarding the structure of the accommodation capacity prevented us in more in-depth analysis.

## 5.3. Tourism potentials for regional development

Due to variety of positive economic impacts, Macedonia identified tourism as a national strategic orientation. In this respect, five strategic clusters were defined and recommended as starting points to boost tourism development in Macedonia (Government of the Republic of Macedonia, 2012). So, lake tourism, wine tourism, cultural tourism, rural and mountain tourism are introduced as strategic orientation of the country by 2015.

Table 5. Cluster for cultural tourism

Place	General condition	Image/ international brand	Image/ regional brand	Tourism resources	Involvement of interested parties	Accessibility	T o t a l  p o t e n t i a l
							s

Ohrid (South-West)	+++	++	+++	+++	+++	++	16
Prilep (Pelagonija)	+	-	+	++	++	+	7
Skopje (Skopje)	+++	+++	++	+	++	+++	14

Source: [3: 88].

Table 5 presents the selection of top-three locations within the cluster for cultural tourism. It is visible the effort for balanced regional development. Based on several criteria, generally on tourism resources, comparative tourism values and development potentials, the city of Ohrid is ranked on the first place.

Table 6. Tourism potentials of South-West planning region

Place	Type of tourism
Ohrid	Lake tourism; Eco tourism; City tourism; Events; Cultural tourism; Wine tourism; Alternative forms of tourism
St. Naum	Lake tourism; Eco tourism; Cultural tourism; Fishing
Struga	Lake tourism; Eco tourism; City tourism; Events; Cultural tourism; Wine tourism; Alternative forms of tourism
Kicevo	Mountain tourism; River tourism; Fishing; Hunting; Eco tourism; Cultural tourism; Transit tourism
Debar	Thermal tourism; Mountain tourism; River tourism; Fishing; Hunting; Eco tourism; Rural tourism; Lake tourism
Pesna	Speleological tourism
Radozda	Lake tourism; Fishing
Pestani	Lake tourism; Cultural tourism; Fishing; Eco tourism
Trpejca	Lake tourism; Cultural tourism; Fishing; Eco tourism
Vevcani	Rural tourism; Cultural tourism; Events; Mountain tourism; Eco tourism

Source: [3: 41-42].

Although all eight statistical planning regions in Macedonia have potentials for tourism development based on variety of natural and cultural attractions, the undertaken analysis indicates on shortage of identified types of tourism as priorities for regions' tourism development. Yet, the priorities may serve as a starting point in the process of creation competitive tourism supply which might enable regional development, but with obligatory attention of their sustainability.

The above noted analysis outcomes clearly indicate an inappropriateness of current tourism development. This is mainly due to the lack of correspondence and balance between existing tourism potentials and development effects. Table 6 presents certain tourism potentials of the South-West planning region which might produce positive results, not only within that particular region, but in broader frames as well.

## 6. Future challenges

Positive effects of tourism are rising from day to day, not only for a separate region like the South-West, but also for Macedonia. It is noticeable that tourism has strong influences on the regional development so the developing countries as Macedonia are exploring it as a chance for development. Namely, tourism development affects the regional development and is interconnected with variety of other activities, like new jobs creation, traffic development and higher prices of land, from agricultural to building land, and alike.

However, numerous constraints and opportunities for regional prosperity through tourism development arise in the case of the South-West planning region. The key challenge is the lack of critical mass of users and suppliers. The local consumer base tends to be too small to support a diversity of businesses.

Consequently, it is difficult to develop a range of tourism product, and many regional destinations become tourism 'monocultures' with a small number of product types. Furthermore, tourism businesses tend to build greater reliance on tourism markets than those in major urban areas. This increases the pressure on tourism infrastructure, particularly transport and destination marketing. It also increases the need for tourism businesses to collaborate within and across other seven regions, as it will require a number of destinations to build an experience that will justify a visitor making the trip.

Beyond tourism policy, regional development policy generally can contribute to innovation capacity of destinations. In this respect, it is necessary that several point marks are included: (1) departments of regional development to recognize that departments of tourism have traditionally been charged with promotion rather than development and management; (2) many regions are not well connected with the people and organizations who represent important interests at state and national level, and facilitation is required to forge connections; (3) expansion of public sector funding programs to include build capacity to assess feasibility; and (4) to follow recent trends in regional development programs toward specific developments with immediate impact on particular communities.

### 7. Conclusion and recommendations

The paper in general shows that the potential role of tourism in economic development of the South-West planning region is significant. However, further development in tourism depends on: (1) public policies directed towards specific investments which is tailored according to the needs of the region; (2) efforts to increase tourist accommodation capacity and the occupancy rate in the planning region and (3) significant efforts to increase tourism income through subsidies, tax deductions, etc., as a precondition for regions' tourism development.

Furthermore, from the analyzed data can be seen that tourism potentials of the South-West planning region are still insufficiently used. The reason for this lies mostly in the nonexistence of a tradition of tourism development, poor development of the traffic network and the lack of modern hotel accommodation. There are only few geographic areas in Macedonia which are strongly affected by location factors in tourism development. This is the first factor that makes the South-West planning region different from other planning regions in Macedonia. With exception to the past few years due to the global financial crisis, this region notes upward trend in terms of tourist arrivals and nights spent. The foreign tourists mostly come from the neighboring countries and together with the domestic ones visit it for the well preserved and clean environment, the Lake Ohrid and the numerous cultural and historical monuments. Additionally, the research outcome disentangle that tourism industry must have a significant position in the regional programs and the development strategy being defined as a key opportunity for development.

So, the research allows increased understanding of the way tourism operates in the South-West planning region, and identifies potential challenges Macedonia may face in its attempt to employ tourism as part of a comprehensive regional development strategy. At the same time, it defines some strength that can be brought to tourism planning and management processes in the South-West planning region.

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## PLANNING AND PROMOTION OF SUSTAINABLE TOURISM DEVELOPMENT IN MACEDONIA

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### **Abstract:**

*Due to the fact that tourism generates many impacts which are contributing to the overall economic development, the inevitable connection is evident to the process of state, regional and community planning. This study addresses the role of government in its efforts for undertaking tourism policy that ensures hosting visitors by maximizing the benefits to all involved stakeholders, while minimizing the negative impacts associated with accomplishing successful destination. This has been a priority task to all governments, particularly to small and developing countries as Macedonia. So, the research addresses the role of government in its efforts for planning and promoting sustainable tourism development in Macedonia. Several key areas of governmental influence on tourism development are assessed based on available primary and secondary sources of desk-research. The paper is reach on comparable quantities analyzed by descriptive statistics with a data set generally covering a twenty year horizon and over. Despite the significant governmental efforts, the up-to-date results point to modest and limited outcomes with regards to the sustainable tourism development. This empirical evidence underlines the importance of government actions, support and encouragement as a prerequisite for well-established tourism planning process in the line of accomplishing positive impacts with larger extends.*

**Keywords:** Tourism; Government; Sustainable tourism development; Macedonia.

**JEL Classification:** L83, M38, O21, Q01.

### • Introduction

Being identified as one of the most promising industries that mainly contribute to world's economy, tourism became a challenge for every country. Small and developing countries are particularly interested in taking advantages of all positive impacts that tourism implies. It is generally accepted the role of tourism as a potential contributor to socio-economic development in destination areas. Moreover, the conventional thinking about the relationship between tourism and development is broadly addressed. The accent is put on the issue how governments have responded to the challenges the concept poses toward understand the complexities associated with sustainable tourism development [1], [2]. In this respect, it is underlined the necessity of posing practical plans for fostering harmonious relationships among local communities, private sector, NGOs, academic institutions, and governments at all levels. Furthermore, the aspect of developing management practices and philosophies that protect natural, built, and cultural environments while reinforcing positive and orderly economic growth, is addressed [3], [4].

Macedonia is one of the countries which have identified tourism as a mean for generating various micro and macro-economic impacts. Consequently, a National Strategy for Tourism Development 2011-2015 was prepared with a main vision - Macedonia to become famous travel and tourism destination in Europe based on cultural and natural heritage [5: 3]. Up-to-date, tourism in Macedonia has accomplished an average growth of 4.64% per year, which is higher than the average growth of the entire economy (3.12%). One may say that the contribution of tourism in the gross domestic product (GDP) is very modest with an average of only 1.7 % per year, but the impression is completely opposite when compared to the average for Central and Eastern Europe (CEE) of 1.6% [6: 6]. Regarding the participation of tourism employees in the total workforce of Macedonia, the national average is 3.1%, which is more than twice bigger than the average of the CEE being 1.4% in 2009 [6: 6].

The importance of tourism to national economy can be evaluated by tourism inflows which in 2009 represented 26% of total inflows of services and 8% of exports of goods in Macedonia. In the same line, the tourism inflows were 20% higher than the foreign direct investments. Accordingly, the net tourism inflows in Macedonia have an average of 1% of GDP [7]. Such condition indicates high potential of tourism effects especially in the line of international tourist arrivals, when an upward trend is expected to continue in the next period [8], [9], [10]. Moreover, certain efforts have been detected in applying tourism as a tool for enhancing and balancing regional tourism development in Macedonia [11].

Furthermore, the projected values referring tourism development in Macedonia are very optimistic. Namely, according to estimations by 2021 it is expected tourism contribution to the national GDP to reach 4.9% thus bringing revenue of US\$200 million. Moreover, the total contribution to employment including jobs indirectly supported by tourism industry is forecast to rise to 35 000 jobs (5.4%). Furthermore, the investment in tourism is projected to reach the level of US\$ 95 million representing 2.8% of total investment [12]. Consequently, Macedonia identified tourism as an industry which might contribute to enhancing foreign export demand for domestic goods and services, generating foreign currency earnings, new employment opportunities, repaying the foreign debt, increasing the national income etc.

- **Governmental intervention in sustainable tourism development**

One may argue that formulating appropriate tourism development plan and policy is not a trouble-free process [13]. Namely, tourism policy must be created in a way that ensures hosting visitors by maximizing the benefits to stakeholders, while minimizing the negative effects, costs, and impacts associated with accomplishing successful destination [14]. Yet, all efforts in order to consider and understand the interrelated nature of tourism industry require monitoring and evaluation when tourism policy issues are involved [15]. However, many case studies on planning provide indications that tourism policy may be viewed as simple by those whose job is to create and implement it [16].

Due to the fact that tourism generates many impacts which are contributing to the overall economic development, the inevitable connection is evident to the process of state, regional and community planning. In the same line, it is important to create a strategic document for tourism development as a strong mechanism in assessing the development priorities [17], [18], [19], [20].

In order to accomplish the projected economic targets, each government must define its role in undertaking operative measures and activities. Everyday practice has justified the state intervention in tourism industry regardless the size and effects. However, the overall state intervention usually does not provoke fully positive impacts on tourism development. On the other hand, the absence of governmental intervention in free market economy may lead to short-term benefits in tourism oriented enterprises, so the lack of a long-term control over tourism supply may occur. Therefore, the necessity of a balanced state approach in terms of tourism intervention is a must. So, the government may serve as balance between the exploratory power of private tourism enterprises on one hand, and its own interests, on the other. In this line, it must have been precious since the basic goals of the government and the basic goals of the enterprises may not intersect always, although having common interests in most cases.

Accordingly, the partial state intervention is identified as the best solution ever, despite the cognitive conclusion that this kind of “mixed” entrepreneurship often initiates strategic conflicts among the state and the private enterprises. In this respect, the preliminary task is to identify the priority areas of state intervention as the only way of making it the most effective. The government may not be directly involved in tourism support, except in some areas of national importance such as developing tourism information systems or national tourism promotion. Moreover, the government may initiate actions and activities for tourism development by ensuring funds or setting quality standards. So, this kind of intervention is acceptable as a supportive and balance-oriented concept. Therefore, the role of the government is to act as an economic power that will guide and manage tourism development. Its intervention is justified only when tourism by itself may not act efficiently.

- **METHODOLOGY**



Primary and secondary sources based on desk-research are applied in the paper. Different types of analyses are performed based on qualitative approach since the official statistical data are not always sufficient for pointing concluding remarks on particular issues.

Accordingly, the paper underscores the need for continuous analysis of tourism contribution as important consideration to all tourism key-actors responsible for creating development strategies in Macedonia. In this respect, the main conclusions should initiate urgent need for undertaking serious measures and activities for enhancing sustainable tourism development in Macedonia. More specifically, an effort is made to underline the importance of government actions, support and encouragement as a prerequisite for well-established tourism planning process in the line of accomplishing positive impacts with larger extends.

- **Analysis, results and discussion**

The role of government in maintaining tourism development is especially important and needs to be adequately defined in ever-changing environment. Its mission is particularly crucial in the process of implementing tourism development plan in order to achieve sustainable growth of tourism industry. This task can be accomplished by different measures and activities in the line of supporting international tourism or, by redirecting domestic tourists towards domestic tourism destinations. In both cases, it is fundamental to look at several issues referring the general role of government in different planning periods, the process of privatization, creating comprehensive tourism legislation, tourism promotion and the fiscal policy as well.

#### **4.1. Governmental role in different planning periods**

In order to gain more interesting conclusions regarding the general role of government in tourism development planning in Macedonia, a retrospective breakdown is made. Additionally, the major characteristics of several sub-periods are pointed out. The number of tourist arrivals is the basic variable analyzed within the period 1956-2011 (Chart 1).

Chart 1. Tourist arrivals in Macedonia, 1956-2011

Source: [21]

The lack of official statistical data referring to the earlier period for applied variable prevented us in its visual presentation in the Chart 1. However, it is known that before 1956, Macedonia had an administrative system of management, so generally the goals, aims and objectives of development plans were focused on domestic tourism. The state had an active role, so the investment policy was generally concentrated on enlargement of public hotel capacities as well as on the establishment of catering service and restaurants for the working class. In the line of supporting the domestic tourism, the government introduced certain reduction of traffic taxes.

The period covering 1956-1965 was characterized by workers self-management system. The government enhanced tourism development in Macedonia by undertaking various measures and activities for introducing an "open-door" and "good-neighbor" policy. Moreover, the government built many new accommodation facilities, educated and trained personnel for tourism industry, invested in tourism infrastructure, allowed free market price policy, presented discounts for domestic tourists up to 40% in the season and up to 60% in out-off-season, introduced subsidies in hospitality, granted capital tourism investments, invested in enhancement of international tourism flow etc. The positive upward trend can be seen in Chart 1. An exception of this positive trend is 1963 when a catastrophic earthquake destroyed Skopje - the capital of Macedonia. However, despite all above noted positive measures, this period is branded by the lack of clearly defined long-term tourism policy. So generally, the state acted partially and unsynchronized towards tourism obstacles by undertaking short-term and ad-hock measures and activities.

The period from 1966-1975 is an interval when tourism was defined among the priority areas of economic development of Macedonia.

Due to that fact, the government started to conduct extremely strong intervention by introducing tax allowances for stimulating construction of new tourism facilities, loans, credits, funds for regional development etc. The main aim was to initiate and stimulate positive tourism development outcomes. The accomplishment of this task is visually supported by the Chart 1 presenting that the tourist arrivals in this sample sub-period, really expanded.

Between 1976 and 1990, the government significantly changed its role in qualitative manner. Namely, the state continued with its intervention but only limited to certain, highly important areas such as funding tourism promotion, crediting capital tourism capacities, stimulating tourism income, enhancing tourism supply, initiating tourism networking etc. This is a period when tourism in Macedonia reached its highest peak ever with 1.2 million tourists.

The period from 1991 until today, represents a twenty year horizon of independence. The role of government in planning tourism development has considerably changed. Namely variety of shocks with which the country was faced (the collapse of former Yugoslavia, transition process, various reforms, political instability, war conflicts in neighboring countries, economic crisis, internal ethnic conflicts etc.) resulted negatively on tourism development. This is visually presented in the Chart 1 as an extreme downwards movement of the time series. The active role of government was transformed and tourism was marginalized. Consequently, until the end of 1990s, tourism stagnated as a result of a slow recovery and transformation process, a lack of coordination between the key-tourism players, a lack of foreign investments etc. Another breakdown is noted in 2001 due to the ethnic war conflict in Macedonia. After that shock, the government redefined the tourism as an important factor for economic development and put it in its agenda as a priority area. So, tourism is one more time seen as a chance for accelerating the economic development. Respectively, the government identified its role in formulating a medium and long-term tourism policy, preparing and implementing tourism development plan, creating tourism legislation, assuring tourism quality etc.

#### 4.2. Tourism promotion

With the establishment of the Agency for promotion and support of tourism in Macedonia in 2008, it became fully responsible for national tourism promotion. Before that, the Ministry of economy through the Tourism department was in charge for preparation and implementation of the Program for general tourism advertising. Regardless the institution accountable for raising tourism national visibility, the budget foreseen for this type of activity is of highest importance. Undertaking measures and activities for supporting tourism promotion is a common example of state intervention. So, permanent budget increase is an inevitable activity in order to gain more economic effects. As a case-example, we may mention the one from 2009 when Croatia had bigger budget for tourism promotion for 60% compared to the previous year [22].

In Macedonia, the budget expenditures allocated for the implementation of the Program for tourism promotion are very modest. Approximately EUR 130000 was allocated for 2012 [5], which is slight, though constant increase per year. The need for major efforts in the field of tourism promotion in Macedonia is illustrated by the fact that Macedonia has been ranked low on the list of the most attractive destinations for travel and tourism. Namely, Macedonia was ranked at the 76<sup>th</sup> place out of 139 countries in 2011, having better rank only from neighboring Serbia, and Bosnia and Herzegovina [23: xv].

If we make a detailed analysis of all indicators concerning certain sub-indexes, many interesting concluding remarks emerge, in particular with respect to travel and tourism regulatory framework, tourism business environment and infrastructure, tourism human, cultural and natural resources etc. The tourism infrastructure index is categorized within the business environment and the necessary infrastructure for tourism and travel development. Thus, it represents its appropriateness by a score of 3.8 being ranked at the 69<sup>th</sup> place out of 139 countries [23: 256].

As part of the effort for strengthening its tourism competitiveness, Macedonia has launched its first national web tourism portal in 2005. It is a platform created as a public-private partnership between an international donor and the Ministry of economy. Although, many other private initiatives act as additional tourism portals in order to support country's tourism profile, there is still need for more work.

The chaos of tourism and travel information present in the digital environment may be overcome by introducing tourism recommendation systems. It is a promising way to be different from the competitors and to meet tourists' needs and preferences in more intelligent way [24].

The shortage of allocated budget for successful tourism promotion of Macedonia, underscores the lack of professional approach towards promotion of its tourist products. Thus, despite the governmental efforts in this line, the modest and limited budget is the biggest obstacle in achieving better results.

## 5. Conclusion and recommendations

Tourism is an industry that may not be self-developed, so provokes necessity of applying certain forms of state intervention. In this respect, state intervention in tourism means direct participation of the government in tourism market. This may be accomplished generally, in two ways. The first one refers to selective allocation of funds which means market intervention of government as a financial institution. The second approach is a direct control over tourism enterprises which means state's inclusion in the business. Consequently, if tourism development is out of control, variety of conflicts may arise. So the government must be included in order to make certain positive-oriented interventions. To which extend this intervention will appear, depends on many factors, out of which the political orientation of government is the most explored. Usually, governments that support free market and open economy, often create encouraging environment for successful tourism development in contrast to central-oriented ones.

Tourism outcomes in Macedonia refer to the need of government support and encouragement in the line of accomplishing positive impacts with larger extends. Yet, the state intervention should be based on balanced background regardless the applied forms. So it is irrelevant whether the state interferes directly through the Ministry of economy, or indirectly by the foreign policy. The main aim is to implement different measures and instruments in order to manage tourism flows in the line of fulfilling the projected goals.

The general conclusion is that Macedonian tourism suffers from lack of coordinated activities and organizational forms functioning on horizontal and vertical line, unclear set of goals, aims and field of interest within the public, as well as the private tourism sector. Although some significant efforts have been made in promoting tourism, yet the modest and limited budget is the biggest obstacle in achieving greater competitive advantages. The result is a poorly developed tourism industry. Therefore, as a starting point, partial tourist products must be introduced until the moment when certain preconditions are created in the sense of strengthening the cooperation between all key actors in tourism. Hence, it can be concluded the need for further governmental intervention in tourism in Macedonia, with emphasize to be supportive and balanced since up-to-date effects are positive, but very modest.

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**CRITICAL SUCCESS FACTORS FOR ANE-TOURISM SERVICES IMPLEMENTATION. THE CASE OF ALBANIA**

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**Abstract:**

*With the rise of the Internet, online delivery of public information and services has become crucial to be a key enabler to support E-government services. On par with the development of all nations in the world, the government of Albania has taken every effort to implement and improve public services delivery system within the E-government concept. This study examines the extent of E-services features applied in the E-Tourism sector in Albania.*

*The study will identify the critical success factors for a successful implementation of an E-Tourism portal. In order to achieve this, a list of factors is identified for investigation. A study is carried out systematically to investigate the critical success factors of an E-Tourism portal. The success factors are based on the feedback from the potential users of the portal. Upon identifying the critical factors, a selection is done based on the priority ranking. With the critical factors extracted from the study and based on the framework of an E-Tourism service, E-Tourism portal has been developed.*

**Research Objectives**

*We have set the following objectives:*

- 1. To identify the relevant factors necessary for an E-Tourism system for the Ministry of Tourism of Albania.*
- 2. To assess empirically, the critical success factors for an E-Tourism system in Albania.*
- 3. To propose a framework that can be adopted for the development of an E-Tourism services implementation initiative in Albania.*
- 4. To develop a prototype of E-Tourism portal based on the proposed framework for Albania.*

**Research questions**

*The management problem of critical factors raises many questions to be addressed by the researcher as part of this study:*

- 1. What are the important factors for an E-Tourism system?*
- 2. What are the critical factors of a successful E-Tourism system?*
- 3. Is E-Tourism important for Albania?*
- 4. Are the communities and enterprises in Albanian tourism industry collaborating electronically?*

*Using these questions as a starting point, a scope of work that will significantly provide the customer of what is expected from a successful E-Tourism portal will be identified.*

**Key words:** *public information, services, management, e-tourism.*

**JEL Classification:** *M39*

**Introduction****Critical Success Factors**

The technology has evolved and the development methodology like Service Oriented Architecture (SOA) has spanned into a framework for E-Tourism services.

The aim of this study is to develop an advanced E-Tourism portal to connect customers with virtual service providers anywhere at all times with the ever growing needs and requirements of the modern day tourists. The vision is to enable extensive exchange of information within the tourism industry supply chain players cutting across all time and geographical limitations. This will be done through the integration of information and bringing together the stakeholders to work together. The availability of an integrated E-Tourism services portal will be complementing the existing E-government initiatives of the Tourism Ministry of Albania. The results show not only the critical success factors but also the ranking.

These are used to develop the proposed E-Tourism portal for Albania. The implications of this result will lead the E-Tourism portal to be more in line of the Voice of the Citizen. E-government is an important application of the internet and is used by authorities to encourage broad use of computers and to facilitate communication and interactions with its institutions, citizens and businesses. The World Bank Group (2002) defines E-government as "the use by government agencies of information technologies (such as wide area networks, the internet, and mobile computing) that have the ability to transform relations with citizens, businesses, and other arms of government".

E-government is about doing things electronically with the use of the most innovative information and communication technology to deliver the most effective and efficient service to Albania tourist and citizens. To adopt E-government efficiently and effectively, the government relies on information and communication technology (ICT).

E-government offers huge benefits such as reduce corruption, discrimination, and better service on government related matters towards citizens, business and government employees. E-government is a tool in building good governance and transparency.

Critical Success Factors (CSF's) are the critical factors or activities required for ensuring the success of your business. The term was initially used in the world of data analysis, and business analysis. Critical Success Factors have been used significantly to present or identify a few key factors that organizations should focus on to be successful.

## RESEARCH METHODOLOGY

The primary aim of this research is to study the critical success factors of an E-Tourism based on the primary data and secondary data.

The researchers used quantitative research approaches due to exploratory nature of the research problem. The researcher conducted content analysis using qualitative analysis in identifying the suitable contents for the E-Tourism portal. From the established success factors for the E-Tourism portal the researcher progressed towards investigation the critical success factors using the quantitative analysis using the questionnaire survey.

### The Sample

This is a study of the E-Tourism portal in Albania. The relevant populations of this study are the general public, enterprises and the government agencies in Albania and Macedonia. On this basis the sample had to be chosen from the general public across the population in Albania .

The researchers considers quantitative method to complete this study (Holme&Solvang, 1996). Predominantly qualitative method will be used to investigate the list or potential success factors for the development of E-Tourism portal for Albania.

Initially the researchers will identify a list of success factors from the literature review. This will form the secondary data as the researcher will be compiling data and models from the literature review conducted. These compilations are based on the established work done prior to this work.

Upon conducting the review the researcher will investigate which is the critical success factors from the list established.

The researcher will use questionnaire survey to extract the information from the target respondents in this study. The questionnaire survey is an observational cross sectional descriptive and analytical study using random sampling.

The survey conducted on the respondents will form the quantitative method. The data collected from the respondents are primary data.

The survey will be executed mostly through electronic mail correspondence sent out to the respondents. A small number of surveys will be done directly on a face to face basis. These surveys will be administered by the researcher based on the template questionnaire. The researcher also anticipates a small number of respondents to conduct a self administered questionnaire. The questionnaire is structured in such a way that the respondents fill the template by clicking the relevant answer from a drop down list for each of the questions.

### **The Instrument**

The instrument used by the researchers in this study was a questionnaire survey. The survey was divided into 3 major parts. Part A deals with the Demographics section. This was necessary to understand the background information of the respondents. Part B contains the current background information of E-government in Albania and Macedonia. Part C contains the questionnaire survey paper. Selections of the Success Factors from which the respondents will highlight the factors deemed important are included here. In this part the researchers chose an extensive list of factors from the wide literature review done during the course of the study. From the list a practical number of factors which the researcher believed to be suitable and relevant to the scope of study were selected.

The selected factors were then generated into a structured questionnaire design with a Likert scale of 1 – 5 as the answer. The scale one was used to indicate the least important and 5 being the most important as perceived by the respondents. The scale three was used to indicate indifference. The questionnaire contained mostly closed ended questions and a few open ended questions. The open ended questions were analyzed using the Affinity techniques.

### **Research Design**

The study is mainly a quantitative research. Questionnaire survey is used to get response data from the sample respondents. The survey is preceded by a quantitative analysis to complement the questionnaire survey. The analytical studies are used to identify the success factors from other E-Tourism portal. The outcome of this is to generate a list of factors perceived as important for the implementation of an E-Tourism portal in Albania. The overall research is designed to identify the key success factors for the successful implementation of E-Tourism portal in Albania.

A model was created to lead the identification of the critical success factors of an E-Tourism portal development. This model development includes the questionnaire design. This model was then laid out to test the selected factors from the literature review and the established concepts of E-Tourism.

Data collection was done by the researcher from online survey. Primary data was used in this research. The researcher collected primary data from questionnaire survey as part of this study.

### **Research variables**

The Critical Success Factors of an E-Tourism portal are divided into four parts, as shown below, any parts of these include pages and those pages especially to that parts, the researcher has some pages for general information, exchange and interactive and any transaction can the tourists do it through E-Tourism Portal (Y)

- Informational
- Interactive
- Transactional
- Collaborative

## Methods

The questionnaire was sent by email to a selected number of users in Albania at random. However the respondents were categorized into groups which are identified from the literature review and mainly includes students, clerical, management, professional, housewives, academics, businessmen and civil servants. Other important variable of demography was included in the questionnaire survey. This will include age group, educational background, work status etc.

## Demography data analysis

It can be seen that there are a total 102 respondents in this survey. Among the respondents, 68 are in the 21 – 30 years old age group. This group accounts to 66.7% of the respondents. 2 of the respondents are from the younger age group of less than 20 years old comprising 2% of the respondents. Among 32 of the respondents are from the 31 – 40 years old age group forming 31.4% of the respondents. It is interesting to note that from the total of 102 respondents; only 15 female respondents participated in this survey. They account only 14.7% of the respondents.

The rest of the respondents that is 85.3% were males. In total there were some 87 male respondents in this survey.

In terms of educational background 75.5% or 77 of the respondents hold a Bachelors degree. Masters and PhD holders form 20.6% of the respondents. There are 20 Masters holders and one PhD holder among the respondents. Only 4% of the respondents do not have a degree. There are 2 Secondary school leavers and another 2 have a diploma.

There are 33 respondents who are in a Senior Management position comprising 32.4% of the total respondents. Among 9 managers accounting to 8.8% of the respondents were seen here. There were 23 students or 22.5% of the respondents taking part in this survey. Computer technicians form a fifth of the respondents amounting to 20.6% with some 21 of them in this group. Among 9 of them were engineers, 2 trainers and 2 of them were supervisors.

Greater parts of the respondents are from the Information Technology fraternity. There were 32 respondent or 31.4% of the respondents in this group. Some 26 of them were in the education sector forming 25.5% of the respondents. Service industry forms 17.6% with 18 personnel. Healthcare sector respondents form 18.6% with their 19 responses. Manufacturing sector had 6 respondents accounting to 5.9% of the total respondents. One of the respondents did not specify the sector he or she is from.

In terms of number of times dealing with the public sector the result shows that 67 of them dealt with the public sector for less than 5 times in a year. This amounts to 65.7 % of the respondents. Some other 25 respondents say they dealt 5-9 times in a year with the public sector accounting for 24.5% of the respondents. There were 5 persons in the 10-19 and 4 in the more than 20 times group in dealing with the public sector.

More than three quarter of the respondents dealt face to face with the public sector. This amounts to 79 respondents or 77.5%. Some 13 respondents used telephone as their means of dealing with the public sector accounting to 12.7%. One person used an agent to deal with the public sector accounting to 1% of the respondents. Seven respondents stated that they used other means to be in touch with the public sector. This group accounted for 7.8%.

In this study the researcher conducted a survey using the quantitative method to identify the critical success factors for an E-Tourism portal. The statistical analyses are used to strengthen the findings. The academic rigors were systematically observed and put in place by the researcher to ensure the results of this study adds to the knowledge boundary. The activities undertaken in the literature review, research methodology, questionnaire design, data collection and data analysis goes on to establish the critical success factors of the E-Tourism portal. The lists of factors are ranked to show the relevant importance of each of the factors from the highest to the lowest.



The research identified the potential success factors from the Literature Review and the observations from other portals. Identification and selection of the factors has been from the prior recognition only. The factors were preselected rather than systematically searching for the factors.

Other new factors were not able to be extracted from the respondents as this was not within the scope of the study.

In this study the researcher only considered one sided perception of the respondents. In future studies, the researcher can include another perception namely the Importance from the respondents. The researcher is of the opinion that future work and research inline of this research can include a number of other inclusions. The possible areas to be included in similar studies in future are including the online customer satisfaction survey and also the customer complaints management system.

### **Result of evaluation form**

Twenty students participated in the evaluation of the E-tourism portal. The evaluation includes three parts of questions:

- \_ Contents
- \_ Usability
- \_ Design

Student's evaluation results gave a clear idea and position message for the researcher. About 85 % of the participants said the E-tourism system is useful for citizens and tourist in the Albania. Total 87% of the students found that the E-tourism system was easy to use and any end users can use this system (Portal) without facing any problems or barriers. Total 86% of participants found that the E-tourism portal was clear and nice. Some suggested adding more pictures about tourism places.

Also 83% of the participants said there were enough services at the moment in e-tourism system. The result shown the mean of contents is (4.14), the mean of the usability is (4.2) and the mean of the design is (4.4). So in this case that indicate the evaluation of e-tourism system was good.

### **Recommendations and Conclusions**

The study has shown some useful information for the development of a tourism portal. Some areas for improvement are:

- Choice of a few language for the benefit of the portal users
- Interactive response for the respondents to evaluate the current status
- Dynamic interaction with the service providers based on the concepts of internet chat

This study has contributed a valuable experience of learning and conducting questionnaire surveys in an objective way. In terms of new and factual information, this questionnaire survey has objectively evaluated several factors of the E-Tourism portal and provides new insights. These critical success factors will be used more objectively in developing a future E-Tourism portal for the Ministry of Tourism in Albania .

The general objective of this research was to determine the critical success factors for an E-Tourism services implementation initiative in Albania.

Using the questionnaire survey as the basis of this study the researcher is able to conclude as follows:

- Identify the potential success factors
- Ascertain the critical success factors for the E-Tourism portal
- Rank the critical success factors from Most Important to Least Important

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**SUSTAINABLE TOURISM DEVELOPMENT. A PERSPECTIVE FOR KORÇA REGION.**

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**Abstract:**

*Nowadays, there is a growing concern for the protection of the environment and the adoption of business policies that will enable to the earth's resources to be sustained. The new environmentally aware values now emerging are challenging the underlying concepts of marketing. It is also essential the maintenance of a profitable and sustainable tourism sector at any particular destination. In this aspect, concern for sustainability is central to the management of both markets and the destination. Marketers are using marketing tools not only for creating a successful destination but even for oriented them to the sustainable tourist destination. This paper attempts to tell how a destination as Korça region can remain competitive and build a sustainable character, a factor which represents one of the most important competing advantages by using a model for sustainable tourism. So is made a study for this region and are build two questioners one for tourists and one for community. In the end is recommended how to make this destination sustainable and successful.*

**Key-Words:** Sustainable tourism, sustainable tourist destination, competing advantages, successful destination.

**JEL Classification:** M20

**Introduction**

Along with the growth of the tourism industry there has been an increasing debate about the negative effects of unplanned tourism development and the haphazard approach to mass tourism, particularly in developing countries (Getz, 1987). Factors such as cultural denigration, loss of traditional pride and ethnic identity as well as environmental degradation are reported (Hughes, 1994). Despite widespread concerns over the socio-cultural and environmental effects of tourism development, tourism scholars assert that the 'marketing approach' to tourism planning remains stagnant with a traditional focus on growth and economic gains (Ryan, 1991). This conceptualization is focused on a short-term view, whereby promotion activity is a key tool used predominantly to increase visitation, profits and market share. In essence, tourism marketing is seen as being analogous with advertising and selling a destination. The key criticism about contemporary tourism marketing practice is that it has not yet addressed fully and adequately socio-cultural and environmental sensitivity particularly at the community level (King et al., 2000). It is at this level that both positive and negative impacts are most acute. The criticism coincides with the observation that although the 'marketing concept' and techniques have been mentioned in many tourism studies, the techniques employed by the tourism industry are less advanced than in other industries (Calantone and Mazanec, 1991). From a pure marketing perspective, the fundamental question - 'who are the consumers of tourism?' - remains contested.

- “Sustainable Communities Model” (SCM)

Tourism marketers are being challenged to integrate *community needs and wants* into their previous exclusive, but inadequate, consumer (tourist) focus. Clearly, to implement a more responsible tourism marketing paradigm, the 'new' tourism marketing model needs to be more explicit in providing clear guidelines on how to include local community needs and wider social development issues into its processes. Achieving public participation however has not been a straightforward task. To exercise effective participation or involvement, local people and planners need motivation, education and training. In this context, community based marketing like other forms of planning should be viewed as a process that assists people and organizations within the community develop the skills necessary to manage or market their own place. Marketers and planners need to realise that community, who has been omitted from marketing programmes, should be identified as primary tourism customers. Based on this perception, an adaptation of the fundamental concept of marketing, which has its key concern with being 'customer oriented', should dictate the overall tourism marketing programme with a greater attention being paid to the community. One of the models that can bring sustainability is Sustainable Communities Model. This model is developed to:

- Quantify the actual environmental impacts & linkages of various development decisions
  - Analyze environmental & economic costs, savings, synergies & trade-offs
  - Optimize the sustainability
  - Being applied to private sector community development & redevelopment
- **Korça Region**

The Korça Region is located in the Southeast of Albania and borders Greece and Macedonia to the South and the East. It is a mountainous region with two major lakes, Lake Ohrid, one of the oldest lakes in Europe, which is shared with Macedonia and Lake Prespa which is shared with Greece and Macedonia (100 km<sup>2</sup> in Albania). The highest peaks are Gramozi in the East of the region at 2,523 m and Morava at 2,047 m. The altitude provides the region with an excellent climate which is very favorable for tourism - cool in summer and the snow in winter is an attraction for visitors. Population today is estimated at 361,000 inhabitants, 60% of which are actively engaged in work; however, there is some doubt about the accuracy of this figure as there is much population movement and many inhabitants work in Greece. The economy of the region is based on agriculture including farming, forestry and fisheries which account for 30% of overall production in the region. In recent years the construction and transport sectors have expanded, as have some service sectors such as the communication sector and tourism. However, the textile sector which under the previous regime was thriving is now declining. Today, SMEs in the Korça City and Pogradec areas are attempting to revive this industry. The focus of regional development plans has been on construction in recent years. Growth is expected in the transport sector, the communication sector, the tourism sector and trade in food stuffs. Remittance from immigrants living abroad is an important source of income and investment for the region.

Whilst the Korça Region has a very long history, distinctive traditions and an exceptional environment, tourism in most of the region is emerging as an economic sector (with to a certain extent the exception of Pogradec on Ohrid Lake where leisure vacations have been established over a longer period). Figures for tourist arrivals have not been collected or compiled but according to local stakeholders, there has been a significant increase of visitors in recent years. The region has an excellent mix of soft and hard cultural assets as well as outstanding natural assets. These are described in greater detail in the following section as are the markets that are currently visiting the Korça Region. The next few paragraphs provide an impression of the richness of the Korça Region but do not attempt to present the totality of the tourism products that exist.

• **Tourism Products in the Korça Region**

The region has a wide range of products based on its history, culture and traditions, its villages and its lakes and mountains.

*-The Villages of the Korça Region*

These constitute a major tourism asset and are located throughout the region. Several villages are located near Korça City including Voskopoja, Boboshitica, Dardha and Vithkuq.

**Voskopoja** is the best known and features on most tours that pass through the South East of Albania. Founded in the 16<sup>th</sup> century, Voskopoja by the 18<sup>th</sup> century was a major urban settlement housing the Academy, a centre dedicated to the development of culture and education.

**Boboshitica** is a historic village located on the plain close to Korça City. Several old houses and churches still exist in the village which is now especially famous for its mulberry trees.

**Dardha** is a mountain village, 20 km from Korça at 1344 m in altitude. The local inhabitants of Dardha are reputed for their hospitality, generosity and their traditional folkloric dance, music and costumes.

**Vithkuq** village is located in a very picturesque hilly environment 26 km from Korça. It is rich in fauna and flora. The village is split into three areas and boasts a number of historical monuments.

The villages on and around **Prespa Lake** offer visitors a different tourism experience in the Korça Region. The commune of Prespa comprises nine villages in total, seven of which are on the lake shore and two in the mountains, offering a range of landscapes and activities to tourists.

*-Current Tourist Markets Visiting the Korça Region*

Little research has been carried out on tourism market segments visiting the Korça Region.

*-The Domestic Market (including Albanians living in Kosovo, Macedonia and Greece)*

This is by far the largest existing market to the Korça Region which is attracted for a number of motives. Leisure tourism is focused around the Ohrid Lake and Pogradec is the destination for these tourists, particularly in the summer. Increasingly the domestic market from the main centres of Albania like Tirana and Elbasan are discovering villages of Prespa Lake and the other traditional villages of the region to enjoy the reputed local cuisine offered in tavernas, the good climate and fresh air and nature activities such as enjoying the snow and skiing in winter. Festivals and fairs, particularly those organized in Korça City in the last couple of years but also in other centers such as Pogradec, are gaining a reputation throughout the country and attracting domestic tourists from all over.

*-Ethnic Albanians living in Other Countries*

These include the Albanian communities in the United States, Canada, Germany, the UK, Italy, France, Australia and the Middle East. It is estimated that there are 1.8 million people of Albanian extraction living abroad.

*-American and Canadian Albanians*

The size of this market is difficult to estimate as there is little information.

*-People of Albanian descent in other Countries of the World*

Through the waves of emigration before and after the communist era, Albanians have settled in countries around the world. These communities have in common a sense of kinship and there are associations and organizations in most countries where there are Albanian communities

*-Foreign Tour Group Market*

According to key informants interviewed for this study, there are approximately 50,000 foreign tourists that come to Albania on organized tours using tour operators, of these just 5% to 10% include the Korça Region in their travels. Therefore, the number of foreign tourists on organized tours that annually visit the Korça Region is 3,000 to 5,000.

*-Independent Traveler Market*

These come to the Korça Region for a variety of reasons, from visiting friends and relatives, for business or work or simply for leisure.

*-Cross Border Market*

As the Korça Region borders both Macedonia and Greece, inevitably there is a significant amount of cross border movement for business, shopping and leisure.

*-Business Tourism Market*

Travelers on business are catered for in the three main cities of the region. There are a several locations which provide services for business meetings and seminars in the main cities.

-The major market of Korca region is it's community. Nobody has taken any study for this community to see how potent are they as a tourist consumers and what are their tendencies to spend money for tourism in their own country. Also how much are they informed about environment sustainability and sustainable tourism.

The major of touristic places in this region are in villages and the communities there are not good educated and informed about the importance of sustainable environment. The people that live in this villages are oriented in agriculture they even think that development of tourism in their places will be in perspective. The results of the questionnaires made in three villages Vithkuq, Voskopoja, Liqenas focused in their communities and in tourists are as below:

In this section the information gathered shows us a presentation by some of the local communities. This study areas have a significant community and interesting features, so of Liqenas area consists of a community which is considered as a minority (Macedonian) and shows some special qualities of the Albanian population, area Voskopoja so composed on a percentage top of the Vlachs that a population with its colors communication and lifestyle, while Vithkuqi area Vlachs constitute a very small percentage of the population. Given these features first question which relates to the length of time residential population tells us that a good part of the population has more than 10 years living in the area and a few came from other areas of the remote as a result of internal migration and increasing difficulties to live in these areas after the '90s, especially after the economic difficulties of recent years. From the survey indicated that 43% of the population lived from 11-20 years, 29% lived for more than 20 years, 14% live more than 12 months, and 7% respectively live 1-5 years and 6-10 years. However we should note that a high percentage of the population in these areas has migrated to neighboring countries and perhaps this powerful migration affects the results presented above. In terms of work performed 36% of residents work in agriculture, 28% had private business, 22% worked in the private sector, 14% in the public sector and 0% of the unemployed. To view links residents and tourists tourist sector surveillance gives us this information about 43% had frequent contact with tourists (12-24 times per month), 35% meet ever (6-11 times), 15% had low contacts (1-5 times), 7% had no contact and 0% very often (more than 24 times).

Regarding the improvements to be made in their locality, 100% of people think they need to make improvements in all existence attractions .Duke giving people opportunity to list three necessary upgrades have the following results: - 80% believe that:- improvements to be made in cult objects will maintained significant architectural buildings, will be organized the infrastructure to go to these attractions. While 20% of people think that: must be built the infrastructure and must been organized many events . It is interesting to see how necessary it is to participate from the perspective of residents-73% think they agree, 23% agree, 4% remain neutral and no one has the answers I'm not at all agree, I am not agree, I don't know. It seems that people are interested to get involved and see the necessary involvement in decision-making processes. About the question:-How able are people to be involved in local development processes? -64% says that are highly skilled (stating agree), 22% think they are able (indicating agreement), 7% were neutral and 7% do not think they are able to participate and no one has responded I'm not at all agree or do not know.

To see how people perceive participation as a way to bring more benefits than problems . About 29% remain neutral, 22% agree, 21% agree, 14% are not agreed and 7%, respectively, are not quite agree not know. Seen that not all are able to perceive the results of participation and may not have the necessary knowledge, but most believe that participation benefits. Therefore it is very important if you need to build a sustainable tourism relying on the community to inform residents about the benefits of participation and ways of involvement. If the economic benefit is stimulating the participation we have the following results: -43% agree, 29% disagree and 7%, respectively, are not at all agree, are not agree, do not know and neutral. Do you see any need people getting information and the implementation of training - 36% agree, 29% agree, 14% respectively are neutral and are not agreed, 7% not at all agree, and no one said do not know . Some researchers believe that the participation of the community (especially in developing areas where training is lowered) is required in the final stage of the planning process. But studies carried out recently emphasized the importance of community involvement in the early stages of planning. The opinion of the residents in the study area is 36% agree, 21% agree, 29% were neutral, 7% not at all agree and are not agreed, and no one has the answer I do not know. Often a wider participation of groups that have special interests in the tourism sector can lead to the emergence of conflicts and in the study area have the following results: 58% agree, 17% agree, 9% not at all agree and 8%, respectively, are not agreed and are neutral and no one has responded I do't know.

In the questionnaire directed to tourists we have these results:-Interests of tourists about attractions in the area from the perspective of residents is:-43% of the tourists prefer to visit cultural sites, 47% prefer natural scenic sites, 6% prefer to visit museums, 4% prefer other attractions. As shown most powerful attractions of these areas are cult objects and natural beauties. Seeing separately importance of these attractions have received the following conclusions:

For objects of worship 64% say they are very important, 14% think they are average important, 7%, respectively, less and no, 8% think they are extremely very important. Visits to the museum about 33% think that they are less important, 23% not at all important, 24% moderately important, 14% very important, 6% extremely important.-Visits to nature, about 7% think that they are less important, 0% not at all important, 14% moderately important, 64% very important, 14% very important. Visits to other sites, about 57% think that they are less important, 7% not at all important, 22% moderately important, very important 7%, 7% extremely important.

### Conclusions

Sustainable development is now recognized as an essential approach to achieving development goals without depleting natural and cultural resources or degrading the environment. Benefits of tourism development to local communities include: new jobs and businesses; additional income; new markets for local products; improved infrastructure, community facilities and services; new skills and technologies; greater environmental and cultural awareness; and protection and improvement of land use patterns. Countries must realize that tourism affects local communities and is not necessarily desirable or feasible for everyplace or each community, mainly because ecology and the economy are becoming ever more interwoven, locally, regionally, nationally and internationally. Countries must make sure that tourism development that takes place is sustainable in the long-terms. If looked at globally, sustainable models of tourism development require a global ethic which encourages the participation of individual tourists, groups and communities, without whom sustainable tourism growth will be next to impossible. Three main principles of sustainable development must be used as guidelines while planning tourism development:

- (a) Development must be ecologically sustainable and compatible with the maintenance of essential ecological processes, biological diversity and biological resources.
- (b) Development must be socially and culturally sustainable and must increase people's control over their lives, be compatible with the cultural values of people affected by it, and maintain and strengthen community identity.
- (c) Development must be economically sustainable and efficient and resources must be managed so that they can support future generations.

Doing an overview of Korca region are presented and the main tourist markets and tourist potentials from the results of the study determined the most important products for tourists and key markets in the region. So is making a determination of favorable factors and determinant Korca region which strongly influence the development of tourism and positioning this destination. The success of the development of a competitive and sustainable tourism destination is to develop activities that included community and reduce local power in the decision-making processes. Awareness of host community about the importance of their participation in the construction of strategies, plans, tourism development programs. Increasing trainings to local representatives to tell about the forms, methods and techniques to be used to ensure broad community participation in local development processes.

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**TOURISM INDUSTRY & GLOBALIZATION IMPACT ON THE PERFORMANCE FOR THE ALBANIAN TOURISM ENTERPRISES**

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**Abstract:**

*Tourism is defined as one of the sectors with a major impact on the economy of every country. It consists of many, independent enterprises, covering a wide variety of activities in both the private and public sectors. The phenomenon of globalization has contributed significantly to the spread of tourists around the world. This paper is focused in the relationship between globalization and tourism. The aim is to identify the factors facilitating globalization of the tourism industry and how these factors influence the performance for the Albanian tourism businesses. After removing the visa regime with Europe, where Albanians are likely to make the holidays? Inside Albania or abroad? Did the Albanian tour operators feel any possible threat? I will address some theoretical issues on this paper in identifying some of the factors, why is this happening and what should be done more. Finally the paper will conclude with some findings & conclusions.*

**Keywords:** Globalization, Tourism industry, tourism businesses, performance

**JEL Classification:** M39.

**-INTRODUCTION-**

Tourism can be conceptualised as a global process of commodification and consumption involving flows of people, capital, images and cultures (Meethan 2001: 4). Tourism has evolved more and more compared to previous periods. Nowadays tourism has reached such development as may be considered the largest industry in the world. The scale of tourism that now exists is phenomenal and the choice of places to visit is extensive as ‘the world has become one large department store of countryside’s and cities’ (Schivelbusch, 1986: 197). There is almost no country today in the world which is not a sender and receiver of significant numbers of visitors (Urry, 2003). Also there is no country in the world not supporting its economic development from tourism sector. So tourism has emerged as a leading economic driver. Tourism takes place within the wider context of globalisation of the world economy (Sugiyarto et al, 2003). So different researchers recommend that any potential study of tourism development should be done from the context of globalisation and its impacts. Tourism is one of the most powerful exemplars of globalisation as the movement of people is fundamentally affected by the globalisation of infrastructure; the ability to use the Internet for making bookings; the exponential growth in air transport; and the shift to free markets; all these changes have all facilitated the growth of international tourism (Shaw and Williams, 2002).

Despite the numerous, negative consequences that it has, globalization is an important phenomenon, one that cannot be simply ignored, because every country in the world—regardless of size or level of development—is globalized and affected by globalization. Under the view of opening up to the world, Albania can not be excluded, too.

Inevitably as a consequence of globalization, governments, consumers, stakeholders, businesses and their activities are affected, tourism enterprises too. In the framework of tourism globalization, the related businesses to it should restructure and reposition themselves to meet the possible challenges and maximize the opportunities that will arise. This is the main reason, why we are taking in the study the tourism - globalization relationship and the possible impact to tourism enterprises performance. The concept of big 'tourism-development dilemma' is related to the cases in which tourism is attractive as a means of stimulating social and economic development but where that development often fails to materialise or benefits only local elites and comes with significant costs to local communities. This is surely the Albanian case. In these 22 years of pluralism, very little has been done in terms of tourism development, defined as chaotic tourism. The question that arises are:

"Did the Albanian tourism enterprises play a peripheral role ?? They are passive recipients of the impacts of global tourism or actively engaged in dynamic processes ?? Do they have possibilities to be competitive? . Are the Albanian tourism enterprises able to recognize, influence and manage all those factors that provide competitive advantage. These are the questions, we will try to give answers. The basic objective of the paper is that: "a better understanding of tourism and globalization is essential for the development, successful operation, and long-term sustainability of tourism created from tourism businesses".

### ***1.-Globalization and tourism industry-***

Literature suggests different definitions about globalization. In principal, it is related with a lot of changes: economic, political, social, technological, cultural- that are seen as increasing interdependence, integration and interaction between people, companies, countries. The widening of linkages between places has become a major factor in the development of international tourism. The reasons why tourism is so much evolved are manifold. They include a number of factors: new tourism products, globalization, changes in technology (transportation and telecommunications), etc. These improvements are the only reasons why global travel shrinks in terms of time and distance. So the globalization of the tourism industry has created new tourism attractions, new markets for more touristic products, more investments in infrastructure. In addition, globalization also enables consumers (tourists) to gather information easier, faster, and at lower costs. Thus, they become well aware of alternative products (the use of internet has helped so much).

Taking into account the development of the stages of globalization of tourism industry and its main characteristics, globalization can be summarized in six keywords:

- Information
- Openness
- Change
- Diversity
- Adaptation
- Sustainability

But the current process of globalization is generating unbalanced outcomes, both between and within countries. It is obvious that globalization has brought about a new competitive landscape referred to as "hypercompetitive markets", especially in the tourism sector (Hitt, Keats, and DeMarie, 1998, 24), one that presents enormous threats to firms since it makes a firm's relative competitive advantage very time-sensitive (Harvey and Novicevic, 2002). Globalization phenomenon is translated in more competition. Firms operating at different levels (local, regional, and global—are now competing against each other. This strong competition will become more difficult for Albanian tourism businesses, most of them which are mainly small, weak, without any great experience in tourism compared to similar companies. When considering the Albanian tourism industry and its components (structure) it is important to understand that it is predominantly made up of small businesses not exceeding more than 15-20 employees and most of them concentrated in accommodation and transport.

Against this high level of competition, the tourism enterprises should provide superior value in terms of quality, price and services provided, better than competitors in order to be successful. As addition to higher competition are the consequences of globalisation: the loss of autonomy of nations; a decline in the importance of place and local factors; and the homogenising of products and cultures, as we can see direct implication to tourism (Dunning & Hamdani 1997; Castells 1993; Barnett & Cavanagh 1995). According to Swarbrooke (2001) globalisation has changed the nature of competition between places and has increased the need to prevent product standardisation and the loss of uniqueness which globalisation can cause. One of the hideous consequences that everyone can see in the majority of the Albanian tourist areas. For example, if we take a quick look at Albanian restaurants, most of them offer Italian, Greek, menus. Why they don't offer Albanian traditional dishes?? Offering traditional elements, not standardized is a necessity. Only differentiation, it will be a good strategy to create comparative advantage. As a conclusion we can say: "To strengthen the tourism sector to become a dynamic and sustainable that aims to provide benefits for all the parts included" everything depends in the manner of how Albanian tourism businesses will create superior value. Having right management efforts, marketing activities, high quality of services, and environmental management are useful in creating higher value in tourism products, so that tourism destinations can achieve better competitive market positions against potential competitors.

### 1.1 Factors facilitating tourism globalization

These factors include the increase in worldwide business and trade, technological developments in transport and communications, increased cultural and political interdependence, and the role of multinational corporations. The cumulative impact of all these developments is a radical transformation of the economic environment where tourist enterprises operate, implying that the sector has no option but only to compete.

First of all, the growth in international trade and foreign investments, the removal of trade barriers, all these have facilitated the expansion of business tourism. Doing more business means more traveling abroad, means more expansion of tourism globalization.

Technological developments had created new opportunities to tourism, generating more tourists. Technology improvements in transportation, communications and information are a major factor that influences tourism industry development. These new technologies have made the world very small in tourist eyes. So the internet has helped possible tourist to explore various destinations, make reservations in hotels, airlines, etc. On the other hand these new technologies are helpful to tourist enterprises daily activities too. According to Page (1999), information technology has particularly revolutionized the organization and management of tourist businesses.

Tourism globalization has been facilitated by widening interconnections between states that border with each other. (Albania and neighborly relations with the Balkan states.) Numerous efforts have been made since 1990 in this regard, in expanding the interlinks with them. The existence of various agreements for the removal of barriers with neighboring countries has brought in exchange for more tourists for either side. Another dominant factor for tourism globalization are multinationals companies and their activities spread over different countries (mergers, acquisitions, alliances, etc), what means more tourism globalization.

Country image is very sensible to tourism. A positive country image can be translated in more tourism. In a country, accompanied by political turmoils, can't be discussed for tourism investments growth and higher contribution from tourism to economy. Can we discuss for tourism today in Libia?? There is no sense to answer such a question because reluctance is very high to everybody. This has been the situation in previous years in Albania. Adding to this the lack of a genuine strategy on tourism from Albanian governments has led the Albanian tourist businesses to operate as free satellites and not in coordination with all other parties. This is why the Albanian tourist businesses are not at a level where should be (the existence of multiple resources in combination with right managerial efforts would have brought another result). At the end, identification of factors that facilitate globalization of tourism creates the possibility to the businesses related to tourism being more dynamic in maximizing opportunities that emerge from tourism globalization and reaping more benefits.

### 1.1.1 Factors related to possible tourism development

Tourism should be seen as an interrelated system and all aspects of tourism development, including natural resources, institutional elements, environmental and socioeconomic aspects should be considered. International literature about tourism suggests that :

- Tourism is characterised by a collection of government, businesses, activities and processes that assist people in making decisions about travel.
- Involvement of tangible (e.g. tourism products) and intangible resources in the production and consumption of tourist products.
- in order to meet the needs of the demand market, tourism planning and development should be approached by improving the supply-demand match.
- Continuous interaction with the daily lives of local communities.
- involves the production and consumption of tourist experiences.

According to tourism system adopted by Hall,(2008) different factors and prerequisites can influence tourism development.

Some of these factors with direct impact(positive or negative) are:

- Stable economic and political situation of the country.
- Possible crises,wars (Albania ,year 1997)
- Motivation and accessibility to travel
- Technology and transport
- Seasonality(intended objective “an extended tourism throughout the year).The risk in the tourism industry is high due to seasonality.

Some of prerequisites that are necessary to tourism development include:

- Capital
- Infrastructure and superstructure
- Attractions and facilities
- Labour
- Hospitality
- Transport

(Dwyer and Kim 2003; Enright and Newton 2005) had argued that the principal factors contributing to competitiveness will vary amongst destinations, and as such, destinations must take a more tailored approach to enhancing and developing tourism competitiveness, rather than adopting a single,universal policy or strategy. Albanian tourism businesses should follow their own unique development model. To achieve this, the Albanian tourism businesses firstly should determine what kind of tourists must have as their target?? Or the visitors from abroad.Or the both of them??.In my opinion both of them. Panorama of the past few years, accompanied by an extraordinary influx of Albanians preferences to choose to rest outside is already waning. It was the period when most of the Albanians prefer to chose as the main destinations of their holidays Turkey, Greece, Italy, Spain,Croatia. Only a few of them choose the Ionian coast and the magnificent Alps to the north as their holiday destination It is not the aim of this paper, the identification of factors that led albanians to these kind of preferences.A little scary situation for Albanian tourism enterprises,a situation that now is inverted. But what is observed more from Albanian tourism enterprises today,leading them to new challenges(competition more stronger than before) :Over 90% have noticed changes in the consumption pattern of clients. Possible tourists have become more price-quality conscious and spent less money during the last two years(global crisis,possible factor). Albanian tourism businesses at this stage should have clear ideas, to better manage of the situation (a longer-term vision ) and to attract more guests because tourism businesses of neighboring states, affected by the crisis are struggling to acquire more market share by using different strategies to attract tourists (very cheap tourist packages from them).

## 2. Tourism situation in Albania

Tourism as a system brings results not only to tourism related businesses, but to all the parties involved (local communities in receiving social and economic benefits, tourists in receiving more benefits from travel experiences if the tourism destination and attractions are appropriately developed and promoted. Tourism development in general is associated with the inflow of foreign currency, the generation of higher income, the creation of employment, an expanded revenue and tax base for governments and a contribution to a country's balance of payments (e.g. Archer, 1977; 1982; Elkan, 1975; Fletcher and Archer, 1991; Lea, 1988; Sinclair and Bote Gómez, 1996). As we can see there are many positive impacts, this is the explanation why tourism sector development is so important to our country too. We can't leave without mentioning in this paper the role that tourism enterprises play in the Albanian economy, with considerable contribution to the gross domestic product (GDP). So total tourism contribute in GDP is estimated at 3.8 - 4% and the contribution to Albanian economy is around 11 % (statistics from world travel and tourism council).

*Why tourism to Albania? Because* there are a lot of natural and cultural resources which can form the basis for a developed tourism industry, creating employment and generating incomes. These resources are not concentrated in a single place but spread everywhere, from north to south (great advantage). This wide distribution of multiple sources combined with the right management efforts, marketing activities, represents the greatest potential for Albanian future tourism development, types of tourists that will be attracted and tourism enterprises performance. However today's reality is quite different. Despite numerous potentials for tourism development, Albania shows weaknesses that undermine competitiveness, such as: lack of political commitment in having concrete actions, poor control systems for effective environmental management, a difficult investment climate, unresolved property rights, poor infrastructure and ineffective promotion efforts.

Most of the problems that constrain the tourism in Albania are:

- 1- Lack of enough information about Albania to potential tourists that want to explore something different, unique.
- 2 - Absent of a genuine tourist map to orient the possible tourists.
- 3 - Lack of public infrastructure - despite the commitment of the Albanian government in this regard.
- 4 - Environmental problems (e.g. noise pollution, cleanliness of the roads, beaches).
- 5 - Inappropriate, not legal constructions that bring more waste and damage of environment.
- 6 - Short tourism seasons.
- 7 - Lack of qualified staff with a direct impact on performance of services offered.
- 8 - The poor quality of public transport compared to the standards that exist outside.
- 9 - Lack of proper tourist resorts or villages. Lack of vision in this respect compared for example with Turkey, the country that Albanians had explored during last years as the best way to make their holidays.
- 10 - Law on "Moratorium of speedboats" prevents exploiting beautiful seaside areas that exist.

More and more, we find destroyed, polluted areas, illegal constructions. 20 years post communism period has been associated with irrevocable consequences to tourism (eg Durrës seaside case). Despite the destruction of the environment these businesses have the potential to develop further and to move forward compared to companies of neighboring countries that operate in saturated markets. This is shown mostly by the results achieved and the efforts made to change the situation (According to **Travel & Tourism Competitiveness Index 2011 and 2009**, Albania is ranked 71/139 for year 2011 and 90/133 for year 2009). So the future challenges to Albanian tourism enterprises are:

- Improvement of the actual position
- Increase of the value generated from available resources
- Sustainable development of tourism.

### Conclusions and Recommendations

In order to develop tourism in Albania, a special attention should be paid to tourism businesses (tourism supply).

A combination of right management efforts, marketing activities, quality of services, and environmental management are utile to tourism enterprises in creating higher value in tourism products ,enabling them to achieve better competitive market positions against potential competitors ,especially from neighboring countries . In accordance with tourism globalization challenges should be done more in :

- Promoting the private sector as the driving force of the future tourism development .
- The related businesses to tourism should restructure and reposition themselves to meet the possible challenges and maximize the opportunities that will arise from globalization of tourism
- It is necessity that tourism enterprises should undertake the sufficient investments as the only way to provide a wide ranch of tourism products in accordance with tourism demand.
- Stimulation of networking between public and private sector.

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**AN INVESTIGATION INTO INFORMATION AND COMMUNICATION TECHNOLOGIES-  
BASED APPLICATIONS FOR SUSTAINABLE TOURISM DEVELOPMENT OF  
DESTINATIONS**

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**Abstract:**

*Sustainable tourism is a heavily researched concept but in reality there has been limited implementation of the principles and practices of sustainable tourism for destinations. Adopting a destination focused perspective, this paper presents research which expounded Information and Communication Technology (ICT) as a practical, new and innovative approach to sustainable tourism development i.e. computer-supported sustainability. A literature review revealed that there was no specific study focusing on the uses and applications of ICT for sustainable tourism development despite the mention and benefits of doing so. However it did identify that several opportunities existed in destination management for using ICT as well as a collection of ICT-based tools/applications which can be used for managing different aspects of sustainable tourism. Therefore an investigative analysis was necessary in building a solid body of work on the uses and applications of ICT for sustainable tourism as a practical approach for destination managers. These findings formed the input for the primary research which was conducted in two phases: surveys administered to destination managers and e-Tourism experts followed by semi-structured interviews with experts in this domain identified from the surveys. The primary research alongside the literature findings led to the development of a descriptive framework which identified, categorized and described the uses of these ICT-based tools/applications for managing tourism's impacts. Assessment procedures based on the sustainability goals of the destination were then developed in order assist destination managers selecting the ICT-based tools/applications that were best suited for managing the sustainable tourism development of their destinations. The conclusion of this research clearly identifies that destination managers' sophisticated application of ICT to sustainable tourism is the next logical and practical step they can take in making sustainable tourism a workable reality for their destinations. This research is the building block for prospective research in the ICT-sustainable tourism domain. Future research avenues would be to use the results presented to determine the suitability, applicability and feasibility of the ICT-based tools/applications presented for destination managers. This existing research can be used to develop a more coordinated approach to theory development and engage in more empirical research to address tourism challenges with regards to using ICT for sustainable tourism development.*

**Keywords:** *sustainable tourism, information and communication technology, e-Tourism, ICT-based tools/applications, destination management, computer-supported sustainability.*

**JEL Classification:** *M39.*

### Changing Consumer Requirements

The use of technology in tourism has definitely led to a paradigm shift since it has empowered the consumer and now assists in shaping how they make their decisions. Customers have become smart agents and are now in better positions to compare prices and product offerings (Connolly and Sigala 2001, p. 327). They are also expecting destinations and tourism business at the destinations to have an online presence and the technology they require when they are there. These savvy Internet customers want packages which are more flexible to their requirements. They want more personalized products and services and they want these to be available online. Travelers now have access to a vast amount of information not only provided by suppliers but by tourist organizations, private businesses and by the travelers themselves. Information search is an important part of the purchasing decision making process and through the use of ICT and the Internet, uncertainty and risks can be reduced and the quality of the experience can be enhanced. According to Buhalis and Law (2008) more research leads to more information and a more informed customer can identify the products and services that best caters to their needs and are able to interpret and interact better with the local culture and resources.

The Internet has not only allowed organizations to engage more with the customer but it has also decreased the time in between communication leading to faster response rates. With the advance development of the Internet and Web 2.0, customers are now able to network with each other, interact with businesses and local people at the destination. O.Reilly (2006) defined Web 2.0 as 'the business revolution in the computer industry caused by the move to the Internet as platform, and an attempt to understand the rules for success on that new platform'. In recent years, Web 2.0 applications have taken on a life of their own and with regards to tourism, it is causing fundamental changes in how travelers use the Internet and their online experiences and expectations. Prior to Web 2.0, consumers were only able to engage in information search and possibly make some purchases. Now customers are able to identify, customize, comment and purchase tailor made products. Web 2.0 has placed the tourist in the middle of functionality and product delivery (Buhalis and Law 2008). The Web today is now characterized by information pull rather than push with a second generation of Web .based services such as wikis, , social networking, user generated content, openness, sharing and collaboration (Tapscott and Williams 2006).

The content generated on these sites is shaping tourists. tastes and choice of destination products and services. Organizations should use the power of these new technologies to quickly identify the needs of these tourists and provide them with comprehensive, personalized and updated products and services. They can have dedicated persons scan through blogs, online communities and see what these tourists are writing about their experiences and use this to better cater to their needs. Suppliers

Perhaps the most affected areas in tourism from the use of ICT has been distribution and marketing (O.Connor, 2000; O.Connor and Frew, 2002). The topic of the Internet revolutionizing tourism with regards to distribution channels and booking systems has been well documented (Sheldon 1997; Werthner and Klein 1999). Disintermediation refers to how the role and functions of intermediaries are being reduced or in some cases disappearing in the tourism value chain through the use of ICT (Werthner and Klein 1999). The Internet has re-engineered the production and delivery of tourism products (Belbaly et al. 2004; Gratzner et al. 2004; Buhalis and O.Conner 2006, Ndou and Petti 2007) and has dramatically altered both operational and strategic practices (Buhalis and Zoge 2007) since it has allowed tourism suppliers to be flexible and creative in their strategies by providing them with enhanced features to attract and sell to the consumer.

Before the Internet, tourism suppliers had no alternative but to use intermediaries for product distribution (Buhalis and Law 2008). The widespread use and adoption of the Internet presented suppliers with the opportunity to distribute their product directly to the end-consumers and allowed them to speak directly to the consumer without the involvement of a third party. The Internet has therefore added an element of transparency in the marketplace (Buhalis and Law 2008). This significantly altered the role of tour operators and travel agents since online bookings changed their sales channels (Werthner and Klein 1999; Buhalis 2003; Werthner and Ricci 2003).



ICT has also empowered small and medium sized enterprises since they can now compete with larger organization by using the Internet strategically and developing e-Commerce strategies. They can distribute, market and promote their products online just as large enterprises do, hence making them more competitive as well as resulting in cost savings.

Moreover, Web marketing is now considered the norm in tourism. The Internet is now seen as a multi-promotion tool and distribution channel for tourism (Gretzel et al. 2000; O'Connor and Frew 2004). Suppliers can now have one-to-one conversations with the consumers dispersed over a wide geographical sphere in a cost-efficient manner using a variety of online promotional activities. ICT has provided an avenue for new product development in tourism. It offers great possibilities for price differentiation, greater networking for dispersed elements and fosters a wider array of product choices (Milne and Ateljevic 2001). Buhalis and Law (2008) described this as 'fitness to purpose' where ICT is used to package the tourism product to cater to the individual needs of the traveler and thereby offering huge opportunities to both the consumer and the supplier, resulting in an enhanced final product. The Internet has also enabled the profiling of consumers which allows organizations to become more customer-centric. Tourists portals collect and organizes information which can then be used to tailor fit the product to the tourist requirements (La Micela et al. 2002). Recommender Systems can also be developed. These are applications which can provide suggestions to customers based on their needs and constraints on product and services and influence the decision making process (Ricci 2002).

The adoption of ICT by organizations is also leading to important consequences on the demand and use of labor (Milne et al. 2005). This has resulted in increasing demand for high quality IT staff, new skills and managerial requirements as well as organizations training their staff on the use of the technology (Koutsoutos and Westerholt 2005). According to Milne and Ateljevic (2001), researchers have started to focus on the consequences of an e Business strategy on the use of labor, training and delivering quality service.

ICT usage is critical to tourism suppliers since it allows them to develop, manage and distribute their offerings worldwide (Buhalis 1998). To remain competitive in the future, tour operators and travel agencies need to re-examine their product offerings and incorporate ICT in their business practices. They now have to focus on consulting and having more complex and diversified products (Werthner and Ricci 2003).

### **Virtual Communities**

Virtual communities are becoming a powerful force in the tourism world since they serve as a forum of customer-to-customer or customer-to-local resident communication rather than a form of marketing. Rheingold (1993, p. 58) defined a virtual community as 'a group of people who may or may not meet one another face-to-face, and who exchange words and ideas through the mediation of computer bulletin boards and networks'. Virtual communities are now commonplace with the development of sites such as Face book, Twitter, Be boo and My space and these communities are growing daily. The attraction of using these communities are that they provide seemingly unbiased comments/opinions/reviews from people who have experienced what you are about to experience and they provide key insights, tips and tricks which you could not have received before. This process is influenced by trust amongst the community members (Usoro et al. 2007).

It also builds relationships amongst people and provides an easy source for obtaining information. According to Wang et al. (2002), online travelers are keen to meet with other travelers who share their attitudes, interests and way of life. Sharing knowledge, advice and experiences in these online communities are replacing old customs of hoarding and accumulation. Due to the many questions about the quality and credibility of information on the Internet, virtual communities offer a sense of security since consumers seek the opinions of others who have shared or are about to engage in similar experiences in order to managed this perceived risk. Organizations need to pay attention to these daily growing virtual communities in order to better understand consumers behavior and motivations.

This allows organizations to better position their products, offer tailor made services, deal with customer complaints and determine what customers like and dislike. Brand awareness and brand association can also be strengthened through the assistance of virtual travel communities (Buhalis and Law 2008).

### **DMO and ICT Usage**

Adopting ICT, as part of their business strategy, can have huge positive implications for DMOs. ICT has been used primarily for marketing and promotion of products and services, portraying an image of the destination and communicating their message to the tourists (Yuan et al. 2006). It can also assist them in improving their business processes more efficiently and facilitating better destination management and planning (Buhalis 2000; Ma et al. 2003; Yuan et al. 2006). By taking advantage of Intranets (internal systems that are accessed by employees) organizations can re-engineer internal processes, while Extranets can support the development of close relationships with trusted partners which can lead to online transactions, expansion of the distribution channel and extension of the value chain (Buhalis 2003, Buhalis and Deimezi 2004). The reality today is that if a DMO fails to adopt technology then they are choosing to fail (Buhalis 2003).

The overarching aim of this research was to investigate the uses and applications of ICT for sustainable tourism development. The research problems identified and the research questions presented earlier demonstrated that the application of ICT to sustainable tourism lacks empirical research in assessing how these ICT-based tools/applications can be used by destination managers. Furthermore it adopted the view that ICT can be an innovative approach to sustainable tourism and it facilitates the tourism industry to engage in more innovative behaviors. To accomplish this, it was felt that a phenomenological research approach would be most suited. This approach allowed the researcher to undertake rich, in-depth exploration on the opinions and perspectives of destination managers and e-Tourism experts on this important and relevant topic.

### **Methodological Approach**

In view of the above discussion, this research will be adopting a constructivist ontological stance and an interpretive epistemology. There has been limited published theoretical and empirical research on the application of ICT for sustainable tourism development for DMOs and destination managers. Therefore, a deeper understanding of the uses of ICT for sustainable tourism is required from which a sound body of knowledge can be constructed on how DMOs and destination managers engage and make the best use of these tools for their destinations. According to Blaxter et al. (2001), under-theorized research or research which lacks empiricism is best suited to an inductive approach since it facilitates ideas and theory generation from the collected data. A deductive approach focused on measurement and determining cause and effect relationships was felt to be inappropriate. The researcher was concerned with vestment which is the empathic understanding of the worldview of the populations being investigated (Newman 2004). This was important for gaining an accurate representation of the uses and applications of ICT for sustainable tourism by destination managers. An interpretive perspective was therefore warranted in understanding destination managers and e-Tourism experts. opinions, perspectives and motivations for selecting and using these ICT-based tools/applications.

Furthermore the newness of ICT-based tools/applications to sustainable tourism as a research field and the exploratory nature of this study aligned itself to a more flexible and open research design rather than one that was highly structured and rigid. An interpretive stance would bring forth data that was not constrained by fixed, analytical categories and would allow the researcher to visit and re-visit the linkages between the data and the theory and explore the respondents. viewpoints on ICT for sustainable tourism. Interpretation, rather than statistical analysis, was better suited to researching respondents. perceptions, attitudes and feelings (Denscombe 2003).

Added to this, to answer the research questions posed, information was required from a large number of experts based at various geographic locations all over the world.

Due to the international scope of this research, a more flexible and open-ended approach was more desirable to elicit the required information.

This research developed assessment procedures on the most appropriate selection of these ICT-based tools/applications by destination managers. Understanding this process was one of the main aims of this paper. An interpretative approach was more appropriate since it allowed the researcher to paint a representative picture, as best as possible, with the collected data on the how these ICT-based tools/applications were selected. It also allowed for the generation of richer and more relevant forms of data which were more context-bound and provided for a deeper understanding of how destination managers' selection process materialized. Such a process fosters the development of theories which are real-world grounded and more relevant to the individual (Patton 1990).

### **Research Design**

Based on the delineation of the research domain, a cross-sectional research design was selected. This design consists of survey research on a sample at a single point in time (Bryman and Bell 2007). It is very versatile since it allows vast amounts of different types of information to be obtained from questioning the respondents. The strength of survey research lies in its ability to learn about people and their experiences, perceptions and opinions by asking well-chosen questions (Cooper and Schindler 2003). Following the secondary research, primary research was conducted in two phases: online questionnaires and semi-structured interviews.

Primary research therefore included both quantitative and qualitative methods due to the dynamic nature of the research topic being investigated. These methods complemented rather than competed with each other (Bryman 2004) with the literature displaying support of the use of a multi-method approach (see Newman 2004; Bryman 2004; Bryman and Bell 2007) and allowed for triangulation of the collected data and a more thorough understanding of the research problem under investigation (Bryman 2004; Bryman and Bell 2007).

This first phase involved administering online questionnaires to the destination managers and E-Tourism experts. A separate questionnaire was tailored for each population (See Appendix one and two). These online questionnaires were administered first in order to gain an overall picture on the uses and applications of ICT for sustainable tourism. Despite widespread general discussion of the uses of ICT for sustainable tourism there are very few destinations which were employing ICT for this purpose and there were also very few destination managers or e-Tourism experts who possess knowledge of this field. Therefore it was necessary to distribute the questionnaires first in order to discern which DMOs were using ICT for sustainable tourism and which e-Tourism experts were familiar with this topic. Evidence of this is seen from when the questionnaires were distributed, several respondents e-mailed the researcher indicating their willingness to participate but their lack of knowledge.

### **Sustainable Tourism and Destination Management**

The fifth objective of this paper focused on determining the areas of sustainability where ICT-based tools/applications can be used in destination management. Destination managers and e-Tourism experts were asked to rank the areas where they felt ICT would be most useful for sustainable tourism development based on the findings in the literature. Both groups ranked information management as the most important area of applying ICT-based/tools applications for sustainable tourism development. As previously discussed in the literature, information management is key to developing destinations in a sustainable manner and all of the tools/applications identified above can contribute in some way to managing the information needs of destination managers.

Tourism is an information-intensive industry and managing this information is crucial to the success of the industry (Sheldon 1997; Werthner and Klein 1999, Buhalis 2003). Through better information control, destination managers can better plan and manage the tourism industry.

Destination managers recognized tourist satisfaction as the second area where ICT-based tools/applications can be most useful. This may have been identified as being critical since satisfaction is important to tourist returning to destinations and was ranked as being significant. E-Tourism experts identified transportation as the second area where ICT would be most useful for sustainable tourism development. In contrast to the destination managers these e-Tourism experts identified community participation as the third most useful area for ICT-based tools/application as compared to the destination managers who ranked this as their area of least importance. E-Tourism experts may have ranked this area high because in the literature there has been a lot of discussion on involving the community in the tourism development process and the necessity of accomplishing this. However in reality this is rarely happening and destinations may have prioritized other concerns. As mentioned before, destination managers may be unaware of this since such information may not be readily available in a form which they can use to engage the community in the tourism development process.

In retrospect of this objective, from the results and the literature, it was evident ICT has a prominent role to play in information management. However, this does not downplay the significance of using ICT for other areas identified despite the disparity in rankings. The uses of ICT are wide ranging and they should not just be limited to managing information but rather adopting a full spectrum approach to managing a destinations sustainability concern.

#### **Approaches to Managing Sustainable Tourism Development**

The sixth objective of this paper was to critically examine the current approaches in destination management for the use of ICT-based tools/applications for sustainable tourism development. In researching and surveying respondents, it was fair to postulate that all destinations were using ICT for sustainable tourism but at a very low level. Most destinations have Internet access and hence providing information online instead of a printed format can indeed be considered a sustainable activity. However, it appeared that these destinations were unknowingly using ICT for this purpose and were unaware that ICT can be used for sustainable tourism based on the seemingly insufficient usage in the findings. With regards to more advanced uses of ICT, there were very few destinations that were readily engaging with ICT for this purpose. One destination interviewed was now considering this whilst another was readily using ICT for sustainable tourism. They followed the approach of using the ICT-based tools/applications which were best suited to their sustainability issues. For example, if a destination wanted to map visitor usage of an area so they can better manage capacity or zone areas, this destination would consider investing in a Geographical Information System to fulfill these purposes.

We encountered difficulty in trying to accomplish this objective. In destination management, there did not appear to be any coherent approach towards using ICT for sustainable tourism development. Rather, it seemed to be used on an ad-hoc basis or as need basis. Moreover, respondents were unsure about the type of approaches DMOs were adopting in using ICT for sustainability. Due to the low level of usage of ICT for sustainable tourism, it was difficult to critically assess. Perhaps this objective would be better accomplished in future research when there is knowledge transfer of this work and destinations are engaging more with the technology. Despite these difficulties, the researcher was still able to consider how destination managers select these tools/applications as discussed in the subsequent section.

#### **Assessing the Selection of ICT-based Tools/Applications**

The final objective of this research was to assess how destination managers select these ICT-based tools/applications for their destinations. In using ICT for sustainable tourism development, there will always be critical success factors and barriers to usage.

The researcher admits that these factors do exist but in order for this work to be of real value to destinations there must be some type of selection process for the use of these tools.

The stage of tourism development was also seen as being important in the selection of these ICT-based tools/applications. Despite no statistically significant relationship existing between the stage of tourism development and ICT usage for sustainable tourism, the general consensus from the experts interviewed was that ICT would be used more at the development and consolidation stage for sustainable tourism development. This was confirmed with the results of the destination managers survey. Even though it would have been better for destinations to use ICT for sustainable tourism during the early stages, it was during the development and/or consolidation stages where difficulties due to improper tourism planning and over-development were realized (Martin and Uysal 1990). This provided greater justification for use in the earlier phases as tourism's negative impacts become more advanced in the later stages of a destinations tourism development. Moreover, in the early stages of development, destinations many have problems in up-taking ICT for sustainable tourism due to funding. Their priority would be on marketing and promoting and getting the destination known rather than on sustainable tourism development. An example of such a destination is Aruba which is a well established but only recently has begun to develop a sustainable tourism plan because they have now realized the problems of over-development. If destinations at the beginning of their tourism development, plan and grow their industry in a sustainable manner then they can prevent many of the problems which occur later on in the destination's life cycle (Manning and Dougherty 2000). ICT can help in this process. It was also discussed that the funding regime of the DMO has a role to play in the type of ICT-based tools/applications which were selected. Member-based DMOs were more accountable to their membership and therefore would be less likely to invest in these tools but government-based DMOs have a responsibility to the wider community and may be more inclined to invest in these technologies. They also tend to have access to greater funding.

### Conclusion

From the results presented it is evident that ICT can be used in a variety of ways for managing sustainable tourism development. It acknowledged that destination managers had some level of awareness of the use of ICT for sustainable tourism and they recognized the importance of doing so but yet in reality it was not being carried out in practice. These results also described a number of opportunities that exist in destination management for using ICT and a number of ICT-based tools/applications in support of these opportunities. It identified that the use of ICT for sustainable tourism can be a new, innovative approach for dealing with some of the negative impacts of tourism demonstrating that these applications can be classified according to the Abernathy and Clark (1985) model. Furthermore, these findings elucidated that factors exist which influence destination managers. selection and the type of DMOs that use these ICT-based tools/applications.

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## THE IMPACT OF GIS APPLICATION IN THE TOURISM DEVELOPMENT OF ELBASAN REGION

Bederiana Shyti<sup>376</sup> and Evis Kushi<sup>377</sup>

### *Abstract*

*This paper provides an initiative for the application of GIS (Geographic Information System) in the tourism industry in Albania. It is applied in Elbasan, which is an important destination in this country for both native and foreign tourists. The application of GIS consists on bringing geo-referenced data of Elbasan region, provided mainly by the District Office, into digitized maps, assigning all objects to thematic layers. The results show that GIS may help to the development of tourism industry in Elbasan region in order to become more competitive not only in Albania but also in the regional and international tourism market.*

**Keywords:** digitized map, geographic, information, district, Internet.

**JEL Classification:** L83, L86

### **I. Introduction**

As in other Mediterranean countries, tourism is one of the most important industries in Albania and Elbasan represents one of the most important tourist regions in this country regarding culture, history, and tourist attractions. According to the information provided by the District Office in Elbasan, during 2010-2011 activities like hostelry, restaurant and bars, commercial centers, transport communication and other different infrastructure constructions favoring growing employment in tourist areas of Elbasan region, have increased. The Tourism Development Strategy in Elbasan, prepared by the District of Elbasan (2008), aims at a safe and important tourist destination characterised by a diversity of natural and cultural attractions in a small geographic surface. This should be managed in an environmental and social way that can be easily accessed by European tourist markets.

However, as for all Albania, the tourism industry in the Elbasan region has many difficulties about the promotion, such as the lack of graphical tourist guides and maps, lack of information based on the internet, lack of digital information for tourism facilities, insufficient promotion from the government and other public institutions, etc. Considering this problem, one of the main objectives of the “Action Plan for the Tourism development”, prepared by Elbasan District and SNV Balkans in 2009, is to achieve a double increase in the number of foreign tourists until 2013 and to improve the tourism promotion through different means. Kadilli (2010) also emphasises the necessity of the new structures for the communication of the historical and cultural attractions in Elbasan city. Therefore, one solution for this situation is the application of GIS in this region and providing it online for tourists and all interested visitors. The reasons for that are explained in the following sections. So, the main aim of this paper is to apply for the first time GIS in Elbasan, an important tourism destination in Albania. The paper is organised as follows. Section 2 analyses the tourism development in Elbasan region. Section 3 presents the GIS application in tourism generally, and then Section 4 explains the GIS application in Elbasan region more specifically. Section 5 concludes.

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## II. Tourism development in Elbasan region

Elbasan is one of the largest cities in Albania and an important tourism destination with a lot of attractions. It lies in the field with the same name, in the right of river Shkumbin. It has a surface of 3292 km<sup>2</sup> and a population of 451.112 habitants (Source: Elbasan District, 2011). It is limited in north and north-west with Tirana, in east and south-east with Korça, in west and south-west with Berat. About 38% of Elbasan district is formed by mountains, 34% by hills and 28% by fields. There are four districts in its structure: the district of Elbasan, which is the centre of this region, the district of Librazhd, the district of Peqin and the district of Gramsh. Officially, Elbasan has 7 municipalities, 43 communes and 386 villages.

The majority of information provided by local authorities indicates that Elbasan is well-known for its traditional gastronomy, beautiful songs, and the Castle which is the only city castle in Balkans. Remains of once monumental Elbasan Castle are by far the city's best known landmark and attraction. Built in the 15th century from Sultan Mehmet II this castle was once far bigger, but parts of it were dismantled in the 1800s. Inside its walls there are numerous traditional homes and buildings as well as a 19th century built Turkish bath. Besides the Castle, Elbasan has several museums to visit and a number of churches dating back to the 15th, 17th and 18th centuries. Also, some of the main natural attractions include: the natural trees of Bysheku, the natural tree of Bezistan, the lake of Shebeniku, etc. Regarding the hospitality, Elbasan region offers a considerable number of goods hotels, restaurants etc. It has a fairly temperate climate so it's not usually too hot or too cold in the city. Generally speaking, there are warm to hot summers with average high temperatures from 20's to 35's C from June to September. Winters are mild to cool and rains fall usually during the winter season.

## III. GIS application in tourism

With the tremendous development of the technologies of information and its important role in the tourism industry, one can say that both information technologies and the tourism industries are two powerful tools for the economic growth of a country. Most of tourist information is distributed through different sites in the web, which is more difficult to use because of the widespread tourist information. Therefore, a better solution for this problem is the use of maps in order to present effectively the information. Tourism is concerned with travelling between close and distant places and maps are very important for the tourists who want to visit these places. However, Fajuyigbe et al. (2007) explains that, in the traditional form, a map suffers from a number of problems. For example, maps are static, which means they are difficult and expensive to keep to date. Also, map are often complex people are not always able to extract a particular data of interest.

On the contrary, through GIS, one can extract and use the different sets of information from a map. GIS is able to show a large amount of tourism information which is always up to date. The incredible role of GIS in tourism industry is defined by Semcor Company. "The concepts of time and place are ingrained in the tourism industry. Having an understanding of your customer base and where they come from, and knowing what they want to see and do and how to get them there are essential to the success of any tourism operation. Whether you are a hotel manager, a diving instructor, or a government official, a GIS can provide you with the tools you need to better prospect, understand and serve the needs of your clients" (Semcor 2001).

If people use GIS system in the tourism industry, then questions about locations, conditions, modelling, trends etc. are always easy to answer. These questions are most likely very important for all the decisions that a tourist or an investor take in order to plan a trip or to make a tourist investment. GIS provides the linkage between the spatial data and semantic information. It makes a combination between database operations and geographic analysis benefits that are offered by maps. Another definition of GIS, which explains the properties of GIS and its analytical functions, is given by Ake (2001) in Table 1.

**Table 1**

Definitions of GIS

Properties of GIS	GIS Analytical Functions
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A process	A system for capturing, storing, checking, manipulating, analyzing and displaying data, which are spatially referenced to the earth.	Presentation and thematic mapping Data query Spatial query
A toolbox	Containing tools for collecting, storing, retrieving, transforming and displaying spatial data.	Database integration Route finding
A database	Spatially referenced entities	Point in polygon analysis Overlays Buffering
An application	Cadastral information system, marketing information system, planning information system, etc.	Visualisation and 3-D modelling
A decision support system	Integrating spatial data within a problem-solving environment	

Source: Ake, 2001

Components of GIS, according to ESRI (Environmental Systems Research Institute), are hardware, software, data and people. GIS operates in spatial data that refers to a known location on the Earth, and the attribute data referring statistical and non location data associated with a spatial entity.

### Creation of Spatial Database

Data is the core of the GIS and the most difficult part of it to assure. The most important action is to digitize the existing map by using ArcView GIS software. The tourism facilities in this digitized map (roads, hotels etc.) are classified. The process of the spatial database creation includes the following steps:

Acquisition of graphical map that covers the entire region,

A tour in all the tourist centers in order to verify the existence of features and relative distances from each other,

Conversion of all the proper maps to digital maps using ArcGIS 9.2,

Creation of the database for each theme,

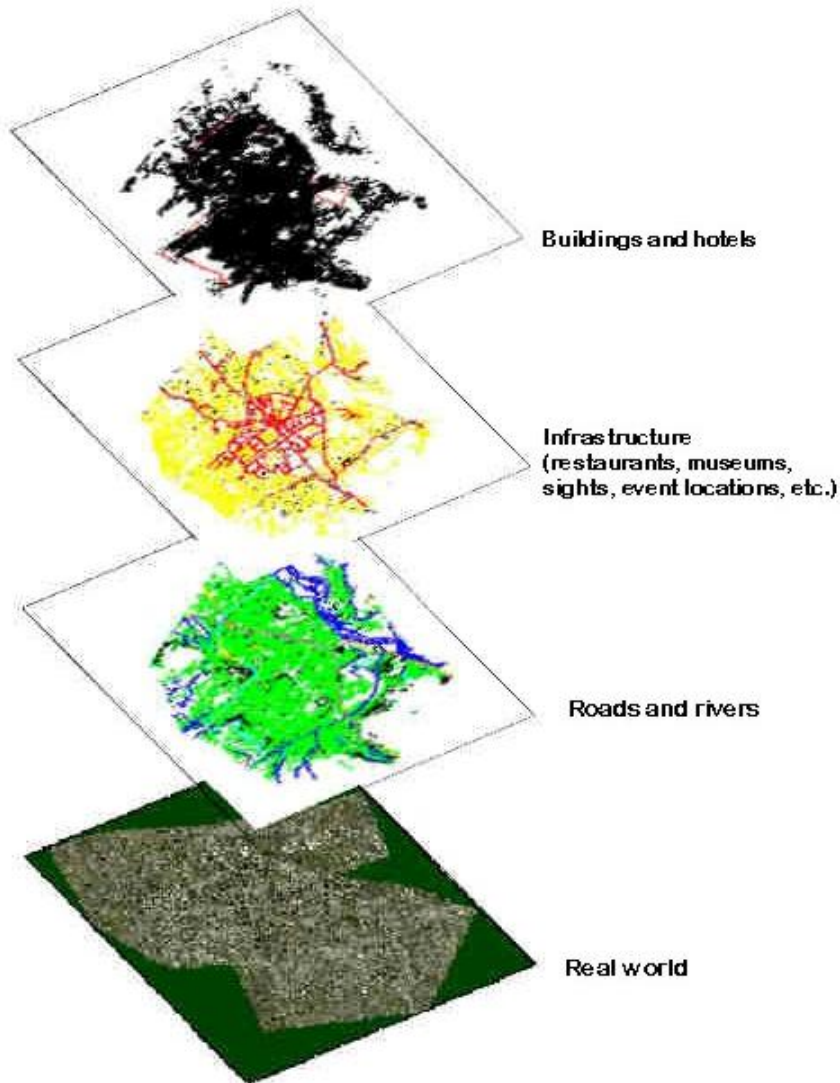
Creation of the relationship and reports between map features,

Transformation into real world coordinates.

In order to create the tourist map, it is necessary to consider first each thematic layer that contains each object. Then, the next step is the combination of these objects, such as roads, buildings, vegetations etc. A model of these layers is presented in Figure 1.

### Figure 1

A model of thematic layers



*Source: Author's application in GIS*

#### **Attribute data creation**

Attribute information on the tourist facilities can be collected from different sources. Attribute data creation includes the following steps:

- Compilation and addition of text information to features and vacations in tables,
- Creation and editing of pictures and images to text labels,
- Attaching images of respective feature location using the hotlink features.

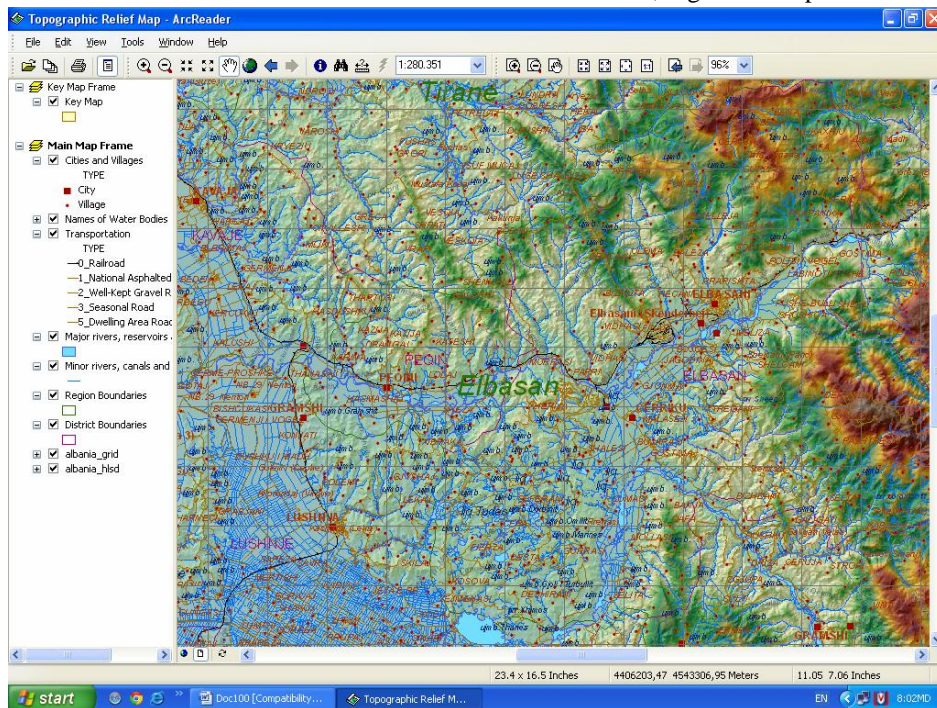
GIS is an information system that, integrated with multimedia tools, is capable to answer many questions about where facilities and resources are located. Some of its most important benefits are intelligent mapping capabilities, analytical capabilities, modeling and prediction, and revenue generation. These functionalities and revenue generation are attained from the combination of tourist attributes with geographic criteria or objects selected in a rectangular map region.

GIS is capable to create maps of the chosen themes, edit features in the map for specific purposes and update information for tourism features. So, the maps are always updated and have the capability to create the "historic map", to show the situation at some points in history. In addition, digital data may be joined with geographic data. Within a GIS, there is a combination of the simple analysis (such as statistical measures) and analysis of inter-relationships between various tourism related variables.

#### **IV. GIS application in Elbasan region**

In order to apply GIS in tourism for Elbasan region we collected initially information using both primary and secondary data. Secondary data include existing tourism literature, Internet information, and particularly information provided by local authorities. So, this paper makes use of information provided by the Ministry of Tourism, Culture, Youth and Sports (MTCYS, 2011) and the Institute of Statistics (INSTAT, 2011) in Albania, in form of maps, guides, publications, brochures, etc. Also, some important tourism data is taken from the District Office of Elbasan. The department of tourism in this institution systematically collects data for the tourist places.

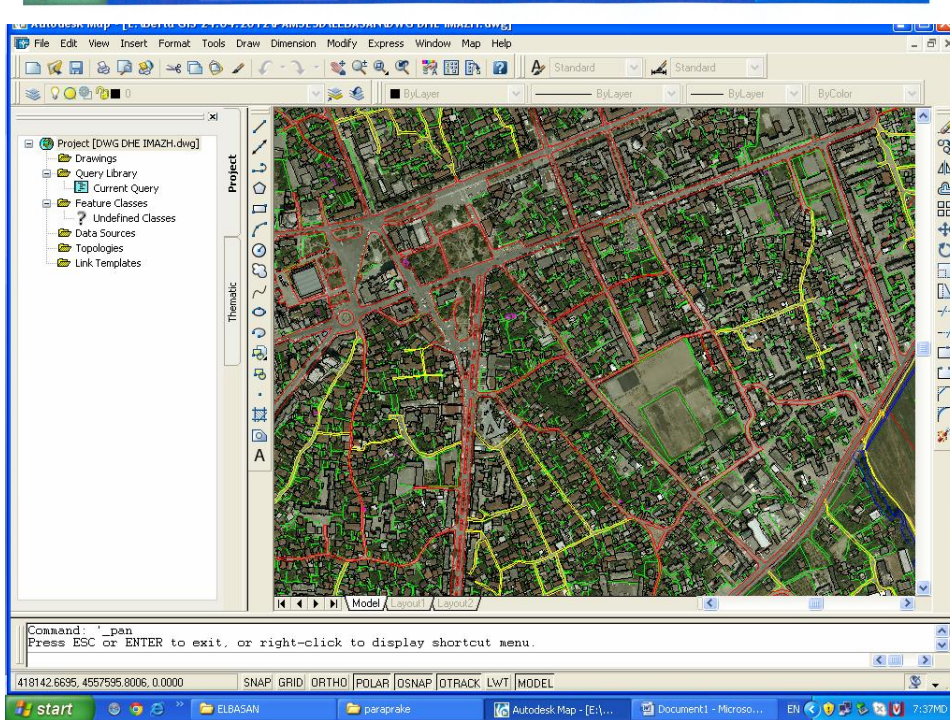
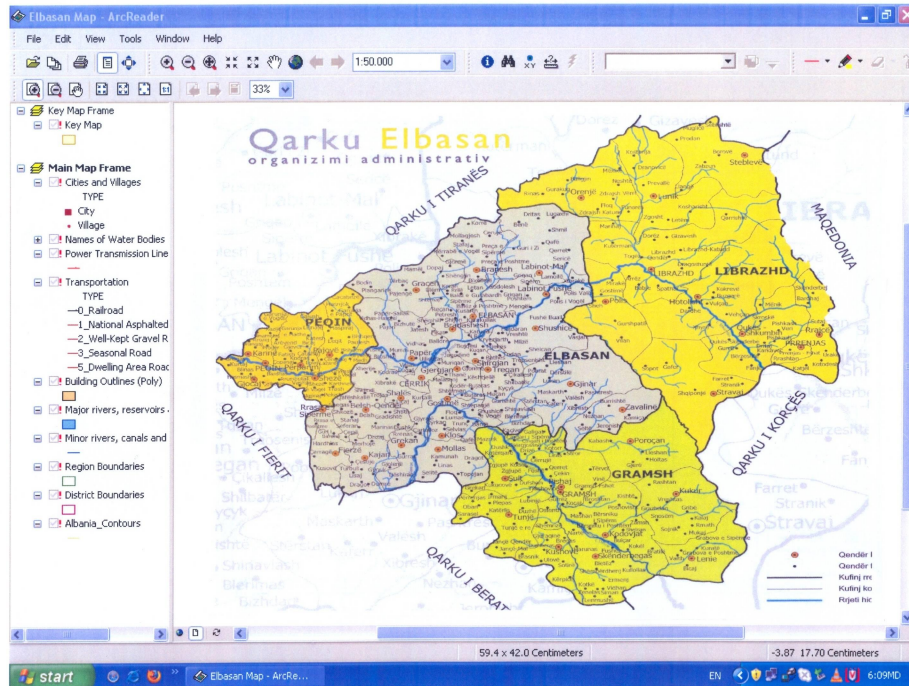
The tourism data is collected also through primary data. These are data collected through interviews and different observations. The interviews were mainly unstructured interviews with representatives of local authorities and tourist centres. The majority of tourist attractions were also observed systematically in order to have more information. Based on the collected information, Figures 2-10 present several maps which are



Source: Office for coordination and development, Elbasan District

**Figure 3**

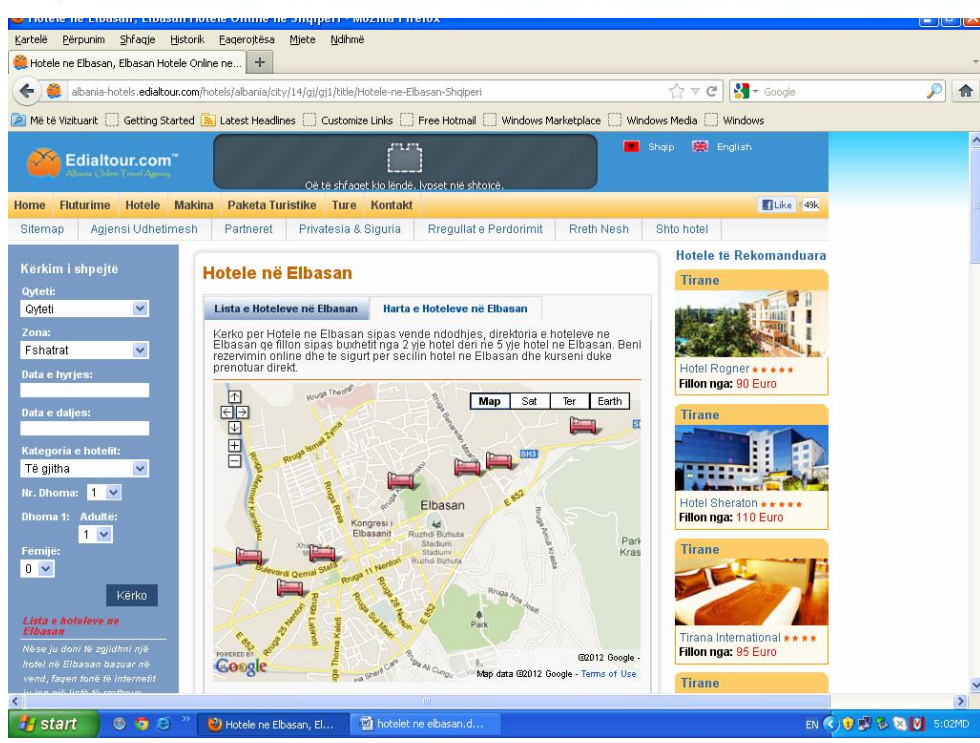
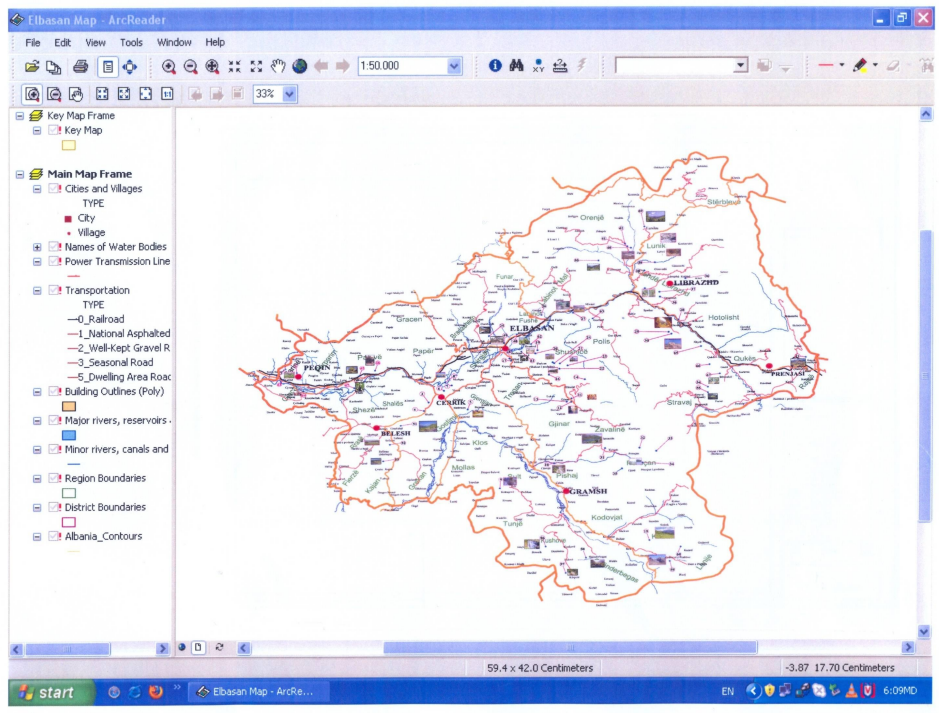
Administrative structure of Elbasan District



Source: *Elbasan Municipality*

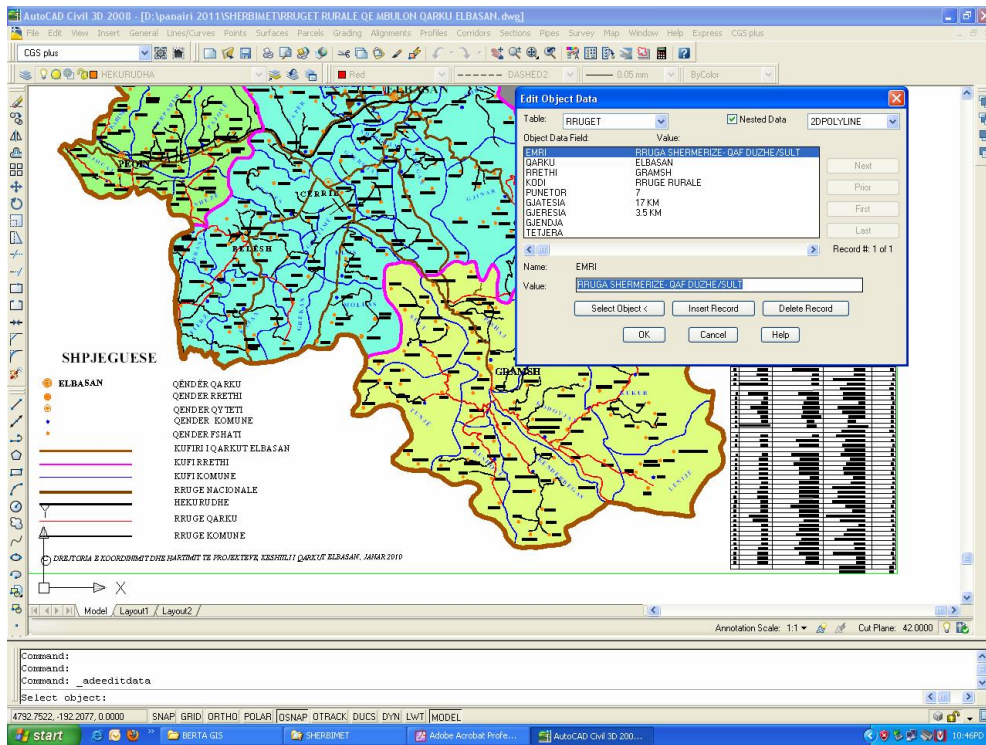
**Figure 5**

Tourist destinations of Elbasan District



Source: <http://albania-hotels.edialtour.com/hotels/albania/city/14/gj/gj1/title/Hotele-ne-Elbasan-Shqiperi>

**Figure 7**  
Route plan and image about query objects



Source: Author's application in GIS

GIS was used in this paper as an analytical tool. After the data collection, ArcGIS 9.2. helped to create both attribute data and spatial data. So, Table 2 indicates how we elaborated the information about the layers and attributes for the different types of tourist centres.

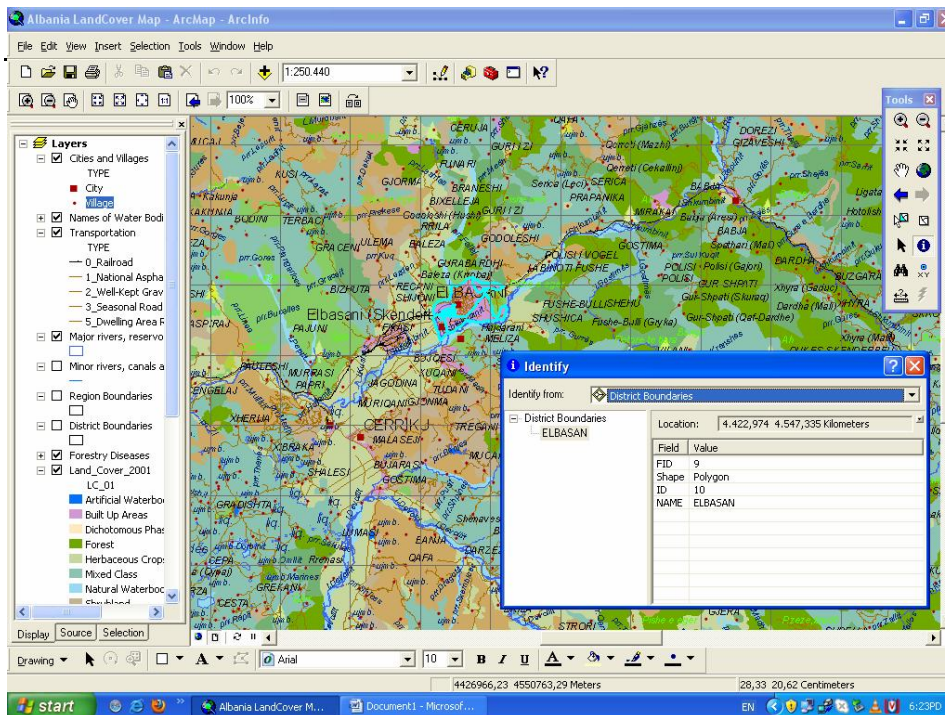
Also, ArcView helped us to create different themes (layers) of roads, hotels, restaurants, museum etc. Finally, the whole digitized map of Elbasan region was created by overlapping all these layers.

**Table 2**

Layers and its attributes

Name of Layer	Attributes
Way	ID, Name, Type
Bus Station	ID, Name
Restaurant	ID, Name, Type of Food, Address
Public Building	ID, Name
Church	ID, Name
Public Garden	ID, Name
Hotel	ID, Name, Category, Pool, Air Condition, Car Rental, Room Service, Shower, Sightseeing, Coffee, Restaurant, Number of Room, Cable TV, Lounge, Laundry, Meeting Room, Fitness, Disco, Address, Web, Telephone, Fax
Mosque	ID, Name, image, document
Police Station	ID, Name, Telephone
Museum	ID, Name, Telephone, image
Boundary Of District	ID, Name, Area, Length

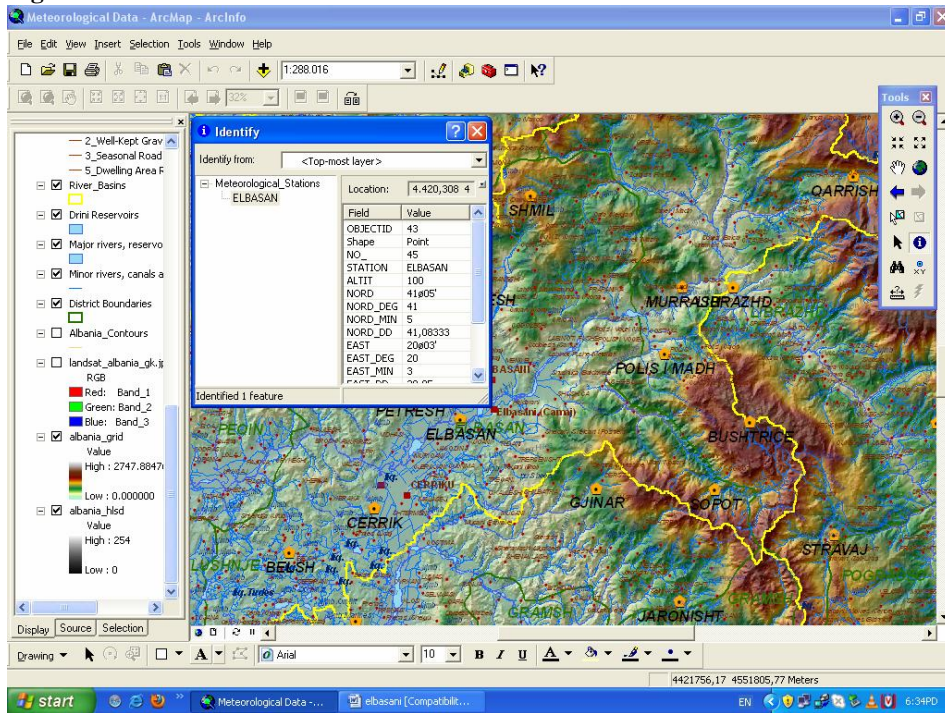
Source: Turk and Gumusay, 2004



sm management

Source: Author's application in GIS

Figure 9

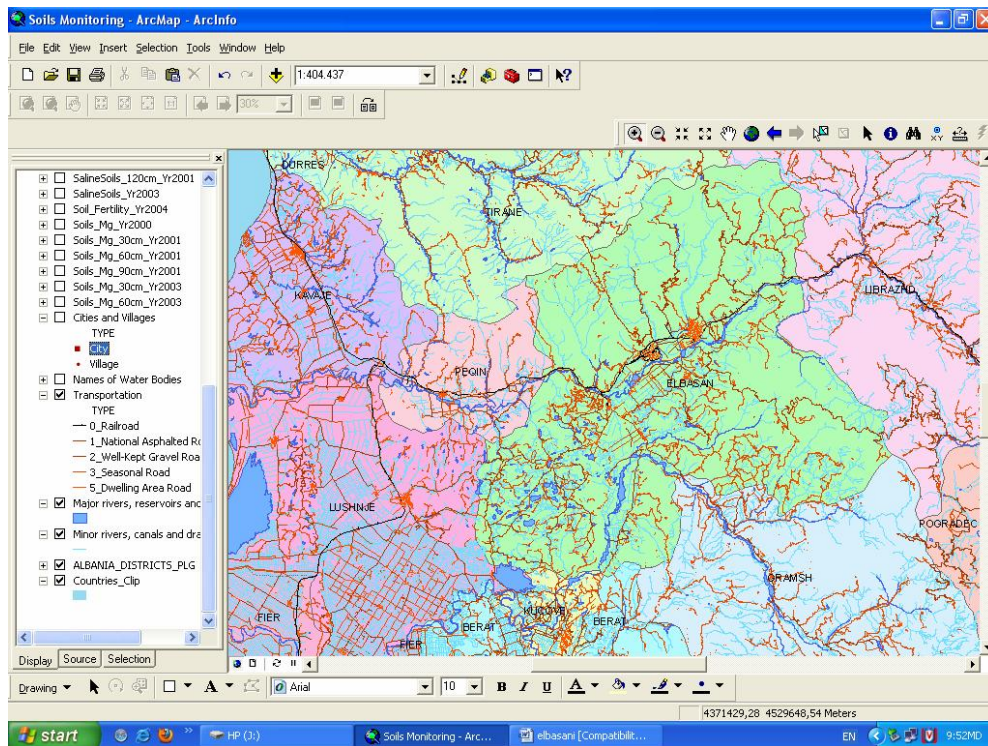


Source: Project for environment protection, Elbasan District

Figure 10

The monitoring of green areas for Elbasan District





Source: Project for environment protection, Elbasan District

## V. Conclusions

This paper underlined the importance of GIS in the development of the tourism industry, with particular focus in Elbasan District. The analysis shows that the application of GIS in Elbasan certainly provides a better management and planning of the tourism industry in this region. This region has a lot of attractive tourist centres, but people from abroad have no information access. Of course, tourist centres, guides, brochures, leaflets, etc. are very important, but these are insufficient considering the main aim of the tourism industry in Elbasan District to achieve a double increase in the number of foreign tourists until 2013. Therefore, providing GIS information in Internet gives an important contribution for the management, promotion and the development of the tourism industry in Elbasan region in general. Only in this way, tourists, different tourism agencies and all interested people would have access to real information which is always up to date. Moreover, GIS minimises the difficulties in the use of maps, graphical tourist guides etc. So, providing a perfect combination between scientific methods and practical and visual work we may declare that GIS is practically a revolution for the humanity. It helps people to save money and time, and easily find the most updated information.

However, the process of data collection and analysis of the tourism industry in Elbasan region identified the lack of information, statistics and market research. For example, it is obvious that the tourism is developing in this region, but it is impossible to find any statistics about the number of tourists and their origin. Therefore, local authorities, including Municipality, District and Prefecture or other institutions and researchers, should undertake more studies, collect more information, and analyse this sector more systematically.

Finally, the growing interest of tourists for this region in particular and Albania more generally suggests the need for more sophisticated and complex applications of GIS, making it an indispensable tool.

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## SECTION XII: ALBANIAN LAW, EUROPEAN LAW, INTERNATIONAL LAW

### DOMICILE AND RESIDENCE OF INDIVIDUALS UNDER EC LAW AND ALBANIAN LEGISLATION

1. Blendi Himçi  
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#### **Abstract:**

*The concept of domicile and that of residence are considered as binding factors in private international law. In particular, in the field of taxation, these concepts affect directly to the right of the state to tax individuals (even companies). This paper will examine, first, the concept of domicile, not only because it has traditional importance, but also because it makes it easier for an understanding of the concept of residence, which appears in various forms. Evolving these concepts will be done in two perspectives: first, domicile and residence under EU law, and secondly, domicile and residence in Albanian legislation, focusing on tax law and tax agreements concluded by the Republic of Albania.*

**Key words:** domicile, residence, Albanian Law, European Law.

**JEL Classification:** K33.

#### **1. THE MEANING OF DOMICILE**

The term "domicile" is considered not only as Connecting factor for the rules of international private law. This term is also important in the right tax, which is considered Connecting factor in relation to inheritance tax and income tax. Domicile is a legal concept more technical and therefore becomes hard its definition. Different European countries legislation provides different definitions of the term "domicile". This difference becomes apparent in particular pot of comparing legislation that belong to different families of law, civil law and common law. If we refer to English law in general, the domicile is considered the same term "permanent home", while according to the tax legislation<sup>378</sup>, A person is treated as domiciled in the UK if: a) he was domiciled in the UK Within 3 years immediately preceding the relevant time, or b) he Was resident in the UK in not less than 17 of the 20 years of assessment ending with the year of assessment in which the relevant time-falls.

Civil law countries have different definitions for the concept of domicile. Swiss legislation<sup>379</sup> defines domicile of a natural person as the "state in which he resides-with the intention to remain permanently". So, the Swiss Courts Consider the domicile<sup>380</sup> as "the place where the person concentrates domestic history, leisure and professional activities."

According to the French concept, a natural person is generally domiciled in the place where he encounters historic principal Establishment<sup>381</sup>.

Under German law: "a person who settles permanently in a historic place establishes domicile in that place<sup>382</sup>". According to Austrian law, domicile requires the intention to take up a permanent residence<sup>383</sup>.

<sup>378</sup> Inheritance Tax Act 1984 (sec.267).

<sup>379</sup> Swiss Federal Code on Private International Law, Art. 20(1)(a).

<sup>380</sup> Layton and Mercer, European Civil Practice, London: Sweet&Maxwell 2004, Vol.2, Para.64.051.

<sup>381</sup> See Art. 102 of French Civil Code.

<sup>382</sup> §7(1) of the BGB (German Civil Code).

Under Italian law, a natural person's domicile is the place he encounters historic Designated as head office for historical business and Interests<sup>384</sup>. The Belgian Code of Civil Procedure defines the domicile of Physical Persons, nor the place where one is Registered with the Municipal authorities<sup>385</sup>. What does seem clear in the legislation of these countries is the fact that an individual may have more than one domicile. In some countries, the individual can have only one domicile<sup>386</sup>, in some others, the individual may have domicile in two different places<sup>387</sup>, and maybe in some states this fact don't emerges<sup>388</sup> clearly.

## 2. THE MEANING OF DOMICILE UNDER EC LAW

The concept of "domicile" is also important in EC Law. Under the Brussels I Regulation on Jurisdiction and the Recognition and Enforcement of Judgements in Civil and Commercial Matters, the concept of domicile is used for the Purpose od deciding whether the Regulation applies. Domicile is used as a Connecting factor in the European Enforcement Order Regulation Creating a European Enforcement Order for Uncontested Claims<sup>389</sup> and as an alternative to domicile in the European Small Claims Procedure Regulation<sup>390</sup>. Domicile is used as an alternative to habitual residence in the EC Insolvency Proceedings Regulation<sup>391</sup>. It should be noted that Regulation provides a definition of domicile for companies, but not for individuals. However Regulation stipulates that the definition of which member state will be applied. Given that the concept of domicile is defined in different ways in different countries, it may be that an individual, at least in principle, to have domicile in different Member States. Will probably create less problems if the Regulation would determine a definition of domicile. For the purposes of the Brussels I Regulation, the states uses the definition of domicile under domestic law. Is the case of France, Germany and Austria<sup>392</sup>. The Belgian legislation does not contain any definition of domicile for the purpose of Brussels I Regulation.

But let stop at British legislation. As stated above, the definition of domicile in common law countries is different from the one of the civil law countries. England does not use domicile as a basis of jurisdiction in civil and trade law. This has created a problem for England. Under these conditions, the UK made a special new definition for domicile for the purposes of the Brussels Convention and the Brussels I Regulation. This definition is similar to the definition of domicile in civil law countries. The same thing happened with Ireland. Thus, England and Ireland have two different definitions of domicile, that are used for different purposes. Under English law, for the purposes of the Brussels I Regulation, domicile is equivalent to the state that:

- a) A person is resident;
- b) Nature and conditions of his residence indicate that there is a stable relationship with him.

The last one is demonstrated by 3 months residence<sup>393</sup>.

## 3. CONCEPT OF RESIDENCE

Since the definition of the domicile of an individual is different in the EU Member States, in the civil jurisdiction his research presents interest in order to connect with an individual residence. Under French law, a person has domicile where he has residence<sup>394</sup>.

<sup>383</sup> §66(1) of the Austrian Code on Court Organisation and Jurisdiction.

<sup>384</sup> Art. 43(1) of the Italian Civil Code.

<sup>385</sup> Art. 36 of the Code of Civil Procedure.

<sup>386</sup> Such an approach is found in the laws of Denmark, Finland, France, Italy, Switzerland.

<sup>387</sup> For example, Germany, Austria.

<sup>388</sup> For example Holland.

<sup>389</sup> (EC) No. 805/2004. See Arts. 6(1) (d) and 20(3).

<sup>390</sup> (EC) No. 861/2007. See Art3(1).

<sup>391</sup> (EC) No. 1246/2000. See Arts. 39 and 40(1).

<sup>392</sup> Layton and Mercer, *European Civil Practice*, London: Sweet&Maxwell 2004, Vol.2, Para. 51.051.

<sup>393</sup> Para. 9 of Sch.1 of the Civil Jurisdiction and Judgements Order 2001.

<sup>394</sup> Layton and Mercer, *European Civil Practice*, London: Sweet&Maxwell 2004, Vol.2, Para. 51.051.

The same in the Spanish legislation<sup>395</sup> and the German<sup>396</sup> one. According to the Italian legislation<sup>397</sup> transfer of residence means domicile transfer. Under Dutch law the domicile of a person is usually where he is registering at the local civil registry<sup>398</sup>. Danish law does not make any distinction between domicile and residence<sup>399</sup>. Individuals need to register the domicile in the local branch of the national registry within 5 days of establishing residence.

From an overview of domestic legislation of various states, is notable that there is no single concept of residence. The term "residence" is distinguished from the term "habitual residence" and in common law countries, distinct even from "ordinary residence". But though these last two concepts are not clearly distinguishing between them is evident distinction between domicile and residence. What makes it easier distinctiveness between domicile and residence is the difficulty in changing the domicile.

The opposite occurs in countries civil family law, where the domicile and residence have almost the same meaning. But let us turn to the meaning of residence in the common law countries. In England, the term "resident" is used in three contexts. First, the term is associated with the concept of domicile. In order to acquire a domicile of choice in a country, the individual must swear a resident in that country. Second, British legislation asks the court to identify the various connections with the Countries in question, one of Which is residence. Third, the residence is considered as a connecting factor for the purposes of tax law<sup>400</sup>. We can say the same for the Canadian legislation. While in Australia and the U.S., acquisition of a domicile requires Physical presence in a state, Rather than residence<sup>401</sup>. The residence refers to physical presence in that country as an inhabitant. In this definition the emphasis should be put on the fact of being inhabitant and not just being physically present in a state. If a person who lives in England, spends ten days holiday in Switzerland, he is physically resident there for that period, but we can not say that he is inhabitant.

In the context of tax law, the residence of an individual assumes a special meaning. An individual shall be treated as non-UK resident if<sup>402</sup>:

- a) The individual is in the UK for some temporary Purpose only and with no intentio of establishing the individuals residence in the UK, and,
- b) During the tax year in questions the individual spends (in total) less than 183 days in the UK.

In the USA, the residence is usually interpreted as the equivalent of domicile<sup>403</sup>.

In civil law countries legislation we find more the term habitual residence. In Germany this term is used as a subsidiary connecting factor<sup>404</sup>. Under German law the residence is distinguished from habitual residence due to the fact that a person does not need to reside in a place for a minimum of time<sup>405</sup>. German legislation does not provide any specific definition for habitual residence. Such a definition is provided by the German Federal Court<sup>406</sup>. Under this definition habitual residence requires a certain level of social integration, and if referred to German academic literature, length of residence, accompanied by the intention to stay, is a qualified parameter to habitual residence<sup>407</sup>.

<sup>395</sup> Id. at para. 62.051.

<sup>396</sup> Id. at para. 52.051.

<sup>397</sup> Id. at para. 56.051.

<sup>398</sup> Id. at para. 58.051.

<sup>399</sup> Id. at para 59.051.

<sup>400</sup> Part 14 of the Income Tax Act 2007.

<sup>401</sup> Scoles, Hay, Borchers, Symeonides, Conflict of Laws, Gale Cengage: 4<sup>th</sup> edition (1 Jun 2004) (Hornbook Series), § 4.18-4.19.

<sup>402</sup> Sec. 832 Income Tax Act 2007.

<sup>403</sup> Scoles, Hay, Borchers, Symeonides, Conflict of Laws, Gale Cengage: 4<sup>th</sup> edition (1 Jun 2004) (Hornbook Series), § 4.13

<sup>404</sup> Von Hoffmann/Thorn, Internationales Privatrecht, 9, Auflage 2007, München: CHBeck Verlag, Para 71.

<sup>405</sup> Id. at para 84.

<sup>406</sup> BGH 29.10.1980; BGHZ 78.293.

<sup>407</sup> Von Hoffmann/Thorn, Internationales Privatrecht, 9, Auflage 2007, München: CHBeck Verlag, Para 75 et seq.

Swiss legislation refers more to habitual residence than the residence, but requires 2 years of residence as a SUBSIDIARY Connecting factor in Relation to the law Applicable to divorce and Separation<sup>408</sup>. Under Swiss law, the habitual residence of a person is defined as the state in which he lives for a long period, even if this period will be limited in the beginning thought<sup>409</sup>. But is not determined exactly how much should be this time period. While the Danish and Norwegian legislation makes no distinction between the concepts of domicile and residence. Most civil law countries use it as a connecting factor in the right taxes. Spanish civil code equals domicile with habitual residence, while the Italian civil code equals the residence to the place where a person has his usual housing<sup>410</sup>.

Most civil law countries identify the residence of a person through his registration in the register of population held by local units. Besides habitual residence in the legislation of some EU Member States we find the term "ordinary residence". Common law jurisdictions consider ordinary residence like a connecting factor in tax laws. Civil law jurisdiction does not considerate this term. But what is the ordinary residence? Ordinary residence does not mean continuous physical presence, but physical presence, up to a constant continuous level, regardless of temporary and randomized absences<sup>411</sup>. Such a definition is found in the Australian law<sup>412</sup>. Under British law, ordinary residence and habitual residence refer to the place of residence of a person in a particular country that he has voluntarily chosen and considered as part of the ordinary rule of his life, regardless of the period that he stay there. A person may have habitual residence in two different states at the same time<sup>413</sup>.

We can say that the meaning of habitual residence Within a particular jurisdiction varies to some extend with the context in which the concept-is used. It is difficult to make a final distinction between the two concepts ordinary residence and habitual residence.

#### 4. THE CONCEPT OF RESIDENCE UNDER EC LAW

Efforts to find a full definition of "residence" are not successful not only in the domestic legislation of the states, but also in the right of the EU. Such a definition is found in the EU Treaties or in Secondary law of the EU. However, it must be admitted that the residence is an important concept in particular to EU treaties that are applied to the free movement of people, services and capital.

The term "residence" is used almost extensively in primary and Secondary EU Law. However perkufizimine of this term gjejmene menmyre laconic in EU Legislation, but never at the treaty.

So, a definition of "residence" is very necessary to Regulation No. 1408/71, therefore, such as in the Art.1 (h): "residence means habitual residence"<sup>414</sup>. We find the definition of the term residence in Rome I<sup>415</sup> and Rome II<sup>416</sup> Regulations: "The habitual residence of a person Acting in the course of historical business activity scarf became history principal place of business".

While in a treaty level, the term "resident" is used in various fields, but without giving a definition. This term is also used in some of the treaties.

<sup>408</sup> Art. 61 of the Swiss Federal Code on Private International Law.

<sup>409</sup> Art. 20(1)(b) of the Swiss Federal Code on Private International Law.

<sup>410</sup> Art. 43 of the Italian Civil Code.

<sup>411</sup> *Shah v. Barnet London Borough Council* (1983) 2 AC 309 at 341-342, HL.

<sup>412</sup> *Nygh and Davis, Conflict of Laws in Australia, Chatswood N.S.W.*; LexisNexis Butterworths 2002, 7<sup>th</sup> ed., p.266.

<sup>413</sup> *Ikimi v. Ikimi* (2001) EWCA Civ 873, (2001) 3WLR 672.

<sup>414</sup> Regulation (EEC) of the Council of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community, O.J. 1971, L 149/2, as repeatedly amended.

<sup>415</sup> Art. 19(1), Second Para., Regulation (EC) No. 593/2008 of the European Parliament and the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), O.J. 2008, L 177/6.

<sup>416</sup> Art. 23(2) of Regulation (EC) No. 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II), O.J. 2007, L 199/40.

First, the term is used in relation to the rights of citizens of the Union. Art. 20 (2) (a) Treaty on the Functioning of the European Union (TFEU) Gives EU Citizens "the right to move and to reside freely within the territory of the member-states." This is further elaborated in Art. 21 TFEU<sup>417</sup>.

We find also the term resident in Art.20 (2) (b) TFEU, where EU Citizens are given: "the right to vote and to stand as candidates in Elections to the European Parliament and in Municipal Elections in Their Member State of residence ". This right is further elaborated in Art.22 TFEU and in Secondary law<sup>418</sup>. So this term is also used in the area of free Movement of Workers, Art. 48 TFEU, in the field of free Provisions of services, Art.61 TFEU, in the field of free Movement of Capital and Payments, Art. 65 (1) (a) and in the Treaty Provisions Regarding police on border checks, asylum and Immigration, Arts. 77-79 TFEU. We face the notion of residence in Art.11 (e) of Protocol No.7 on privileges and immunities of the EU<sup>419</sup>.

For as much as we can in this paper we can see that for the term resident, there is no definition in the provisions of EU treaties, however, it is used in articles that regulate various issues.

## 5. RESIDENCE UNDER TAX LEGISLATION

The concept of residence turns significant in the field of taxation. In particular also for the residence of individuals. As we saw so far, the legislation of different countries, but EU legislation, gives more importance to the notion of domicile and rarely find any definition of residence. But we cannot say this for the tax legislation. We will see below how this term is meaningful in domestic tax legislation of the countries that belong to common law and civil law, and then we will see the EU tax legislation.

### 5.1 RESIDENCE UNDER DOMESTIC TAX Legislation

The residences of individuals is considered as a connecting factor, which reflects an almost essential close relationship between a country and a person. However, it depends directly from the conception of the national legislation of each country about residence. Tax legislation of different countries exploit the other connecting factors, domicile or nationality or economic ties with the country. Connecting factors such as residence, domicile or nationality commonly are used by states to impose taxation in respect of Worldwide Income, while strong economic ties with the country are used as connecting factors of the states to impose taxation on a source basis. But most of residence countries provides foreign tax credit relief in respect of source country taxes.

All states use the concept of residence for tax purposes, as well as for non-fiscal purposes, such as naturalization of citizens, divorce jurisdiction, etc.. But despite different conception made to the residence from different jurisdictions, all of them has a common point: all these conceptions your to put the spotlight on elements of personal Physical presence. What is observed is that the concept of residence includes a quantitative element of a person having in a country some degree of Physical presence characterized by a qualitative element, which is usually personal and non-economic.

The element which differs from one country to another is the amount of physical presence in that state or even the type of interest or activity that is considered personal. We found in the domestic legislation as well terms like "ordinary residence", which covers potential gaps in physical presence, or "habitual abode" and "center of vital Interests" (CVI), which are used to describe physical presence in several countries.

It should be emphasized once again that the definition of residence usually justifies the imposition of taxation in respect of Worldwide Income.

### 5.2 RESIDENCE UNDER EU TAX LEGISLATION

<sup>417</sup> In EU legislation, see Directive 2004/38/EC of the European Parliament and the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and to reside freely within the territory of the Member States, O.J. 2004, L 158/77.

<sup>418</sup> See Council Directive 94/80/EC of 19 December, O.J. 1994, L 368/38, as amended, and Council Directive 93/109/EC of 6 December 1993, O.J. 1993, L 329/34.

<sup>419</sup> As is known, the protocols attached to the EU Treaties form an integral part there of.

Just as in the tax legislation of the Member States, even in the EU tax legislation, we note that the term "residence" is used as a factor to allocate taxing jurisdiction between Member States. In the community law we don't find rules in the field of direct taxation. Like tax provisions we can mention only a few EC Directive as: Merger Directive, Parent-SUBSIDIARY Directive, Interest and Royalty Directive and Saving Directive. Direct taxes are regulated by domestic legislation of the Member States. This is also visible from the ECJ<sup>420</sup>, according to which, when there is no unification of legislation in the context of the community, are Member States with their tax sovereignty, which define unilaterally or with tax arrangements, the criteria for the distribution of tax authorities. In some law cases, the ECJ accepts that the Member States distribute tax jurisdiction between them on the basis of "residence" (as a result residents are subject to Worldwide taxation in the Member State of residence) and on the basis of "source" (as a result the nonresidents in a Member State are taxed only on income having its source in that Member State<sup>421</sup>). In general, the Member States, for the distribution of tax rights between them, refer to the OECD Model Convention for the avoidance of double taxation and the Commentaries published by OECD in Relation to dry Model Convention, but we will examine this issue later.

Choosing allocating factor may result in favor or disfavor of the taxpayer, so he can pay more or less tax in the Member State of taxes. Community law does not require harmonization of tax rates, even don't oblige Member States to prevent double taxation in such a way that the income can be taxed at the lowest tax for both the Member States that concludes the agreement. The right community, however, wants to be treated equally, as residents, as well as non-residents, as domestic income, as well as those created in another member state.

In conclusion we can say that this residence in EU tax legislation is seen as a simply guidelines that helps in assigning and assessing tax jurisdiction.

## 6. RESIDENCE UNDER OECD MODEL CONVENTION

As mentioned above, when we speak about taxes and tax authorities, EU Member States refer mostly OECD Model Convention (Hereafter OECD MC) and its commentary.

The concept of residence in the context of the OECD MC represents mainly importance in solving those cases where double taxation arising as a result of dual residence of the taxpayer or as a result of colliding source state legislation with that of the state of residence and vice versa. In these cases the conflicts arises because, under their domestic law, one or both the contracting states, pretends that the taxpayer is resident in their territory.

As we saw above, most states taxes not only people who have domicile in that state, but also those who can stay there for a certain period. Conventions for the avoidance of double taxation does not stipulate mandatory standard for domestic legislation of the concept of residence. At this point, the contracting states are free to apply their domestic laws. The conflict between the internal legislation of the contracting states arises not because of the meaning of residence, but because of the preference that will be given to which of the laws will apply. The convention solves such thing, it explicitly defines which of the two concepts of residence will be given the preference.

Art. 4 (1) of the Model Tax Convention on Income and Capital (2008) states: "the term" resident of a Contracting State "Means any person Who, under the law of that State, is liable to tax therein by reason of historic domicile , residence (.....) or any criterion of a similar nature (.....).

This term, however, does not include any person Who is liable to tax in that state in respect only of income are from source in that state. "

As noted, the definition of residence in the OECD MC refers to the concept of residence according to the national legislation of the Contracting States.

<sup>420</sup> ECJ, 23 February 2006, C-513/03, Van Hilten § 47.

<sup>421</sup> ECJ, 15 May 1997, C-250/95, Futura § 22; ECJ, 13 December 2005, C-446/03, Marks&Spencer § 39; ECJ, 29 March 2007, C-347/07, Rewe §69.



Criteria to be classified as "resident of a Contracting State" OECD MC determines, among other things, domicile, residence or any other criterion of similar nature. So in the case of individuals, the definition of residence tends to cover various forms of personal connection with the country in which, according to national legislation, the individual is fully liable to tax<sup>422</sup>.

From the analysis of the second sentence of paragraph 1 of Article 4 of the OECD MC, we see also that does not benefit from their status as "resident of a Contracting State" a person who is subject to tax only the income that creates in the territory of that State or for capital situated in that State.

In conclusion we can say that the OECD MC makes a definition of the term "resident", but this definition refers to the domestic law of the Contracting States. The convention undertakes to allocate taxation rights, defining that the legislation of the Contracting States shall apply.

## 7. DOMICILE AND RESIDENCE UNDER ALBANIAN LEGISLATION

Albania is one of the last former countries of the socialist camp in the Western Balkans, which came in the way of democratization in the early 90s. During these last 20 years of the country's economic development is accompanied with fundamental changes to the legislation. But let's focus on the study. During the 50 years of communist dictatorship, Albania experienced years of complete isolation. Removal of Albanians abroad for a long time without losing contacts with the country was an impossible dream. Adding to this the fact that in 1969 Albania was proclaimed as the only country in the world without taxes on individuals<sup>423</sup> we can't expect a legal arrangement of the resident term tax framework. The democratization process in the country was accompanied not only with the free movement of people within the country, but also the migration of many Albanian citizens abroad and the establishment of more foreign nationals in the country.

Albanians efforts to build a capitalist society and a market economy, revealed dozens of accumulated problems. Employing hundreds of Albanians abroad or foreigners in our country has become a permanent source of foreign exchange for the country and affects the stability of the domestic currency, but at the same time is a potential risk for the particular phenomenon of double taxation. This is also why in this moment of review the term resident gets special attention. Let's see first how the term domicile is defined and then residence in the albanian legislation, focusing on later tax legislation.

### 7.1 DOMICILE AND RESIDENCE UNDER DOMESTIC LAW

Civil Code of the Republic of Albania makes a distinction between the term "township"<sup>424</sup> and the term "residence"<sup>425</sup>. This law defines township as a country residence, freely chosen by the person himself, which is connected to the work or the permanent location of the property or the realization of interests, and that person usually stays or most of the time. In the conception of the law about township there are important two aspects: first, the person close connection with this country, because of his interests (work, service, location of the property or other interests), and secondly, the period of staying in it (typically or most of the time).

Article 12 of the Civil Code also provides that a person can not simultaneously have more than one residence. This means that an individual can not have strong ties and for a long time with two places at the same time.

<sup>422</sup> Commentary on the OECD MC 2003, Art. 4, No. 8; Wassermeyer, in *Doppelbesteuerung*, Debatin & Wassermeyer, eds., Munich: Beck, 2004, at Art. 4, No. 2; Vogel, DTC, 3<sup>rd</sup> ed., Deventer: Kluwer, 1997, at Art. 4, No. 24 a.

<sup>423</sup> Nr.4540 decree dated 6.9.1969 of the Presidium of the National Assembly of People's Republic of Albania.

<sup>424</sup> Article 12 of the Civil Code of the Republic of Albania, law no. 7850, dated 29.07.1994, as amended.

<sup>425</sup> Article 14.

On the other hand, in the law, we find the term "residence of the person"<sup>426</sup>, a term entirely distinct from the residence. From a comparison of definitions given respectively in article 12 and 14 of the Civil Code, the distinction between the two concepts is given in the verb. As for residence it is used the verb "lies" in the case of residence the law uses the verb "is". In the first case the attitude is a result of its duration (usually or most of the time), while in the second case, the person is linked to domicile due to a special reason, which has an exact time and can't be due to his long-term interest. So the difference that the Civil Code of the Republic of Albania makes between the terms residence and abode is necessarily associated with the residence time of an individual in this country and the type of interest that relate to it.

In the family code<sup>427</sup> it is used the term domicile and residence, but not given a specific definition for the purposes of this law.

In the law that governs adoption procedures<sup>428</sup> we find widely used the term "resident" without reference to any particular definition for the purposes of this law. For example, Article 14/3, and sets out the conditions of submission of the application for adoption, the law stipulates that: "The foreign citizens resident for two years in the Republic of Albania, .....". while in section 4 of this article states: "Albanian citizens resident outside the Republic of Albania .....". despite the fact that this law there is no particular conception of the term "resident" is easily understandable the fact that the residence is associated with the country of residence of the person for a relatively long period.

We find also the terms residence and abode ranked at the civil status of the individual in the Law no.10129, dated 11.05.2009 "On the registry". Chapter III of this law makes a detailed discussion of the concept of domicile, residence registration obligation, and changing his statement. This law defines residence as the place in which citizen usually lives for more than three months without interruption or more than six months in a calendar year<sup>429</sup>.

In the law that govern the status of foreigners in Albania<sup>430</sup>, Section 3/27 defines the term resident as a "foreigner, that has a continuous residence permit, issued by the competent authorities of Albania". But the law does not specify any time for "habitually resident".

## 7.2 RESIDENCE UNDER TAX LAW

Unlike the rest of the Albanian legislation, the tax legislation refers many time to the term residence in the application of the tax liability. An individual is considered resident in the Republic of Albania for tax purposes, where there is a permanent, family therefore vital economic interests in Albania, although may work in different periods abroad or may have foreign citizenship<sup>431</sup>. But in the context of tax law, will be regarded as tax resident Albanian diplomats employees assigned to work by the state in embassies, consulates or international organizations abroad, although it can live for not too long abroad Albania. The law defines precisely the time of residence in the Republic of Albania to be regarded as resident on the basis of the Albanian tax legislation. So, who, for tax purposes, will be considered an Albanian resident individual (regardless of nationality) that stands in Albania during a tax year, ongoing or intermittent, in total, more than 183 days. In this calculation are considered days of physical presence, then not only the working days, but the day of arrival, departure, holidays<sup>432</sup>. As noted in the criteria set forth by the tax law, as the basis for the definition of residence criterion serves io residence, as defined in Article 12 of the Civil Code, which examined above the reason of detailing the concept of residence is the extension of the tax liability.

<sup>426</sup> Article 14 of the Civil Code states that: "the residence of a person is the place where he is to perform certain jobs or tasks, to continue a school or specific course, to be treated, to serve a criminal sentence, and other cases of this nature. "

<sup>427</sup> Law no. 9062, dated 8.05.2003 "Family Code".

<sup>428</sup> Law no. 9695, dated 19.03.2007 "On adoption procedures and the Albanian Adoption Committee."

<sup>429</sup> Article 14 of Law no. 10129, dated 11.05.2009 "On the registry".

<sup>430</sup> Law no. 9959, dated 17.07.2008 "On Foreigners".

<sup>431</sup> Article 3/1 of the Law no. 8438, dated 28.12.1998 "On income tax" changed.

<sup>432</sup> The same, articlei 3/2.

Individuals resident in the Republic of Albania are subject to personal income tax liability for the period for all the income tax that provide (within and outside the territory of the Republic of Albania), while non-resident individuals are subject only to income tax liability that provide tax during the territory of the Republic of Albania<sup>433</sup>.

We can find the same concept of residence for individuals in the law that governs tax procedures<sup>434</sup>.

The tax residence is the place where the taxpayer has full tax liability on the income statement, payments and assets subject to tax under the tax legislation in force. The law reiterates once again the three criteria for determining the residence of the individual. Are considered albanian tax resident all those individuals who meet at least one of the following criteria:

- a) Whos has residence in the Republic of Albania, in terms of Section 12 of the Civil Code, therefore, have a permanent home, have family, life and economic interests in Albania (country of vital interests), despite that it can work in period different abroad or may have foreign citizenship.
- b) Who has Albanian citizenship and exercise functions on behalf of the Republic of Albania as diplomatic officials or employees appointed by the state at the embassies, consulates or other similar international organizations abroad.
- c) Who stays in Albania on a continuous or intermittent period of time, a total of more than 183 days during a tax year, regardless of the nationality or the place where their vital interests. In the calculation of the duration of stay in Albania, days of physical presence, then, not only working days, but the days of arrival and departure days holidays.

When discussing tax legislation in Albania we can't avoid tax agreements, that after the ratification, become part of the national legislation. The agreements for the avoidance of double taxation, which has been signed by the Republic of Albania, in accordance with the Guidelines of the Minister of Finance<sup>435</sup>, The definition of the term "resident of a Contracting State" means any person (individual or company), which under the law of that state is fully liable to tax in that State (subject to tax all income at the state, regardless of where the realized income)<sup>436</sup>.

Application of the criteria for determining the residence of individuals is done step by step with the priority given to the agreement, that individual is considered a resident of the Contracting State in which he has a permanent home available to him, but if that individual has a permanent home in both contracting states (or any of them), then he is considered a resident of the state where the center of his personal and economic interests, and if the state where the center of his personal and economic interests can not be determined, then this criterion does not allow determining the residence, then passed on the following criteria is "the place where the individual has an habitual abode". If this makes it impossible to determine the residence, then it moves to another criterion that is "citizenship" and, if the individual is a national of both States or any of them, the competent authorities of both Contracting States shall settle the question by understanding mutual in accordance with the procedures set forth in the article is about "mutual agreement procedures." So, for the elimination of double taxation agreements signed Albania uses as criteria for determining residence the same criteria found in the OECD MC.

As a result, the concept of domicile and residence appear closely linked to each other, at least in the legislation. However, the term residence finds extensive use in tax legislation, while in general, refers primarily to internal legislation to the term domicile.

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<sup>434</sup> Article 8 of the Law no. 9920, dated 19.05.2008 "On tax procedures in the Republic of Albania".

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<sup>436</sup> For the purposes of the tax agreement, the term resident of a Contracting State includes also separate contracting State and any political subdivision or local authority there of.

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**THE DUALITY OF EUROPEAN AND ALBANIAN DOCTRINS AT THE CLASSIFICATION OF LESION CAUSED DURING THE PROFESSIONAL JOB LIKE ONE EXTRACONTRACTUAL OR CONTRACTUAL DAMAGE: THE ROLE THAT PLAY AT EC AND ALBANIAN PRACTICE THE CONTRACT OF PROFESSIONAL INSURANCE**

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**Abstract:**

*Mostly we are involved at one situation when we need the professional assistance, and mostly the results are not in our advantage and can damaged us. In this cases the responsibility of this specialist is classified like one contractual responsibility or extra contractual responsibility? In this cases, who is the role that the insurance Company have, based at the professional insurance contracts?*

**Key words:** Albanian and European doctrine, duality, contract, professional.

**JEL Classification:** K39

1. A short expose of problems that we deal at the classification of the damage caused being professional and during our job. Usually during our live we need often an expert supervision and consults, who usually is one person that exercise his profession as a private job or working in a public or private institution, and who is legally obligated, depended from the kind of assistance that he give to us, to assist us like legal consultancy, prepared legal or juridical acts or exercising his profession in our self, as the physician do. On this cases it happens that we, depending from “clientelisme”, personal knowledge or the fame and publicity that is created for this professional, to choose by our self to directed to him, to take the necessary professional service. But usually it happens that without having any presentation, any kind of basing information about this “professional person”, we choose to direct to him, conditioned by circumstances that aren’t depended from us<sup>437</sup>. In all cases, as we choose by our self the person that we want to assist us like professional and to take care of us, as we choose this person not from our personal conviction but obligated from the different created circumstances, we don’t have signed any contract or agreement with this professional for the service that he will give to us, our expects from his assists, for the right and obligations that depends from the created relationship. More than an evolution relations, this appear that is one relationship born by its self, without any person involved in this situation having the target to created it, but having always the common target, the specialist to give his assistance exercising his profession / the client to pretend this professional assistance, exercising his universal right as a human<sup>438</sup>. So we ask our self, how we can classified this relationships, will be their under the general legal contractual principles as a services contract, agency contract, ordination contract, supervision contract ect or, their will be ordered by extracontractual responsibility ‘principles’?

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<sup>437</sup> For exp when we are at an hospital and when on us the physicians exercise their profession, their are employed in this institution, this make unable to choose by our self, the person that we want to take care of us.

<sup>438</sup> The relationship between the specialist and his client mostly is one casual relation, that have the volition to make their duty and not to select each other is

To answer this question, the juridical doctrine and the modern juridical theory, offer to us different kinds of alternatives that some times it looks to clasificcate this relation as contractual relation and some times as an extracontractual relation.

2- The juridical experience and Italian doctrins for the damages caused during the exercise of the profession like Physician or Public Notary

To illuminate our theory, asking moderns doctrins and legislations help, we will see that

-The Italian low, if we take as exp the relationsheep between Physician and patient, on first of all, make the difference of kind of service that the physicioan offert to his patient. That juridically looks as on insure definition, at the firs look, wan't bee wrong to classified this relation as a contractual relationsheep (the physician has one work contract weth the hospital or institution when he works for the service that he is obligated to offert of any person /patient) and a little as an extracontractual relation (it is not any kind of legal or verbal contract between physician/patient, that hasn't signed any agreement)

On his book *Giuglio Ponzanelli* perifrased the relation patient/physician 'as one agreement that present the terms of trust, care and custody, depending from technical service of assistance, discretion and professional secrets' <sup>439</sup>

In the past, it was totally clear, that a damage caused from the physician during his job, belongs the "aquiliane" responsibility, is involved as a consequence of violence of "neminem leadere" obligation that any person, included the physician, has to the third persons. In this way the 'extracontractual fault', was been perifrased by juridical literature as an argument, that, must evident the missing procedural tries that the physician must do to benefit the patient interest, if he has done the "Wright tries". This "wright tries", was been clasificated depending of technical capacity, science evolution, social and professional behaviours of one medium physician skills, and the medium practice for the concret cases

But the Physician activity can be clasificated as one intellectual service too, and like this, it's depending from personality that the service has (intuitus personale). So, the professional asistence that the physician offert to his patient depend such from the technical and science capacity of the institution where he work, as from the technical and scientific physician skills, from his general and professional capacity

For many year in Italy, under the obligation of article 2236 of Italian Civil Code <sup>440</sup> the civile responsibility of physician (so the extracontractual responsibility) is involved only in cases when is prouved "the grave fault" on the physician actions, that for many other doctrins, is considerate as a privilege gived to this persons (we illuminate that for other cases it is enough to prouve that if one person don't has reacte as one good neighbor, he is responsible for any damage caused by him) <sup>441</sup>.

In this point of view, the physician at his selectioned extracontractual responsibility, looks like one privileged professionist, compared with other ones who offer their profession as a service for therd persons.

At the last 20 years, the Italian jurisprudence and doctrine, has take another point of view, that looks to rilevate the importance of physician responsibility for any damage caused by him, but that not results in unanimity

In special, the courts, referring the legitimacy of physician obligation qualification, has gone to the conclusion of perifrasing it as one contractual obligation, that can direct to the extracontractual responsibility, according article 1218 of Italian Civil Code <sup>442</sup> only in cases that was prouved the grave fault and grave action, which, will play one symmetric role according to article 2043 of Italian Civil Code

<sup>439</sup> *Giuglio Ponzanelli* - La responsabilita civile, profili di diritto comparativo fq 103

<sup>440</sup> **Art. 2236 the responsibility of the professional person** "in the cases that the profesisonal service involve the technical knowledge over the medial, the profesionist is not responsible of the results, excluding the foul actions".

<sup>441</sup> *I Peza artikulli shkencor* Uniel 2009/2, Fq 143

<sup>442</sup> The debtor that has not accomplish correctly his work, is obligated to pay the damage, excludend the case when he prouve that the damage is indipedend from his actions

In this case we consider as necessary, to understand what has pushed the Italian doctrine, notions and jurisprudences to evaluate the foundations of damage and responsibilities.

The civilistic doctrine has always made the difference between the medical obligation and results obligations, phrased the first as obligations that the accomplishment of duty to take care is imposed from the profession that the physician has, and the second, as obligations that the duty to take care of in his self isn't part of professional practice, but involve the professional and practice capacity that for any physician are personal. Medical service and in general the intellectual service, without any doubt, are included at the category of professions, that has the obligation to act and react based at deontological code, professional ethic, and is so subjective such is totally become one subjective baggage, one intellectual, scientific and technical capacity of each single person<sup>443</sup>, taken away from fixed protocols.

At the same time, the doctrine has been used as obligation that the physician has to use all the technical and scientific assistance and knowledge during his profession, considering intolerant the fact of ignorance of physicians of this technique, in comparison of the high quality that his job imposes<sup>444</sup>.

In this context it is necessary to refer to the Italian Cassation Court decision, at the sentences no 2466/95, that affirmed the physician is obligated not only to use the recommended technical therapy, but he can not justify that the institution where he works don't have the technical necessity<sup>445</sup> -, because, in accordance with this sentence - the physician, in respect of one usual protocol of medication, must refer this case to another hospitalier structure that can accomplish this duty<sup>446</sup>.

Interesting is also the resolution given by jurisprudence, that, conserved the contractual nature of the relationship, qualified the medical service based at the target; so

- For the interventions called routine, or the intervention when the practice guarantees the results, the physician obligation is to guarantee the results, and if the interventions has good results, the contractual obligation of physician is accomplished<sup>447</sup>.

- In the cases of complex and complicated interventions, statistically with unsure results, the doctrine collects all the juridical complication to make the physician responsibility as easy as is possible, referring to the "grave fault", that involve the extracontractual responsibility process.

Having also one social point of view of this problem, the Italian doctrine has taken in consideration the social contact between physician and patient, the trust of patient versus physician and the duty of physician to take care of patient that is defended from human rights, constitutions.<sup>448</sup>

The diversity of qualifications of medical responsibility make low and practice to take in consideration different kind of qualifications of responsibility.

At the Cassation court decision of 13 March 1998 no 2750, is decided that "between the patient and the doctor is one agreement that is also one contractual relationship, based at the fact that patient is presented at the institution. So the physician has double responsibility / extracontractual responsibility versus the patient imposed from duty to take care principle, and contractual responsibility that the physician has versus the institution where he works<sup>449</sup>."

In fact it was doctrine that has made in concurrence of two kind of responsibility, at it was the practice that has given the conclusion that

- this concurrence between contractual and extracontractual responsibility, is derived from the fact that at the same time are damaged the contractual obligations and the human rights that are absolute rights. So, the damaged person, has the duty to choose the practice that went to use for his defence, the contractual obligations or the extracontractual obligations, taken in consideration the different practice of each procedure and the juridical proof and the results.

<sup>443</sup> F.D. Busnelli "problemi di inquadramento sistematico del danno alla persona 2 *Revista Diritto Privato*, v. 1987, fq 22

<sup>444</sup> Poaty f2 32

<sup>445</sup> The Cassation court decision. *revista "Lineamenti del diritto civile"* v 1996 f2 125.

<sup>446</sup> Poaty, fq 130 - the case of the patient involved in a car accident, and the physician has not acted based at the medical protocol damaged the patients

<sup>447</sup> In this case, if results damage, there are contractual damage

<sup>448</sup> *Revista Lineamenti del diritto civile*, v 1996, fq175

<sup>449</sup> *Revista "Lineamenti del diritto civile"*, v. 2000, fq301

But at the traditional doctrines and practice, in cases that between parts is signed the contract, the parts has chose to take off the extracontractual obligations and to consign their obligation at one contractual relationship<sup>450</sup>, *lex contractus*. So based at this consideration in the cases that the relation physician patient is considered as one contractual relation, it is not fair to consider this relation as one extracontractual at the same time, if not, we have one double responsibility of physician<sup>451</sup>. The contract is signed between persons that want to make their rules, and in this moment they exclude the other kind of protections or obligations

At the same time, the contractual responsibility is between parts and can't be expanded at the third parts. As is affirmed from article 1372, comma 2 of Italian Civil Code<sup>452</sup>

Under the influences of German civil code, is evaluated the doctrinal theory of "expansion of contractual defence versus the third parts" that make someone responsible versus the third parts, justified this, with the right to differ the absolute right of third persons that are not contractual parts but are involved on this relation.<sup>453</sup> At the conclusion, the parents of the patient, as exp the parents of lady Latollari, can take using the contractual responsibility all the damage reparations, because the physician has broken the obligation physician patient, that have caused to the patient parents the damage of one absolute human right they have lost their daughter, independently from the fact that if we classified the relation patient physician as contract, the patient parents are not part of this contract, but in this case the contract has effects on the third part too.

At Italian cassation Court sentence no 1150312 the court give authorization of mal informed subject for consequences of one non correct action during the intervention to make complaint versus the institution that has not accomplish the contractual obligation to inform the patient for the risks of this intervention<sup>454</sup>

So is easily to see that to day the application of contractual or extracontractual rules, and the subjects that can profit the payment of the caused damage, is difficult to be distinguished clearly, because there is one movement line that distinguish them from each other, that can change during the practice depending from opportunity of subject profits.

Specially the juridical theory is evident at the professional physician, exercising the pressure of double responsibility, not only the contractual responsibility but also of extracontractual responsibility, having not only the professional profile but also the social profile

In cases that we take in analysis the damage caused from Public Notary, we can distinguish that the juridical doctrine is at the same line of the physician responsibility. At the cases *Ciao versus Mevio and Tizio*,<sup>455</sup> the Italian court at the decision no 24733, te 28.11.2007 and no 1335 of January 20.2009, has recognized the public notary as responsible, because he has not perform all the obligated verifications at the cadastral office for the propriety object in the contract. "the public notary, during his work, has the obligation to duty to take care of one median professional and qualified person, qualified this from his technical and professional baggage that he must have"<sup>456</sup>. So, the court decision, take in consideration that the public notary profession is not only the certification of subject volition, but also is to guarantee the subject for the seriosity and legitimacy of notarial act prepared from him, and to offer the clients the maximal protection. Based at this decision, the public notary that has legalised the propriety transaction contract, is

<sup>450</sup> The extracontractual definition is "the extracontractual obligation is to defend all the subject that have not rite the contract"

<sup>451</sup> I Peza Artikull Shkencor Uniel 2009/2 Fq 148

<sup>452</sup> The contract don't has effect at the third persons, excludended the cases when this is write at the low

<sup>453</sup> Jurnal of Comparative low, v 1998, fq 219

<sup>454</sup> In the case that the physician has recommed the patient to perform one cesarian intervention, that results with serious damage for the patient

<sup>455</sup> Tizio and Ciao, have undersigned one sell contract and the public notary Mevio has give the legitimacy without make any confirmation from cadastral office for the validity of documents

<sup>456</sup> Comentario delle decisione del corte di Cassazione, Milano 2010 fq 215.



necessary and obligatory to offer to the clients the maximal protection and correction of the regularity of documents, so he is legally obligated to make all the necessary verifications

In this sentence the notary is obligated to pay for the damage caused of his client for all the kinds of damage caused including the profit damage, and he is also debtor for the contractual damage<sup>457</sup>.

The notary, after this decision, it was directed to Insurance Company, when he and notarial college that he is member have insured the activity, to pay all the obligations. But the insurance company, hasn't accept to pay the financial obligations, pretending that between the Insurance company and notary it was undersigned a contract that recover only the damage caused, in the cases that it was certified that during his work, the notary has made all the legal and necessary verifications, that one medial professional must do. In this case the notary has not verified the propriety, acting with negligence, so the insurance company has not be part of the court decision. It was obligation of insurance company to prove, based as Italian civil code and practice, that the notary has not make all the obligated verifications. The fault at the notary activity, it was the fact that has liberated the insurance company from the obligation to pay the damage. The question isn't if the subject will be payed or not, but who must pay him for the damage caused the public notary of his insurance company.

Taking in consideration this cases the public notary, the physician or all the professional worker, must pay for damage caused during their job as professional, in cases that is proved that the professional have not act based on the principle of duty to take care of. The marginal question is is the insurance company or the professional that pay for the damage, this depended from the cautions and performance of the professional, if he has act with attention or not

### 3- The problems presented by doctrine and practice in this cases in Albania

This questions will be present in Albania. But in our country the big problem is not the professional contractual or extracontractual responsibility, but the deontologic and financial problems.

Taking in consideration that the professional service in our country is young, it is create at year 90, is not clearly defined the deontological and professional obligations and the insurance of this professions is an utopia for us.

Personally I think that is not late to make the necessary change of legislation on this case, taking in consideration the experience offered by EU doctrine and practice

Referring to article 25 of public notary law, year 1994, is obligated that the public notary in Albania to make insurance contract with company.

Referring to lower and advocate law, there is not the insurance obligation and the same is for physicians or other persons that exercise their profession as service

But also if we take informations from insurance company that operate in our country, like SIGMA, ATLANTIK, SIGAL, INTERSIG, it is one utopia to pretend to have the insurance contract of profession. We have take information from INSIG insurance company where the state has a percentage of capital, and the situation is the same, they don't make insurance contract for professions, only for properties and cars, and life

It is so clear that in our country this company are just on office where every year we must insure the car and the life, but not our professions

We can not say that the insurance practice at the other country is in good way. At the time of global crisis, the insurance company, are in crisis depending from the large kind of payed damage and from the quantity of payment, and there are a lot of juridical sentences that take responsible this company for the damage payment. In the same time, in our country is one different picture of all this situation. There are not a lot of sentences for insurance company, and the damage payed are only the damage caused by care incidents and only the basic damage

To make the theory in practice we can take in analysis the case of physician that has made the surgery intervention of the daughter of Latollari, family, that is results with patient death.

<sup>457</sup> Tizio, has involved at the court the seller and the notary to pay together the financial damage

This case it is considered by practice as one penal case, and the doctor is penal and professionally condemned. In this case are totally present all the elements of the Albanian extracontractual responsibility, we have the fault actions of physician, we have the damage, we have the subjects.<sup>458</sup>

#### 4- The European experience of professional insurance contracts

When I think that our doctrine and practice has difficulty is not only the fact that we take or not the damage payment, but also the question is Who must pay for this damage. The physician, the professional. In this case, it is not one double penalty, the penal and professional responsibility and the financial responsibility? In these cases the penalties are not complementary but double or triple penalty.

If this case was to happen in Italy, or in another European country, the physician would be professionally insured, and the question of double or triple penalty it was not taken into consideration. In minimum the physician that works in one private or public institution, has not the right to exercise his profession without the insurance contract. So, if it was in Italy the physician that has damaged the Latollari family, it was insured, and it was the insurance company that is obligated to pay the damage caused. The family can choose to send the question to the court or to be in agreement with the insurance company. In cases that the family pretends to take one big financial payment for derivative damage, the case must be solved in court, at contrary, must be solved in one private agreement between insurance company and family.

This practice, makes the insurance company the target of all the cases for damage payment, and the professional is totally excluded from this responsibility, the principal source of financial payment is the insurance company. But the damaged persons are totally paid for their principal and derivative damage caused.

This makes in difficulty the insurance company, growing up the financial costs and making in the most of times the falliment of the insurance company, that in one capitalist economy is normal.

It is responsibility of insurance company to protect themselves from fallimentation, and to sign the correct insurance contract taking into consideration the personality, the trust, the behaviour and the personal character of each insured person.

There is another way to insure the profession the double insurance. In this case the professional has two insurance contracts, the first is the contract between the insurance company and the institution where the professional works, and the second is the personal insurance contract between the professional and insurance company. So in the cases of damage payment there are involved two insurance contracts, and the insurance company may divide the payment.

The question is, it is more conventional for professional to make one personal or one collective insurance contract for profession?

Referring to European experience, we see that the insurance contract of profession are signed between the insurance company and the professional organisation like the medical order for example. Usually this contract is for one year, and subject that profits by this contract are the physician that are member of the professional order, and that has undersigned the insurance contract. In this case is important for the insurance company to take into consideration the risk and to define the professional obligations during his job.

In general subject of this contract are the physician that exercise their profession at their office, based at their professional capacity, surgery, oncology etc and during their work, have professional and protocol behaviours.

Is important to take into consideration that all the cases that are recovered by insurance company are the cases when the percentage of success is over 80%, based at the medical practice and protocols. This fact has two effects: in one side the insurance company is defended by the over damage payment and by falliment, and the other side is that the physician is not protected in the cases that he does the called "heroic".

<sup>458</sup> Art. 608 and 609 of Albanian CC

interventions “ and in this cases the inovative mdeical treatment is in risk. This treatment are expensive , beacuse there are involvet the hight tecnology and in this cases the results is not shure .

So to make possible this intervetntions the medical insitution signe the contract with the patient for the unaxpective resulst of intervention. I reccomend the in our cauntry is the necessity to make the inssurance contract for profesionists and to pay for the damage caused of subjects .

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**ENFORCEMENT OF HUMAN RIGHTS AS A GUARANTEE OF RULE OF LAW AND EUROPEAN INTEGRATION**

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**Abstract:**

*Albania's membership in the European Union is subject to the fulfilment of the Copenhagen criteria as a precondition for obtaining the candidate status and then the initiation of accession negotiations. The European Commission Opinion identifies with the Recommendation no. 11, the fulfilment of political criteria for EU membership in particular the reinforcement of the protection of human rights not only as a guarantee for the rule of law but also as a condition for European Integration. Strengthening and protecting human rights, special focus on minority rights and effective enforcement of anti-discrimination policy is a key priority of the Albanian state institutions, aiming at the integration of minorities in public policies and procedures, addressing ethno-linguistic discrimination in compliance with the European Convention of Human Rights and other international conventions for minorities. The purpose of this paper is the identification and analysis of democratic standards, rule of law and integration policies since 1992 in Albania, which guarantee the strengthening of legal mechanisms and real achievement for the national minorities living in Albania in their efforts towards the development of further enforcement in the protection of human rights by: adopting and monitoring the National Strategy concerning the protection of minorities for the period 2011-2015, increase of representative ability to enhance the participation in decision making for major economic and social issues in local and central governmental institutions; completion of legal framework for a functional and effective system in the protection of child's rights; amendment of the legal framework by ratifying the Convention on Ethnic and Linguistic Minorities in accordance with EU standards and best practices; protection of Roma community rights in particular provided in the current legislation and international conventions, as well as the effective implementation of anti-discrimination policies.*

**Key words:** Human Rights, Rule of Law, European Integration, Key Priority no. 11, Action Plan, European Convention of Human Rights.

**JEL Classification:** K19.

**1. Rule of Law and the Constitutionality of Minority Rights in Albania****1.1 Constitutional Guarantees on the protection of minorities**

It is not a coincidence that after the Fundamental Principles of the Albanian Constitution, the fundamental human rights and freedoms comes before the parts that deal with the organization of the state

itself. The part that includes the human rights and fundamental freedoms is the essential part of the Albanian Constitution and the state institutions exist primarily to guarantee these rights.<sup>459</sup>

One of the fundamental principles of the rule of law, under the Constitution of Albania, is the respect for minority rights, which not only promotes social cohesion, but helps in the creation of a sustainable, integrated and multi-dimensional society where human rights are guaranteed to everyone.<sup>460</sup>

In the preamble to the Constitution, clearly proclaims the determination "*to build a state of law, democratic and social, to guarantee fundamental human rights and freedoms.*" In the modern and liberal context, the concept of democracy is identified with that of freedom and equality to all individuals and to communities. Based on Albanian State principles, lies the coexistence and understanding between Albanians and minorities, the responsibility of protection<sup>461</sup> and inclusion as citizens of Albania with fully enjoyment of rights.

Article 20 of the Constitution of Albania provides that "*... Persons who belong to national minorities exercise in full equality before the law the human rights and freedoms. They have the right to freely express, without prohibition or compulsion, their ethnic, cultural, religious and linguistic belonging. They have the right to preserve and develop it, to study and to be taught in their mother tongue, as well as unite in organizations and societies for the protection of their interests and identity.*" In this context, the aim of this article is to guarantee the rights of national minorities, so that they enjoy all the rights and freedoms contained in the Constitution, applicable to anyone and at the same time, to preserve and develop their ethnic, cultural, linguistic and religious identity.

The purpose of the Constitution-makers was that the Albanian society composed a true example of coexistence where all live together in harmony, recognizing the value of cultural differences and changes that characterize the minorities. In its first paragraph, Article 20 of the Constitution provides the right of national minorities exercise their rights and freedoms in full equality before the law. The principle of equal treatment of persons belonging to a minority with regards to the rest of the population of a country, which constitutes the majority, is a *constitutional guarantee* and an approach with the general *principle of non-discrimination* provided in Article 18 of the Constitution. The second paragraph of Article 20 states to the freely declaration, without prohibition or compulsion, by persons belonging to national minorities, their ethnicity, cultural, religious and linguistic identity. The language selected in the formulation of this provision, identifies a very important principle, which is the *non-obligation* of persons belonging to national minorities to declare their ethnicity. The *principle of non-obligation is a constitutional guarantee*, as regards to the right to declare whether or not some particular affiliation that characterize national minorities and it is closely linked to the *protection of personal autonomy of the individual*. In a democratic society, the protection of privacy and respect of safeguards in this respect are essential.

For the realization of human rights and fundamental freedoms for minorities are projected some *constitutional guarantees* protection by international agreements ratified by laws (which constitute part of the internal legal system), the jurisdiction of the Strasbourg Court of Human Rights, the Constitutional Court and the Ombudsman.

## 1.2. Legislation on the protection of national minorities

Albanian legislation has been given special importance to the guaranteeing of human rights and fundamental freedoms, as one of the pillars of modern civilized society. The legal framework on minorities includes a number of legal provisions prescribed in the Constitution, the Criminal Code and Criminal Procedure, normative acts of the Council of Ministers and conventions ratified by the Albanian Parliament.

Albania is a member of the UN since 14 December 1955 and ratified almost all the main UN conventions for the protection of human rights, some of which are the Universal Declaration of Human Rights, 1948 (ratified in 1955); the International Convention on the Elimination of All Forms of Racial

<sup>459</sup> Luan Omari, Shteti i së Drejtës, Botim I dyte, Elena Gjika, Tiranë 2004, f. 294.

<sup>460</sup> Vendimi i Gkykates Kushtetuese nr 52. 01. 12.2011

<sup>461</sup> Constitution of Albania, article 3.

Discrimination, 1969 (ratified in 1994); International Covenant on Civil and Political Rights, 1966 (ratified in 1991); International Covenant on Economic, Social and Cultural Rights, 1976, (ratified in 1991); Convention on the Elimination of All Forms of Discrimination against Women, 1980 (ratified in 1996).

Section XII

Albanian Law, European Law, International Law

Albania is also a member of the OSCE and has signed all its documents, the Final Act of the Helsinki Conference, 1975; Statement of Copenhagen, 1990; Charter of Paris for a New Europe, 1990; Moscow Conference Paper, 1991 etc. mostly of which provide provisions on the protection of minorities.

Albania is a member of the Council of Europe since 13 July 1995 and has signed and ratified a number of important documents such as the Convention for the Protection of Human Rights and Fundamental Freedoms, 1951. Albania has signed the Council of Europe Convention for the Protection of National Minorities, which entered into force on 1 January 2001.

In this perspective, the protection of national minorities is guaranteed as by the domestic legislation and the minority regime set out in international instruments.

The *Council of Europe's Framework Convention for the Protection of National Minorities* guarantees equal treatment and generally the minorities have the same standard of living as most of the population. Roma minority faces a more difficult economic and social situation, which is characterized by substandard living standards, not suitable accommodation and an unsuitable environment for the upbringing and education of children. Although the Roma community is not considered a national minority, but a linguistic minority because of the absence of a state of reference, the principles of the Framework Convention for the Protection of National Minorities are also applicable for them.<sup>462</sup>

Under the provisions of the international agreements on minorities and peace agreements or statements, certain rights and privileges are guaranteed to the racial, religious or linguistic minorities as following:

1. Protection of life and freedom for the entire population regardless of ethnicity, language or religion.
2. Utilization of all civil and political civil rights and equal treatment with other citizens
3. The right to education in their mother tongue
4. The right of free exercise, whether public or private, of any faith, religion or opinion, the practice of which would not be incompatible with public order or public morals.
5. The right to establish, lead and control charitable institutions, religious or social, school and other educational institutions, with the right to use their language etc.<sup>463</sup>

### 1.3. The definition of national minorities

The notion "*national minorities*" has no universally accepted definition. The formulation that has the broad consensus in the legal doctrine and that the Constitutional Court decision No. 52 dated 01.12.2011, defines a national minority as a group numerically lower compared to the rest of the population of a country, at a particular disadvantage - dominant position, whose members - being nationals of the country - have ethnic, religious or linguistic features different from those of the rest of the population and show, if implicitly, a sense of solidarity directed towards preserving culture, traditions, religion or language.<sup>464</sup>

Such definition includes both *objective criteria* and *subjective criteria* which are interdependent with each other. According to researchers of legal doctrine, the group must meet the objective

<sup>462</sup> Projekt Strategjia Kombëtare "Për përmirsimin e kushteve të jetesës së minoritetit Rom" f.9-10. Prill 2003, Tirane <http://www.osce.org/albania/21232> (assessed on April 2012)

<sup>463</sup> Zejnullah Gruda, Mbrojtja Nderkombetare e te Drejtave te Njeriut, Botimi I Katert, Universiteti Fama, 2007, f. 115

<sup>464</sup> The English Translation is done by the Author Romina Beqiri. The Albanian Translation is done by the Court. This formulation has been proposed by Francesco Capotorti, Special Rapporteur of the Sub-Commission on Prevention of Discrimination and Protection of Minorities of the UN Study on the Rights of Persons Belonging to Ethnic, Religious and Linguistic.

characteristics that distinguish it from the rest of the population, such as numbers, history, language, religion, and non-domination.

While subjective component has to do with self-perception of the group as distinct from others, and the desire of individual members of the group to identify themselves together as a group.<sup>465</sup>

#### 1.4. The Position of the Minorities in Albania

Albania has *three* recognized national minorities (Greek, Slav-Macedonian and Montenegrin) and two "cultural minorities" (Vlach and Roma). The most important group is the Greek minority, which is represented by a local association called "*Omonia*". Minority rights in Albania is guaranteed by the constitution of. According to the Constitution of Albania 1998, all the minority groups enjoy the same civil, economic, social and political rights as the Albanian majority.

Albanian legislation on elections, political parties, media, education, and criminal and civil codes, express the rights of minorities and contain provisions against discriminatory treatment.

According to National Action Plan 2010-2015 approval, in the framework of the Roma Decade Inclusion, a special role played the Ombudsman opinions and recommendations with the intension to reflect the most important issues related to human rights standards in Albania.

Issues such as protection from discrimination of vulnerable groups, are issues that have been and will continue to exist and citing the words of Ombudsman in the Report on the activity of the year 2011: "*...but when interventions for the same problem are repeated year by year and no solution is found, then it shows that the public administration institutions have failed to solve these issues lacking also the guaranteeing of the respect for the right of individual.*"<sup>466</sup>

Another concern remains the employment of Roma children, who are among the "*favorites*" by private employers, due to the abuse of low pay. They constitute the vulnerable layer with the risk of social exclusion, freedom and enjoyment of childhood. They are abused within the community and outside of it, identified also as an *insecure generation*. The very low level of family culture and education, because of the mentality, poverty, discrimination or exclusion, did not allow the members of the Roma community to throw steps towards civilization and become an integral part of the Albanian society. Lack of understanding of legal processes and lack of knowledge of the law, related to the absence of legal aid, makes it difficult to further towards prosper their lives. Similarly, the lack of training and education had a negative impact on the impossibility of introducing the community in the labor market. The Ombudsman noted "that the problems' solutions to Roma community are neither easy nor quick, *but not impossible*. They are an integral part and linked with the overall development of Albania with the continued strengthening of the economy."<sup>467</sup>

Regarding the issue of minorities referred to the Ombudsman, it is essential<sup>468</sup> the following tasks:

- Improvement of statistical data in the field of education (pre-higher education), in order to analyze the educational status of Roma children. Development of a legislation with liberal character, in the field of education for Roma.

- Elimination of exclusion and contemptuous attitudes towards Roma in the school communities and the transformation of cultural diversity into a source of knowledge and the atmosphere of mutual respect, tolerance and understanding towards them.

<sup>465</sup> Decision of the Constitutional Court Nr. 52 dt 1.12.2011.

<sup>466</sup> Report for the Activity of the Ombudsman 1 January – 31 December 2011, Tiranë, February 2011. [http://www.avokatipopullit.gov.al/Raporte/Raporti\\_2011.pdf](http://www.avokatipopullit.gov.al/Raporte/Raporti_2011.pdf) (assessed May 6, 2012)

<sup>467</sup> Report for the Activity of the Ombudsman 2011, p. 9.

<sup>468</sup> Report for the Activity of the Ombudsman, 1 January – 31 December 2010, Tirane

- Increased benefits for the Roma community, social protection schemes, by taking mitigating measures.
- Provide opportunities for access to housing and infrastructure in accordance with state standards in Roma-populated areas.

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- Conduct regular and periodic, as an ongoing process, the registration of the Roma population in the National Registry of Civil Status.
- Engaging state structures for the registration of abandoned children (submitted by parents relatives own parents, but without legal documentation),
- Identification of cases of child abuse rom, working on the street and reduce them through punitive measures.
- Increase the number of Roma people, forcing social security scheme, in order to benefit from this scheme, through the creation of specific procedural facilities due to low level of education, cultural and economic.
- Increased access of the Roma community in the public health system. Improvement of sanitary conditions in the Roma settlements.
- Creation of conditions for the preservation and cultivation of Roma Cultural Heritage. Creating an inclusive social environment and evaluating to Roma cultural diversity.
- Education of Roma and their employment, not only *as a constitutional obligation*, but as one of the most effective ways for their *full integration in society*.

## **2. Protection of Minorities: Key Priority towards European Integration**

### **2.1 EU Standards for Minority Rights: *In Variete Concordia***

The Motto of European Union "*In Variete Concordia*" which would mean "*Unity in diversity*" was officially proclaimed on May 4, 2000 in the European Parliament. Since that date, the European Constitution proposes the motto "United in diversity". Based on Diversity and European Union Law, since 1993 the respect and protection of minorities is one of the political criteria for membership in the European Union. EU Charter of fundamental rights includes respect for cultural diversity and linguistic. Especially in the last decade, it appeared important issues regarding anti-discrimination, immigration, integration and intercultural understanding in the EU policy arena. Therefore, the issue of "managing diversity" has become a matter of European interest.<sup>469</sup>

Although many questions still remain open for the European Union and Albania in the framework of integration therefore respects the same logical line in respect of minorities *as a key pillar for the implementation of European fundamental rights*.

Article 2 of the Treaty on European Union states that '*the Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities. These are values common to the Member States in a society in which it rules the pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men* '.

Given this legal framework and procedures set forth in Article 49<sup>470</sup>, the Council of the European Union asked the Commission to submit its opinion<sup>471</sup> within the application for membership in the European Union (28 April 2009).

<sup>469</sup> <http://www.euroalter.com/2009/minority-rights-protection-in-the-eu-contradictions-and-problems/> (assessed September 10, 2012)

<sup>470</sup> Article 49 of the Lisbon Treaty states: Any European State which respects the values referred to in Article 2 and is committed to support these values, you can apply to become a member of the Union. European Parliament and national parliaments notified of this application. State applicant submits the application to the Council, which is expressed by unanimity after consulting the Commission and after



European Council in Copenhagen in 1993, established a number of political criteria for accession to be met by the applicant countries. A country must have achieved '*stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities*'. In the case of the Western Balkans, the conditions set by the Stabilisation and Association Process are also a fundamental element of EU policy, which will be evaluated in this report. These include regional cooperation, good neighbourly relations and the implementation of international obligations.

Set out in the Copenhagen, the political criteria derive from the fundamental values on which the European Union is founded, as expressed in Article 2 of the Treaty on European Union. These principles are stated in the Charter of Fundamental Rights of the European Union. Article 6, paragraph 1 of the Treaty states that: '*The Union recognizes the rights, freedoms and principles set out in the Charter of Fundamental Rights of the European Union of 7 December 2000, as adapted at Strasbourg on 12 December 2007, which will have the same legal value as the Treaties*'.

In the 2011 Progress Report for Albania, one of the most important parts is the fulfilment of the Copenhagen political criteria requiring the stability of state institutions guaranteeing democracy, the rule of law, *human rights and respect for and protection of minorities*.

According to the report, progress has been very limited in the area of minority protection, in the absence of progress in strengthening the capacity of the State Committee on Minorities. In January 2011, the Council of Europe Albania handed third national report on the implementation of the Framework Convention for the Protection of National Minorities. In May 2011, changed the format of the certificates of civil status. There is not anymore the concept of nationality or ethnicity of the individual, but only his nationality. This initiative was followed by criticism from some minority representatives.

*No steps have been taken to the reevaluation of the distinction between national and ethnolinguistic minorities.* Albania has not yet adopted the European Charter for Regional or Minority Languages.

Progress Report 2011 also stated about the census stating that: "Although the interethnic relations are generally good, there was some deterioration in the climate of minorities, especially in connection with the preparation of the census of population. After the trial in the first instance decision, the case of the murder of an Albanian citizen who spoke Greek in Himara in 2010, is being reviewed by the appeal. The Census of Population and Housing which was scheduled to take place in April 2011, was postponed for October 2011. Albania decided to include in the census questionnaire optional questions on ethnicity and religion. Collection of these data can be used to formulate appropriate policies for minorities, based on updated statistics. Adhering to international standards, *including the principle of free self-identification*, has a great importance. "

It is important that in order the state institution fulfil the requirement to the European Integration, should take into consideration as following:

- Social solidarity and equality of minorities in Albania
- Partnership in the identification of responsibilities and the measures taken to support and promote an intellectual and economic elite minority, cola facilitates social integration and application modernization policies.
- Preservation and transmission of cultural values of minorities.
- Financial support and division of responsibilities for the improvement of economic situation
- Protection of human rights and the prohibition of discriminatory practices which function should be exercised by all state institutions, in particular for the Elimination of Discrimination Commissioner.

One way of protecting minorities besides the granting specific minority rights is the adoption of anti-discrimination measures to ensure equal opportunities for members of minority groups and to combat

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obtaining the consent of the European Parliament, which is expressed by an absolute majority of the members constituting. Will be considered acceptance conditions for which the European Council agreed '.

<sup>471</sup> COM(2010) 680, date 9.11.2010

discrimination and social exclusion.<sup>472</sup> This adoption of anti-discrimination legislation is closely related to European Union >(EU) rules and conditions

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## **2.2 Action Plan, Recommendation 11, strengthening and protection of human rights**

Recommendation 11 of the Copenhagen expressly stipulates: *To make concrete steps to strengthen the protection of human rights, especially of women, children and Roma, as well as effective implementation of anti-discrimination policies.*<sup>473</sup>

Under the protection of minority rights and taking into account the difficult situation of the Roma community in Albania, a key priority of the 2011 Action Plan is the realization of the objectives of the National Strategy for the Roma. Given that Albania is a member of the Decade of Roma Inclusion 2010-2015, at the end of 2009 the Government approved the National Plan for Roma Inclusion 2010-2015. Under this Action Plan, the identification of the results of implementation is necessary and serves *as a monitoring mechanism*. In this context, The Ministry of Labour and Equal Chances has the responsibility to expand monitoring mechanisms for the implementation of the objectives of the Action Plan at the local level, the establishment of technical working groups under the Regional Social Needs Assessment and Planning at the regional level, which will provide information about the real situation living conditions of the Roma community, the creation of a database and computerization of data collection at the national and local level in the first six months of this year, which will further improve the monitoring of the Strategy and Action Plan with interference necessary on the major problems affecting this community.

## **CONCLUSIONS AND RECOMMENDATIONS**

Given that the European Integration is a challenging responsibility for the Albanian state institutions, a key priority is related to the respect of the basic human rights especially the rights of the minorities because of the international special importance and domestic one.

The current absence of data on minorities should be resolved as soon as possible together with the registration of the population although still have not come out of 2011 results.

Some of the solutions for more effective implementation of the strategies of the government and civil society in the protection of the rights of minorities are:

Ratification of the European Charter for Regional or Minority Languages.

1. Measures to re-evaluate the distinction between national and ethnolinguistic minorities.
2. Increase of the possibility of education in minority languages and that such opportunities be provided to all persons belonging to minorities (national and ethno-linguistic).
3. Restitution of properties belonging to minorities.
4. Strengthening of the role National Minorities Commission in order to ensure the role of representatives and advisors.
5. Quick implementation of the Strategy for the Roma minority and ten-year action plan for Roma in improving the living conditions of the Roma minority and reducing discriminatory attitudes.
6. Improving Roma Registration in the Register of Civil Status.

Without vigorous intervention in these priority areas for Roma exit from the situation where, no one can speak for equal participation in an open society and in accordance with the opinion of the Court of Human Rights, which require the prevention and punishment of any form of discrimination, direct or indirect, that may be made to any individual.

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<sup>472</sup> Bernd Rechel, *Minority Rights in Central and Eastern Europe*, article by Guido Schwellnuts *Anti-discrimination legislation* p.32

<sup>473</sup> <http://www.mpcs.gov.al/legjislacioni/731-plani-i-veprimit-rekomandimi-11-forcimi-dhe-mbrojtja-e-te-drejtave-te-njeriut-> (Assessed May 2012)

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**RESPECTING THE HUMAN RIGHTS AND PROTECTION OF MINORITIES - ONE OF THE CHALLENGES OF THE ALBANIA'S INTEGRATION INTO THE EU<sup>i</sup>**

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**Abstract:**

*In the context of the Albania's integration into the EU, respecting the human rights and the protection of minorities remains a key priority to reach. This paper aims to show how Albania has moved forward in the accomplishment of one of the main criteria of Copenhagen, that political, whose focus is on human rights. The entire paper sheds light on the European Commission reports which reflect the progress made by Albania in front of the door of the European Union. For the aim of the paper we will emphasize that Albania has become part of the universal and regional instruments of human rights protection, by ratifying a large number of conventions such as the European Convention on Human Rights, the Hague Convention for Protection of Children, the Framework Convention for the protection of minorities, etc. Given the fact that respect for human rights is one of the basic elements of coexistence in a European society, the work will show that Albania has moved in a positive direction concerning the respect of the rights of prisoners, women, children, the guaranteeing of freedom of expression, thought, conscience and religion, the implementation of the principle of equal treatment, the guaranteeing of the right of property, and also the protection of the right of minorities. We will analyze the role played by the ombudsman and the commissioner for the protection against discrimination in this field. The last part of the paper will refer to the conclusions and recommendations Albania must take into account in order to successfully face the challenges of European integration.*

**Key words:** *European integration, challenges, human rights, protection of minorities, report, recommendations.*

**JEL Classification:** *K19*

**1.1. Introduction**

European Union, in all the steps of its creation and expansion, has shown a keen interest towards the respect of human rights. Principles of human rights are set out in the Treaty of European Union as well as in the charter of fundamental human rights. All countries aspiring to be part of the Union must recognize, respect and protect human rights. The European Union Treaty itself, in its Article 6 (1) sanctions that the Union is based on the principles of liberty, democracy, respect for human rights and fundamental freedom, as well as on the rule of law. Article 6 (1) is one of the most important articles to be respected by EU aspiring countries, in reference to Article 49 of the EU Treaty, which stipulates that any European State which respects the principles mentioned in Article 6 ( 1), may apply to become a member of the Union. The first obligation to be accomplished by the states is respecting the "Copenhagen Criteria" which were established in the meeting held by the Council of Europe, in Copenhagen, in 1993. The criteria require that a state have the institutions to preserve democratic governance and human rights, a functional market economy and it accept the obligations and scopes of the EU.<sup>ii</sup> The focus of the article will be based on respecting one of the Copenhagen criteria, the political one, in the context of human rights and protection

of minorities. The entire article will focus on the steps and progress made by Albania to meet the obligations imposed by the Copenhagen political criterion.

## 1.2 How are human rights and protection of minorities sanctioned in the Albanian legislation?

At first, it is worth mentioning that human rights are the focus of all current policies of Albania, in the context of accomplishing the obligations imposed on it by the EU, in order to join the European democratic society. They stand on the foundations of the entire Albanian judicial law. The Constitution, as the fundamental and the most significant law in the country contains a broad catalog of civil, political, economic and social rights. In its article 15, they are sanctioned as indivisible, inalienable and inviolable.<sup>iii</sup> The organs of public power, in accomplishing their duties, must respect human rights and fundamental freedoms, and contribute to their realization.<sup>iv</sup> Albania has also signed a number of international and European conventions in the context of protecting and respecting the human rights, such as: the Convention on the prevention and punishment of the crime of genocide, the International Convention on the Elimination of All Forms of Racial Discrimination, the International Convention on the Economic, Social and Cultural Rights, the International Covenant on Civil and Political Rights, the Convention for non-anticipation of war crimes and crimes against humanity, the Convention on the Elimination of All Forms of Discrimination against Women, the Convention against Torture and other treatments, or cruel, inhumane and degrading punishments, the Convention on the Rights of the Children, the European Convention for the Protection of Human Rights and Fundamental Freedoms, the European Convention for the Prevention of Torture, inhuman and degrading punishments and treatment, the European Framework Convention for the Protection of National Minorities, the European Agreement on people's participation in the procedures of the European Court of Human Rights, the European Social Charter, revised, etc.

One of the most recent achievements has been the ratification of the Convention of the Council of Europe on Human Rights and Biomedicine. Making reference to the domestic legislation, Albania has drafted a package of important laws in the context of human rights protection, promotion of equality between citizens, protection against discrimination and domestic violence, for example, Law No. 9970 "On gender equality in the society" - Law No. 9669 "On measures against violence in family relations", Law no. 10.347 "On the protection of children's rights", Law no. 10,221 "On the protection against discrimination", and so on.

The signing of the Stabilization and Association Agreement, in 2006, marked an important step in the approach of Albania towards the EU. The respect for human rights and protection of minorities are one of the key priorities in the alignment and connection between Albania and the EU. The very text of the European Convention on Human Rights provides in its Article 1 that all the High Contracting Parties shall secure to everyone who is under their jurisdiction the rights and freedoms foreseen in its first title.<sup>v</sup> Albania, as a party to the ECHR, should show high interest to the rights foreseen in its text. If we refer to the protection of minorities, the Framework Convention for the Protection of National Minorities foresees that the protection of national minorities and of the rights and freedoms of persons belonging to those minorities form an integral part of the international protection of human rights. Furthermore, persons belonging to national minorities may exert the rights and enjoy the freedoms foreseen by in this Convention. Albania, as a party in this Convention, is committed to provide full equality to the persons belonging to minority groups in all areas of economic, social, political, cultural, and educational life and give them full opportunities to preserve and develop their culture and their identity.

## 1.3 What is the progress Albania has made in respecting the human rights?

The Republic of Albania is a parliamentary democracy. The entire Albanian juridical framework contains an extended catalog of political, civil, economic, and cultural rights, respect for which is the basis of the Copenhagen political criterion. Knowing and undertaking positive measures to guarantee human rights plays a key role in bringing relations between Albania and the EU closer. In this sense, respect for democratic principles and human rights constitute one of the general principles of the Stabilization and Association Agreement and creates appropriate conditions for Albania to become part of the Union. The

obligation of foreseeing human rights by law and harmonizing this law with the EU legislation is in continuous progress and we should emphasize that in this regard Albania is increasingly closer to the European Union.

What remains to be improved is to respect these rights, which are well-regulated by law, in practice. Despite the efforts of the Albanian legislator and the policies that he undertakes, infringement and violations of human rights occur frequently, especially in failing to prevent torture and maltreatment of prisoners, to fight against impunity, access to judiciary organs, freedom of expression, prohibition of discrimination and domestic violence.

### **1.3.1 Respect for the rights against torture and inhuman treatment**

Prohibition of torture and other inhuman and degrading treatments are one of the most important tasks that Albania must meet in order to join the Union. This right is sanctioned in the Article 3 of the ECHR<sup>vi</sup>, and also in Article 25 of the Constitution of the Republic of Albania.<sup>vii</sup> In reference to this right, the European Commission Progress Report of 2011 states that Albania has made progress in the penitentiary system. General Directorate of Prisons has organized training, and multidisciplinary and thematic inspections, and has made efforts to address the reported cases of abuse. In January 2011, the new methodology for treating the prisoners was enacted, and changes on the manual of rules of treatment and security of those arrested and detained was designed.<sup>viii</sup>

Despite the efforts of the judiciary structures and organs the European Commission has found cases of reporting maltreatment and excessive use of force by the police (for example, the case of 21<sup>st</sup> January, 2012). The same attitude with reference to the prohibition of torture and inhuman and degrading treatment is kept by the U.S. State Department in the States' Report on Human Rights 2011. In this report, ADS determines that the Constitution and law in Albania prohibit these actions, but again, the police and the prison guards beat and abuse with the prisoners. The Albanian Committee of Helsinki and the Albanian Human Rights Group report cases of use of force and inhuman treatment by the police. National minorities, Roma, Egyptians, members of the transgender communities, gays and lesbians constitute the most vulnerable and the most affected group by the police violence.<sup>ix</sup>

#### **1.3.1.1 The system of prisons and their infrastructure**

Albania is walking in the right direction to take measures to improve the infrastructure of prisons and other institutions associated with them. The Albanian legislator continues to pay special attention to the rights of prisoners. A positive step that is worth mentioning in this regard is the adoption, in April 2011, of the decision to include convicted and detained in custody, in the category of persons not economically active, allowing them access to free health insurance.<sup>x</sup>

However the reports dedicated to the observance of human rights by the Albanian state, mention the problems and challenges that must be faced by Albania to join the Union. Still today remain major problems, especially with the poor conditions in some older prisons and detention centers. Changes in prison conditions vary according to the period of their construction: those dating from the communist period or those built after 1991. Mainly, the living conditions in the prison system were previously too severe referring to the hygienic-sanitary conditions, lighting, overcrowding, medical service delivery, water supply and ventilation. On the other hand, we cannot say the same thing for prisons built after 1991, the conditions of which refer more and more to the European standards.<sup>xi</sup>

Also, in the context of the right of prevention of torture and inhuman and degrading treatment, every citizen has the right to, if he feels himself the victim of such acts, address the European Court of Human Rights, after having exhausted all the domestic remedies of the Albanian legal system.<sup>xii</sup>

### **1.3.2 Respect for private and family life**

Respect for private and family life is another right which is sanctioned in the constitution and law, and that the government generally respects it in practice as well.<sup>xiii</sup>

### **1.3.3 Respect for freedom of expression**

The Constitution of the Republic of Albania stipulates in its Article 22 that freedom of expression is guaranteed. In the same article the legislator guarantees freedom of the press, radio and television and prohibits prior censorship to television assets.<sup>xiv</sup>

If we refer to the freedom of expression the Commission has concluded that although progress in this area has been limited, it continues to be respected.

It is worth noting the growing role of investigative journalism in the detection and denouncing of corruption. The moratorium which forbids government officials to file a lawsuit for defamation on the media, continues to apply.<sup>xv</sup> The Commission draws the attention of the organs and the Albanian legal system to protect the image of the journalist. In his findings were observed many cases where journalists have been violated because of their profession, and are self-censored to avoid later unfair attacks against them. It remains an obligation of the Albanian government to take measures to increase transparency, ensure the independence and the protection of journalists' rights, who are leading activists in informing the general public.

#### **1.3.4 Guaranteeing freedom of assembly and association**

Freedom of assembly and association is guaranteed by Article 46 and Article 47 of the Albanian Constitution.<sup>xvi</sup> The European Commission concluded in its latest report on Albania that both freedoms are generally respected. The rallies which have been organized in 2011 in Albania have been peaceful. At this point we need to distinguish the demonstration of 21 January 2011, and shed light on the violence during the demonstrations, in which 4 people were killed. Obtaining the candidate status requires that Albania take measures for rallies and the broader civil society organizations to be peaceful and well organized.<sup>xvii</sup>

If we refer to human rights defenders as leading activists promoting human rights, the report notes that their strategy continues to be implemented. Human rights defenders in Albania consist mainly of a limited number of effective NGOs committed to the protection and promotion of human rights and fundamental freedoms. These civil society organizations operate in a non-restrictive environment, even though it has been occasionally observed their exertion of pressure. In essence, the registration of new organizations has not been blocked by the state authorities.<sup>xviii</sup> However, the fiscal regime which regulates the non-profit sector remains unclear and negatively affects their work. Most of them are dependent on donations, which causes excessive competition for funds in this sector.

#### **1.3.5 Respect for freedom of thought, conscience and religion**

Article 24 of the Constitution of the Republic of Albania guarantees freedom of conscience and religion. In it, it is expressly stated that freedom of conscience and religion is guaranteed and that everyone is free to choose or change their religion or beliefs, as well as to express them individually or collectively, in public or in private, through worship, education, practice or performance of rites. Similarly, Article 10 of the Constitution provides that the State recognizes and respects the religious communities and the relationship between the state and religious communities are regulated based on agreements between their representatives and the Council of Ministers. Referring to the European Commission's progress report and that of International Religious Freedom in 2011, we come to the conclusion that these freedoms more and more continue to be respected.<sup>xix</sup> The International religious freedom report, compiled by ADS, sorts out drafted agreements between the Albanian government and the religious communities as well. We may thus mention the agreement between the Albanian government and the Catholic Church in 2002, the Muslim community, the Orthodox, and Bektashi in 2008 and the most recent agreement with the Albanian Evangelical Alliance in November 2011, by which Protestantism became the fifth official religion.<sup>xx</sup> The freedom of conscience and religion is one of the less violated freedoms.

#### **1.3.5 Respect for women's rights and gender equality**

Respect for women's rights and gender equality is one of the most important priorities of the Opinion, if referring to obtaining the candidate status. The Albanian government has shown a particular attention on the protection of these rights by law, by drafting a package of laws that refer to the protection of gender equality in the society, protection from discrimination, taking measures against violence in the family. Article 18 of the Constitution states that everyone is equal before the law. Law "On gender equality in

society<sup>xxi</sup> regulates fundamental issues of gender equality in public life, equal protection and treatment of men and women, equal opportunities and the chance to exercise their rights and for their participation and assistance in the development in all fields of social life.<sup>xxii</sup>

For the purposes of this article it is worth mentioning Article 3 of the above-cited law, according to which this law will be based on the principle of equality and non-discrimination and on other principles sanctioned in the Constitution of the Republic of Albania, in the Convention "On the Elimination of All Forms of Discrimination against Women", and in all the other acts ratified by the Republic of Albania. In this same article it is stipulated that its provisions must respect and be interpreted in accordance with the international acts ratified, the *acquis communautaire* of EU and CEDAW Regulation.<sup>xxiii</sup> The legislator has given special importance to the forecast by law of all special measures, temporary special measures for the protection and observance of gender equality as well as the creation and establishment of special structures in order to achieve these objectives. With the same seriousness is drafted the law "On measures against violence in family relations"<sup>xxiv</sup> as well, whose main goal is to take appropriate legal measures to prevent and reduce domestic violence.<sup>xxv</sup> The main object of the law is defined to be the creation and establishment of special institutions for the protection, support and rehabilitation of victims, as well as the mitigation of consequences of domestic violence.<sup>xxvi</sup> The law will keep the focus of attention especially on children, the elderly and persons with disabilities. The Commission reports conclude that the law promotes equal treatment, prohibits domestic violence, but what remains to be improved is the realization of these objectives in practice. In the CE progress report for 2011 that we obtained in the study, it is determined that domestic violence continues to be extremely popular and the protection of women against all forms of violence needs to be strengthened significantly.<sup>xxvii</sup> The same conclusion has also come from ADS in its states' report, which determines that domestic violence against women, including spousal abuse, remains a serious problem and that the police do not have the training or the capacity to face the cases of domestic family.<sup>xxviii</sup>

Furthermore, in the context of approximating the national legislation with the EU legislation, the Parliament adopted the law "On protection from discrimination."<sup>xxix</sup> This law has brought a number of innovations in the Albanian legislation providing legal guarantees for the protection from discrimination, the most important of which is the creation of the Commissioner for Protection against Discrimination, as an independent and specialized public institution that provides effective protection against discrimination and any other form of behavior that incites discrimination. ADS, referring to discrimination, has reached the conclusion that the law provides equal rights for men and women, and that women are not excluded from employment in reference to the law, but they are not represented in the highest levels of the field in which they work.<sup>xxx</sup> Meanwhile the CE in its progress report concludes that: "In relation to the implementation of anti-discrimination policies limited progress has been made. CPD Office has conducted several awareness campaigns and training. So far, the office received 8 requests and only 2 of them have been finalized with the recommendations of the Commissioner. (...) General awareness on the Law "On Protection from Discrimination" remains low, especially at the local and among public and relevant professional groups. (...).<sup>xxxi</sup> The law "On Protection from Discrimination" in general, is regarded as a complete law and in accordance with the EU legislation. The Albanian Committee of Helsinki in its report on the activities of CPD, has praised the work of CPD, as an important structure for protection from discrimination, but the little practice of its implementation does not leave room for many estimates. Number of case and appeals before CPD is generally low.<sup>xxxii</sup>

### 1.3.6 Respect for the rights of children

Children are defined in the Constitution of the Republic of Albania as special subjects that require special protection by the state. In this regard, the Albanian government has taken some positive steps, especially with the enact in November 2010 of the law "On the protection of the rights of children."<sup>xxxiii</sup> This law defines the rights and protections enjoyed by all children, accountability mechanisms that ensure effective implementation of protection of these rights, as well as special care for children.<sup>xxxiv</sup> The above-mentioned law's main purpose is to protect the special rights of the child through the implementation of a



comprehensive legal and institutional framework for the implementation of the Constitution, international instruments operating in this area, as well as legislation and measures to ensure the child's exercise of rights in accordance with personality development, based on his best interests.<sup>xxxv</sup> In accordance with Article 32 of this law institutional mechanisms for the protection of children's rights have been created. It has been created the State Agency for the Protection of the Rights of the Child as well as local units for the same purpose.

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CE in its progress report concludes that positive measures have been taken by the Albanian government in the context of the protection of the rights of the child, as well as by the State Police in the implementation of operational plans for the prevention of trafficking, abuse, exploitation and sexual abuse of children. However, even in the context of the rights of the child, Albania has some more way to go towards joining the European society.<sup>xxxvi</sup>

### **1.3.7 Respect for the rights of property**

Respect for the right of private property is one of the most important priorities to be given by Albania in its path of approach with the EU. Property restitution and compensation issues seem to remain the most problematic issues still unsolved by the Albanian government. Guaranteeing the right of private property is regulated by Article 41 of our Constitution.<sup>xxxvii</sup> In the same article as well, it is foreseen the possibility and the right to an expropriation of private property, but always by means of a fair compensation based on the law.<sup>xxxviii</sup> Also, the European Convention on Human Rights Protocol sanctions the guarantee of private property and its integrity. The legislator has also foreseen special laws, particularly referring to the property restitution and compensation process and functioning of the Agency for the Restitution and Compensation of Property.<sup>xxxix</sup> So if you see it in the context of being sanctioned by law, the right to private property is a right guaranteed and it is consistent with the Community acts. But what remains to be done by the Albanian government is to respect this right in practice. EC, in its report made in 2011 concluded that the respect of property rights continues to be a very delicate issue and a real concern, as referred to the initial registration process of real property as well as not fulfilling the requirements of ex-landowners' compensation and restitution of property confiscated during the communist regime. A serious problem concerning this issue we seem to be leaving apart the implementation of the decisions of the ECHR in relation to this right.<sup>xl</sup>

## **1.4 Respect and protection of minorities, part of the Copenhagen political criterion**

### **1.4.1 The protection of minorities - condition of the Treaty or its derivative?!**

If we go back to the Copenhagen criteria which are to be met by the EU aspirant countries, it is worth mentioning the respect and protection of minorities as well, as part of the political criterion, along with the respect for human rights. It seems in fact that the "protection of minorities" is only part of the Copenhagen criteria, not defined explicitly as one of the necessary conditions to be observed by countries aiming to join the EU, in the spirit of the EU treaty (EUT). If we go back to Article 49 of the EUT we see that a necessary condition for states that want to become part of the Union is respecting the principles which are foreseen by the Article 6 (1) of EUT. But so far Article 6 (1) EUT does not define explicitly the protection of minorities as a condition to be fulfilled by the states.<sup>xli</sup> However, if we refer to Article 6 (2) of EUT we can see that "The Union shall respect fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR), signed on November 4, 1950 in Rome, as well as the result from the constitutional traditions common to the Member States - those considered as general principles of Community law." And by Article 6 (2) EUT we can of course go to Article 14 of the ECHR, where the prohibition of discrimination because of belonging to a national minority can be referred as part of the prohibition of discrimination.<sup>xlii</sup> So, only if we make such a connection we can conclude that the protection of minorities is one of the obligations to be accomplished by all countries that want to join the Union.

### **1.4.2 The progress made by Albania referring to the protection of minorities**

Fulfilling the criteria of protection of minorities requires agreements between states for the protection of minority rights as well as the improvement and reform of the existing legislative framework that guarantees their rights. In this regard, the country has ratified the Framework Convention for the Protection of

National Minorities, under which it is obliged to provide full and effective equality of all groups of persons belonging to minorities in all spheres of social, economic, political and social life. In fulfilling its obligations, Albania commits itself not only to recognize and respect the rights of minorities, but also to establish structures and mechanisms responsible in this regard.

Creation of the State Committee of Minorities, the Department for the Implementation of the National Strategy for Roma, as well as the reorganization of the Division of Minorities under the Ministry of Foreign Affairs, are some of the arrangements by which the Albanian government believes the problems faced by minorities have found and will find the right solution in all legislative and executive structures.<sup>xliii</sup> The European Commission in its progress report object of our study, does not seem to be too optimistic in its conclusions. Since the beginning it states that progress seems to be very limited in the area of minority protection. One of the initiatives taken by the Albanian government, as highlighted by the EC in this report, is the change in May 2011 of the format of the certificates of civil status, which seem to lack the concept of nationality, or ethnicity of the individual, but have their citizenship only. The Commission assesses the performance of the Albanian government on guaranteeing equal conditions on the benefits of Roma and Egyptian children from compulsory education, university and post-graduate studies, but it draws the attention of the government in failing to take positive measures to improve their living conditions, the registration of the Roma population, as well as benefits from social security, medical treatment and access to employment.<sup>xliiv</sup>

We should not forget to mention the work and initiative taken in this regard by the institution of the Ombudsman, who, through his recommendations, continues to play a key role in improving the status and living conditions of the Roma minority and beyond.

### **1.5 Towards reaching a conclusion**

This article, being intended to shed light on the way how Albania has moved and the steps it has taken in terms of respect for human rights and protection of minorities, shows once again that our country is increasingly trying to become part of the European democratic society. Given that the attention of the entire article was on the reports of the European Commission, the U.S. State Department, the National Committee of Helsinki, the Ombudsman, in conclusion we can say that the progress made by Albania in accomplishing one of criteria of Copenhagen, the political one, with focus on human rights and protection of minorities, has been partial. There are deficiencies in the work done by the government, in the context of respect for property rights and coordination among responsible institutions for this purpose. The area which has known significant development has been that of protection from discrimination and domestic violence, by the adoption and improvement of the legal framework, which on the other hand in this respect is closer to the European legal framework. Final reports indicate important steps taken in improving the treatment of detainees, improving the conditions of detention and the implementation of the recommendations of the Ombudsman. Other freedoms taken into consideration during operation, such as freedom of expression, freedom of conscience and religion in general continue to be respected by the bodies and mechanisms in charge of the government. In making a conclusion we can say that even if progress reports indicate partial developments we cannot be pessimistic, because by applying and taking into account the recommendations given to us in the end of the reports we will shorten the distance between the Common European Union and Albania.

### **1.6 Recommendations of the EU and the tasks to be carried out by Albania**

Throughout the paper we noticed that respect for human rights and protection of minorities is one of the key priorities to be accomplished by Albania. But what are some of the recommendations of the EU to Albania in this regard? I think it is important to focus on this point in the last part of the article, listing some of these recommendations which should be taken into account on the entire journey towards the Union.

EU recommends that Albania should:

- a) Take the best measures on respecting the rights and protecting the LGTB community (lesbian, gay, transgender and bisexual)
- b) Strengthen measures to protect minorities, mainly Roma.

- c) Include in its legislation stronger measures in order to prevent domestic violence. Establish mechanisms responsible for the implementation of the National Strategic Rights of the Child.
- d) Include quality indicators, as they are only part of the quantity. Strengthen the connections with public institutions, NGOs and the institution of the Commissioner.

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- e) Enhance and promote the role of women in all decision-making sectors. In the budget for Children's Rights Strategy 2011-2015 include funding from local government
- f) units, in addition to State funds and ensure a better balance between the state budget funds and those provided by international partners.
- g) Ensure the effective implementation of anti-discrimination policies by increasing the role of the Commissioner for Protection from Discrimination and individual conscience.<sup>xiv</sup>

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[<sup>1</sup>] See Copenhagen European Council, Conclusions of the Presidency, 1993- (Copenhagen Criteria)

[<sup>1</sup>] Article 15/1 of the Constitution of the Republic of Albania

[<sup>1</sup>] Article 15/2 of the Constitution of the Republic of Albania

[<sup>1</sup>] Article 1/ The European Convention of Human Rights

[<sup>1</sup>] Article 3 of ECHR "No one shall be subjected to torture or to inhuman or degrading treatment or punishment."

[<sup>1</sup>] Article 25 of the Constitution of the Republic of Albania "No one shall be subjected to torture or to inhuman or degrading treatment or punishment."

[<sup>1</sup>] See Progress Report 2011 for Albania – Brussels, 12.10.2011 SEC (2011) 1205, p. 18

[<sup>1</sup>] See Country Reports on Human Rights Practices for 2011-United States Department of State, p. 3

[<sup>1</sup>] See Progress Report 2011 for Albania - Brussels, 12.10.2011 SEC (2011) 1205, p. 19

[<sup>1</sup>] See Country Reports on Human Rights Practices for 2011-United States Department of State, p. 3

[<sup>1</sup>] Article 35/1 of the European Convention of Human Rights (Admissibility Criteria)

[<sup>1</sup>] See Country Reports on Human Rights Practices for 2011-United States Department of State, p. 7

[<sup>1</sup>] Article 22 of the Constitution of the Republic of Albania

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[<sup>1</sup>] For further information see Article 46/47 of the Constitution of the Republic of Albania

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[<sup>1</sup>] Local strategy for the implementation of the EU Guidelines on Human Rights Defenders -Adopted by EU Heads of Mission to Albania on 7 April 2010, p. 1

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[<sup>1</sup>] See International Religious Freedom Report for 2011/Albania at <http://www.state.gov/j/drl/rls/irf/religiousfreedom/index.htm?dliid=192777>

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[<sup>1</sup>] Law No. 9970, dated on 24.7.2008 “For gender equality in society”

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[<sup>1</sup>] For further information see Law No.9669, dated on 18.12.2006 “On measurements against violence in family relations”

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[<sup>1</sup>] See Progress Report 2011 for Albania - Brussels, 12.10.2011SEC (2011) 1205, p. 21

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[<sup>1</sup>] Article 2 of Law ”On the protection of the rights of children”

[<sup>1</sup>] For further information see Progress Report 2011 for Albania - Brussels, 12.10.2011SEC (2011) 1205, p. 22.

[<sup>1</sup>] Article 41/1 of the Constitution: “The right of private property is guaranteed by law”

[<sup>1</sup>] For further information see Article 41/3/4 of the Constitution of the Republic of Albania.

[<sup>1</sup>] For further information see the Law nor.9235, dated on 29.07.2004 “On the Restitution and Compensation of Property”

[<sup>1</sup>] Furthermore read Progress Report 2011 for Albania – Brussels, 12.10.2011SEC (2011) 1205, p. 23.

[<sup>1</sup>] Article 6(1) EUT: “The Union relies on the principles of freedom, democracy, respect for the human rights and fundamental freedoms, as well as on the rule of law, common principles for all member states”

[<sup>1</sup>] Article 14 of the ECHR: "The enjoyment of the rights and freedoms determined in this Convention shall be secured, without discrimination on any ground such as sex, race, color, language, religion, political or different opinion, national or social origin, association with a national minority, property, birth or other status. "

[<sup>1</sup>] For further information see "the second opinion" of the Advisory Committee of the Framework Convention for the Protection of National Minorities

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[<sup>1</sup>] For further information Progress Report 2011 for Albania – Brussels, 12.10.2011 SEC (2011) 1205, p. 24.

[<sup>1</sup>] For further information see "Action plan addressing the recommendations of the European Commission for Albania", 21 March 2012, p. 9

<sup>1</sup> Encyclopedia of International Law

<sup>1</sup> Zh. Zaganjori "Jeta Juridike", no.1/2005

<sup>1</sup> Normative acts that are effective in the entire territory of the Republic of Albania are: a) the Constitution; b) international ratified treaties; c) Laws; d) and regulations of the Council of Ministers.

<sup>1</sup> Any ratified international agreement constitutes part of the internal legal system after being published in the Official Journal of the Republic of Albania. It is implemented directly, except when it is not self-executing and its implementation requires the adoption of a law. The amendment and repeal of laws approved by a majority of all the members of the Assembly for the purpose of ratifying international agreements is made by the same majority. 2. An international agreement ratified by law has supremacy over national laws that do not agree with it.

<sup>1</sup> Xh.Zaganjori in : "Juriprudencë dhe praktikë ndërkombëtare" and "Jeta Juridike" no.2/2005

<sup>1</sup> UE Progress Report 2011

**“THE ALBANIAN CRIMINAL LAW AND ENVIRONMENTAL CRIME – ECOMAFIA”**

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*This paper aims to get an overview on the environment crime and its legal definitions. Criminal offences against the environment (air, land, water, flora and fauna) have become a global concern and problem which calls for immediate solution. Criminalisation of criminal offences against the environment is an effort to impose criminal sanctions on these criminal behaviours harming the environment and consequently the public interest. Environmental crime is complex and special due to the fact that the environment itself is a complex area of several dimensions. It has a special nature. Environmental crime is to a certain extent different compared to the traditional classic crimes. In order to protect the environment from criminal actions, legal and institutional initiatives through programmes of several international structures or bodies are being implemented all around the world. The Constitution of the Republic of Albania affirms clearly the principle established in the Aarhus Convention for the public right to obtain information on environmental situation and also the principle of sustainable development which is internationally recognized in important European legal instruments and United National instruments. Such constitutional obligations are elaborated in important legal acts including the Criminal Code of the Republic of Albania. Criminal law provisions ensure protection of the environment from all the acts or omissions which constitute a threat for the society such as illegal actions committed in guilt and followed by the dangerous consequences. Considering the period from the '90 up to now, it results that there is a positive and evident development of criminal law as regards protection of environment through criminal law. Before the '90, criminal offences in the area of environment were not foreseen in any separate chapter of the Criminal Code, as they are now. An important moment to be mentioned regarding the issue on environmental crime is the position of the European Convention on Human Rights (ECHR) signed in Rome on 4 November 1950. The European Convention on Human Rights in the framework of the legal regulations of the rights and freedoms does not contain, specifically defined or explicitly, any provision about the environment. Therefore, European Court on Human Rights has settled the cases by applying the respective articles of the Convention including the general regulations concerning the protection and the entitlement to fundamental rights including the protection of environment and the right to a clean environment which is directly linked to the right to privacy, property, family life considering environment as part of superior interest of the society. Organised environmental crime – “Ecomafia” as it is broadly known in Italy refers to the entirety of well-defined and organised criminal offences against environment. Organised environmental crime is even more serious from the perspective of the social menace because the criminal consequences fall on many states and societies. Consequently, even cooperation at international level has been strengthened. Organised environmental crime is serious, international and well organised as it is characterized by sustainability and continuation with the sole purpose economic and financial profit.*

**Key words:** criminal law, organized environmental crimes.

**JEL Classification:** K14.

**I. Introduction.**

Criminal offences against the environment (air, land, water, flora and fauna) have become a global concern and problem which calls for immediate solution.

Very often, the print and electronic media highlight that the Ozone layer is being destroyed because of unlawful interventions or that illicit trafficking of hazardous wastes or flora and fauna is becoming a constant phenomenon. The governments of many States in the framework of undertaking general national policies have been preparing strategies and plans for the protection of environment and also the fight against environmental crime aiming at the taking and implementation of both institutional and legislative measures so as to prevent and lower the level of such crime. The criminal phenomena that have a detrimental effect on the environment become a considerable concern when committed in an organised way by organised criminal groups and in such case the term “organised environmental crime” comes to play. Other literatures mainly the Italian one refers this crime under the term “Ecomafia”. Nowadays, many international, domestic, regional and global organisations around the world are undertaking initiatives and cooperating for the protection of environment.

A considerable number of bilateral and multilateral international instruments have been signed. Such instruments impose concrete obligations on the contracting parties as regards the protection of environment. The scope of criminal offences against environment is quite expanded and complex because of the specifics of such offences which are different from those traditional criminal offences. Environmental crime is somewhat specific because it affects not only human beings as it happens in the case of traditional crimes. Environmental crime affects the nature and all its components (land, air, water), and also flora and fauna. Moreover, the victims are numerous. Because of these characteristics, environmental crime becomes very often the subject of scientific research and studies by the jurists who consider the issue from the legal perspective and also from the criminal phenomenon perspective.

## II. Understanding criminal offences against the environment

The Declaration of the United Nations Conference on Human Environment held in Stockholm on 5-16 June 1972 in principle 21 reads: “States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction”.<sup>474</sup> Therefore, the protection of environment through legal instruments has become a challenge for many governments in the world. Such challenge is on the focus of their programmes. Between 1980 and 1990, efforts were made to find an exact definition of environmental criminal offences<sup>475</sup>, however the effort to find a definition has been difficult<sup>476</sup> considering that environment is an area which includes many components and also its “philosophical” nature and particularities and complexity. Notwithstanding this, the environmental legal doctrine has been quite useful in the formulation several environmental crime-related definitions.

Environmental crime can be broadly defined as including both crimes that ‘result directly from the destruction and degradation of the earth’s resources’ and those that ‘aris[e] out of the flouting of rules that seek to regulate environmental disasters’<sup>477</sup>. According to the legal procedural perspective “*environmental crime is defined as violation of the criminal law which protects the environment, health and human safety*”<sup>478</sup> On the other hand, there is a socio-legal perspective which elaborates further the meaning of environmental crime.

<sup>474</sup> <http://www.unep.org/Documents.Multilingual/Default.asp?documentid=97&articleid=1503>

<sup>475</sup> See: Eileen Skinnider -*Victims of Environmental Crime-Mapping the issues*. (The International Centre for Criminal Law Reform and Criminal Justice Policy). March 2011. p. 16

<sup>476</sup> See: Mary Clifford and Terry D. Edwards, “*Environmental Crime: Enforcement, Policy and Social Responsibility*” (Aspen Publishers, 1998) p.26

<sup>477</sup> See: White, R., *Crimes Against Nature: Environmental criminology and ecological justice*. Willan Publishing. 2008, p.88.

<sup>478</sup> See: Eileen Skinnider, Op.cit.,p. 16

Based on this perspective the domain of environmental crime includes as well all the regulations provided for the administrative infringements. According to this perspective, “*environmental crime constitutes any form of illegal activity or formal infringement of rules*”<sup>479</sup> According to the ecocentric and biocentric<sup>480</sup> perspectives, the life and health of human beings is detrimentally affected by environmental harm. Usually illegal criminal offences are committed against water, air, land and ecosystems, i.e biodiversity. However, the debate on the definition of environmental crime is extended and it remains open. The Slovenian Law on the protection of environment 1993, in article 5, paragraph 9/2 defines as environmental abuse “*Any intentional or negligent act or omission of a mandatory procedure which results in an ecological accident, environmental damage, or the destruction of a natural treasure*”.<sup>481</sup> Trying to find a definition on environmental crime, Mary Clifford proposed one philosophical and one legal definition.

“*An environmental crime in an act committed with the intent to harm or potential to cause harm to ecological and/or biological systems and for the purpose of securing business or personal advantage.(general philosophical definition). An environmental crime in any act that violates an environmental protection statute.(legal framework definition).*”<sup>482</sup> Therefore it may be said that crimes against the environment shall mean the dangerous actions foreseen explicitly in the legal acts which cause serious harm to the environment and which consequences is a negative impact on the community and society. Criminalisation of criminal offences against the environment is an effort to impose criminal sanctions on these criminal behaviours harming the environment and consequently the public interest. This has been a starting point for elaboration of some main legal concepts of criminal responsibility, extension of criminal responsibility of legal entities, corporate and representatives acting on their behalf. Indeed, legal persons and representatives working on their behalf are increasingly criminally responsible for criminal offences against the environment. This is the reason for the increasing criminal prosecution of representatives of legal persons during the 1980 and presently because the imposition of criminal sanctions against such persons is one of the most effective means, along with the “polluter pays” principle, of preventing violation of environmental law by legal entities and also commission of environmental crimes.

Directive 2004/35/CE<sup>483</sup> of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage lays down and materializes an accurate framework of environmental responsibility based on “polluter pays” principle. The idea behind this is that an operator whose activity has caused the environmental damage or the imminent threat of such damage is to be held financially liable, in order to induce operators to adopt measures and develop practices to minimise the risks of environmental damage so that their exposure to financial liabilities is reduced. For the purpose of this Directive “environmental damage” means: (a) damage to protected species and natural habitats, which is any damage that has significant adverse effects on reaching or maintaining the favourable conservation status of such habitats or species, (b) water damage, which is any damage that significantly adversely affects the ecological, chemical and/or quantitative status and/or ecological potential ; and (c) land damage, which is any land contamination that creates a significant risk of human health being adversely affected as a result of the direct or indirect introduction, in, on or under land, of substances, preparations, organisms or micro-organisms<sup>484</sup>. It is also important to point out that not all forms of environmental damage can be remedied by means of the liability mechanism.

<sup>479</sup> Ibid. p.17

<sup>480</sup> Ibid. p.18

<sup>481</sup> See: “*Environment Protection Act of Republic of Slovenia*” (1993) p.4

<sup>482</sup> See: Mary Clifford and Terry D. Edwards, *Environmental Crime: Enforcement, Policy and Social Responsibility* Aspen Publishers 1998. p. 26

<sup>483</sup> See: Directive 2004/35/CE, available at

[http://eurlex.europa.eu/smartapi/cgi/sga\\_doc?smartapi!celexplus!prod!CELEXnumdoc&numdoc=32004L0035&lg=EN](http://eurlex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&numdoc=32004L0035&lg=EN)

<sup>484</sup> Damage to environment means “a measurable adverse change in a natural resource or measurable impairment of a natural resource service which may occur directly or indirectly”. See : Article 2/1 and 2/2 of the 2004/35/CE Directive.



For the latter to be effective, there need to be one or more identifiable polluters, the damage should be concrete and quantifiable, and a causal link should be established between the damage and the identified polluter(s). Liability is therefore not a suitable instrument for dealing with pollution of a widespread, diffuse character, where it is impossible to link the negative environmental effects with acts or failure to act of certain individual actors. The Directive does not apply to cases of personal injury, to damage to private property or to any economic loss and does not affect any right regarding these types of damages. In 2008, the EU adopted Directive 2008/99/EC on the protection of the environment through the criminal law, to be implemented in Member States by December 2010. The Directive requires Member States to ‘criminalise’ certain defined breaches of EU environmental law. Previously, Member States had the sole responsibility to determine the appropriate sanction. The range of acts which now require the imposition of criminal law include, *inter alia*, (i) instances of pollution, the generation, disposal and other activities related to hazardous waste, nuclear materials and radioactive waste and the operation of a plant in which a dangerous activity is carried out, but in all cases only where they ‘cause[...] or [are] likely to cause death or serious injury to any person or substantial damage to the quality of air, the quality of soil or the quality of water, or to animals or plants’; (ii) the illegal shipment of hazardous waste; (iii) the destruction of wild fauna and flora and habitat; (iv) trading in protected specimens of wild fauna and flora or parts or derivatives thereof; and (v) the various production, transit and marketing stages involving the sale of ozone-depleting substances.<sup>485</sup>

According to the INTERPOL definition provided in the Environmental Crime Programme, Strategic Plan 2011-2013 “*Environmental crime is a breach of a national or international environmental law or treaty that exists to ensure the conservation and sustainability of the world’s environment, biodiversity or natural resources.*”<sup>486</sup>

The above-mentioned definitions point that the main aim is legal protection of environment from various threats through legal norms or relevant rules. Criminal acts against the environment and those which may be referred to as environmental crimes are complex due to the fact that the environment itself is a complex area of several dimensions. Therefore, one can talk of the environmental or “*ecologic*” crime.

### Special nature of environmental crime

Due to the fact that environment is a multi-dimensional area, crimes against it emerge in different forms. Such crimes are somehow complex and particular for the mere fact that it covers an entirety of crimes connected between them. The perpetrators who commit crimes against the environment may act individually, but mostly environmental crimes are committed by different businesses or companies that have legal personality or in collaboration. In most of the cases, criminal responsible falls on the legal entity. The aim for economic and financial profit is at the focus of criminal actions. Environmental crime is interesting and special even as regards the respective criminal consequences and victims. Environmental crime is to a certain extent different compared to the traditional classic crimes. It rarely happens that the victim is an individual person. Considering the more or less abstract nature, identifying victims easily and quickly is difficult compared to the traditional criminal offences.

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<sup>485</sup> See: Article 3of the Directive 2008/99 of the European Council.

<sup>486</sup> See: Cardwell Paul James, French Duncan and, Hall Mathew –“*Tackling Environmental Crime in the European Union-The case of the missing victim?*” Witney UK.2011. p.1 [http://inece.org/conference/9/papers/French%20D\\_Enviro%20Crime\\_FINAL%20v3.pdf](http://inece.org/conference/9/papers/French%20D_Enviro%20Crime_FINAL%20v3.pdf)

*“Victims of environmental harm are not widely recognized as victims of “crime” and thus are excluded from the traditional view of victimology which is largely based on conventional constructions of crime.”<sup>487</sup> Environmental crime victims challenge the traditional victimology approach as they are often victimized collectively and can involve non-conventional victims (non-human species, the environment and future generations).”<sup>488</sup>*

Since criminal offences are committed against the environment which is a multi-dimensional and immeasurable or boundaries-free area, the victims of environmental crimes belong to an extensive circle of persons or to a considerable part of the community. Illegal actions are committed against water, land, air, flora and fauna. Among such illegal actions one can mention contamination of waters of seas, bays, rivers, lakes, air pollution from emission of toxic substances, woodcutting, killing of animals which are protected species, noise pollution, transportation of hazardous toxic waste etc. The criminal consequences of environmental crimes do not emerge immediately as in the case of criminal offences of murder, theft, fraud, trafficking in human beings etc. Criminal consequences are extended in time and space. For instance, because of air pollution, water or soil contamination from hazardous radioactive substances considerable number of persons may be affected but these consequences emerge after they have lived for some time in the area of where the environmental crime has been committed (for instance families living in the areas where hazardous radioactive wastes are discharged suffer different tumour or immunity diseases).

The human beings are not the only ones affected by the criminal offences against the environment. This is another characteristic of environmental crimes. Criminal consequences emerge as well on the flora and fauna. As an example it may be mentioned the killing of animals which are always threatened including tigers or elephants for the industry of leather or ivory jewellery, or illegal deforestation which results in profits for the wood industry. Criminal actions against the environment are not committed only at national level, therefore, this is not only a *national environmental crime*, but it is also *international environmental crime*.

In order to protect the environment from criminal actions, legal and institutional initiatives through programmes of several international structures or bodies are being implemented all around the world. It is worth mentioning: INTERPOL, Environmental Investigation Agency (EIA), United Nations Environmental Programme (UNEP), European Environment Agency (EEA), (European Union Network for the Implementation and Enforcement of Environmental Law-IMPEL), Osservatorio Ambiente e Legalità – Legambiente, Greenpeace and many others. The focus of the mission of these bodies is the taking of measures to detect, denounce and investigate environmental crime and also the building of capacities through exchange of experience and international cooperation in the fight for prevention of environmental crime. The United Nations Conventions, Council of Europe Conventions and European Union *acquis communautaire*<sup>489</sup> occupy an important place and play an essential role because they determine the legal obligations on the contracting parties in the fight against environmental crime.

<sup>487</sup> See: Eileen Skinnider –“*Victims of Environmental Crime-Mapping the issues*”. Director of Human Rights and Research, International Centre for Criminal Law Reform and Criminal Justice Policy. March 2011. p. 2

<sup>488</sup> *Ibid.* p. 2

<sup>489</sup> Article 37 of the European Union Charter of Fundamental Rights provides for a high level protection of environment and improvement of the quality in implementing the principle of sustainable development.<sup>489</sup> The most important legal act for protection of the environment through criminal law is Directive 2008/99 EC of 19 November 2008 “*On the protection of the environment through criminal law*”.

The approval of this Directive, was the result of a consistent work of the institutions of the European Union to find the most adequate legal basis in order to establish unified legal standards (environmental criminal offences and the respective sanctions) for all the European Union member states.

See : case C-176/03” *European Communities Commission vs Council of European Union*”, 13 September 2005 <http://ec.europa.eu/environment/legal/crime/index.htm>  
<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/1246>

#### IV. Development of the Albanian criminal law in the area of environment

The Constitution of the Republic of Albania in article 56 reads: “*Everyone has the right to be informed for the status of the environment and its protection.*” Further, in the chapter of social objectives, article 59, paragraph 1, letter d) and dh) of the Constitution highlights the term “environment” in more detailed and specific provisions under these objectives, providing for:

*“1. The state, within its constitutional powers and the means at its disposal, aims to supplement private initiative and responsibility with...d) a healthy and ecologically adequate environment for the present and future generations ...dh) rational exploitation of forests, waters, pastures and other natural resources on the basis of the principle of sustainable development;”.*

The above-mentioned constitutional provisions guarantee the right of anyone, as a right deriving from a lawful interest, to obtain information on the situation of the environment and also on the measures taken by the state authorities for its protection. In front of this right stands the constitutional obligation of the state to take all the necessary measures in order to guarantee a clean and healthy environment to the benefit of the society. The Constitution of the Republic of Albania affirms clearly the principle established in the Aarhus Convention for the public right to obtain information on environmental situation and also the principle of sustainable development which is internationally recognized in important European legal instruments and United National instruments.

Such constitutional obligations are elaborated in important legal acts including the Criminal Code of the Republic of Albania. The Albanian criminal law guarantees the protection of environment through criminal law while it undertakes the direct protection of legal relations established in the Constitution or other environment-related laws. Criminal law provisions ensure protection of the environment from all the acts or omissions which constitute a threat for the society such as illegal actions committed in guilt and followed by the dangerous consequences. In the framework of pro, there are foreseen concrete criminal sanctions imposed by the courts against the perpetrators of such criminal offences. One argument in favour of public enforcement is that private law remedies will not sufficiently deter. The arguments are well known: environmental pollution often has no individual victim that could file a liability suit; causation may be difficult to prove and the long time lapse may make it impossible to recognize that, for example, health damage has been caused through environmental pollution, let alone that a tort claim could still successfully be brought<sup>490</sup>. Another example, more specifically related to the issue at hand, refers to the argument that civil law will often not be useful as a deterrent against environmental pollution since damage may be widespread, the whole community victimized or the damage caused to collective goods that are not owned by one individual.<sup>491</sup>

One of the other arguments made in favour of the use of criminal law for the purpose of environmental protection is that the severe types of sanction under criminal law are also used to protect classical interests such as health, property and honour. These were the interests that were protected by most of the penal codes that were enacted in the twentieth century. Under environmental legal doctrine, it is argued that given the deteriorating state of the environment in many industrialised countries, a clean environment is nowadays at least as important as the above interests are. Hence, if criminal law is used to protect these traditional individual interests, it should also be used to protect collective interests, such as environmental ones. This, it is argued, is because most of these individual interests (such as health and property) cannot be enjoyed if the basic requirements for a clean environment have not been met.<sup>492</sup>

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<sup>490</sup> See: Michael G. Faure (2009), *Environmental Crimes, Criminal Law and Economics*, Cheltenham, pp. 322.

<sup>491</sup> *Ibid.*, pp.323.

<sup>492</sup> See: Faure, M.G., & Visser., M. ; *Op.cit.*, pp. 4-5.

Considering the period from the '90 up to now, it results that there is a positive and evident development of criminal law as regards protection of environment through criminal law. New criminal offences are foreseen. Before the '90, criminal offences in the area of environment were not foreseen in any separate chapter of the Criminal Code, as they are now. The previous Criminal Code<sup>493</sup> in article 170 provided for the criminal offence "violation of provisions on the plant quarantine" article 173 provided for the criminal offence "illegal cutting or damaging of forests", and also the criminal offence "illegal fishing" in article 174. These were the only three criminal offences against the environment foreseen by this Code. The real protection of environment through criminal law is guaranteed by our criminal law after 1990 which provides in a separate chapter the criminal offences against the environment under article 201-207. The Criminal Code of the Republic of Albania provides for concrete figures of criminal offences against the environment and also the respective sanctions against the perpetrators of these criminal offences.

The criminal offences against the environment are foreseen in Chapter IV of the existing Criminal Code: Article 201-Air pollution, Article 202-Transportation of toxic wastes, Article 203- Water pollution, Article 204- Prohibition of fishing, Article 205- Illegal forest woodcutting, Article 206- Decoration and fruit tree cutting, Article 206/a- Forest destruction by fire, Article 206/b Forest and forest environment fire destruction by negligence, Article 207- Violation of plant and animal quarantine. Two new criminal offences "Forest destruction by fire" and "Forest and forest environment fire destruction by negligence" were added to this chapter of the Criminal Code with the latest amendments of the Code foreseen in article 22 of Law no.10023 of 27 November 2008. The Albanian Criminal Code classifies the criminal offences against the environment into crimes and misdemeanours considering the type of sentence. The sentence is more severe especially in case of grave consequences of the criminal offences for the life and health of human beings. The sentence is more severe for some criminal offences. It may be up to ten years of imprisonment for the criminal offence foreseen in the second paragraph of article 201 "Air pollution"; from one to five years of imprisonment for the criminal offence foreseen in article 202 "Transportation of toxic waste"; from five to fifteen years of imprisonment in case of grave consequences from the commission of the criminal offence foreseen in the second paragraph of this article; from one to five years of imprisonment for the criminal offence foreseen in article 203 "Air pollution", and from five to ten years of imprisonment in case of grave consequences from the commission of the criminal offence foreseen in the second paragraph of this article; from one to five years of imprisonment for the criminal offence foreseen in article 206/b "Forest and forest environment fire destruction by negligence" and from two to five years of the sentence is imposed from one to five years and according to the second paragraph in case of imprisonment in case of grave consequences from the commission of the criminal offence foreseen in the second paragraph of this article.

The criminal offences of "Prohibition of fishing" article 204, "Illegal woodcutting" article 205, "Decoration and fruit tree cutting" article 206, "Forest destruction by fire", article 206/a and Violation of plant and animal quarantine" article 207 and the first paragraph of article 201 "Water contamination" fall under the category of misdemeanours and the sentence foresee ranges from imposition of a fine to two years of imprisonment. The environmental legislation before 1990 was poor. One could not even think of special environmental laws. *"During this period, the private legal entities were unknown and the biggest polluter was the state. The state was paying more attention to production than to pollution which began to emerge later and which was by then forgotten by the state".*<sup>494</sup> Improvement of the environmental legal framework started in 1993 with the adoption of law no. 7664 of 21 January 1993 "On protection of environment" which has nowadays been subject to consistent improvement. It may be said that our country has an appropriate legal framework for the environment and all its components. The problem consists in the shortcomings related to its implementation.

<sup>493</sup> Adopted by Law no. 5591 of 15 June 1977 and amended by Law no 6300 of 27 March 1981.

<sup>494</sup> See : Prof.Asc. Sazan Guri, Msc.Marianthi Guri, Dr. Kristo Koçi "Environmental law – Basis of the Albanian and European comparative environmental law", Tirana 2010.

The Albanian state is party to several Conventions in the environmental area. It has signed and undertaken the commitment to fulfil the obligations deriving from these Conventions. The requirements and obligations deriving from these Conventions are an integral part of the domestic legislation<sup>495</sup> which contains a considerable number of legal and subordinate legal acts. Moreover, considering the position of Albania as a candidate country for the European Union, the requirements of some European Union Directives in the area of environment are reflected in the Albanian environmental legislation. Our country is listed among the other countries of the world that have signed important Conventions in the area of environment. In order to fulfil the requirements of these Conventions, the Albanian environmental legislation is various and it has been very often subject to new amendments in order to be adapted as properly as possible for the protection of environment, issue of environmental permits, strengthening of competences of the environmental law enforcement agencies and inspectorates and also the administrative responsibility. The perpetrators of environmental criminal offences in Albania commit mostly the following: air pollution, water contamination and forest destruction by fire. It is worth mentioning the forest fires and national parks recently in Shkodra, Tropoja, Vlora, Korca etc and also air pollution because of illegal production of lime in Kruja. The judicial district court of Kruja in its decision no 4 of 13 January 2010 ruled “...to declare guilty the defendant X.Y for the criminal offence of air pollution foreseen in article 201/1 of the Criminal Code and impose the fine of 200.000 ALL. From the judicial investigation it resulted that the lime kiln in possession of the defendant X.Y, through primitive technology and lacking filtration equipment during its work was releasing considerable polluted smoke and gas. The combustible substance used is synthetic waste, plastic-leather, wood material mainly poplar and beech. Because of the combustion of these substances for the production of lime without the respective permit for the exercise of this activity, air is polluted by the release of smoke above the allowed limit and it has detrimental consequences on the health of the employees and the inhabitants of the area, thus distorting the natural environmental balance. The environmental expertise confirmed environmental pollution and it identified the release of intoxicating substances such as smoke and soot 20 times higher than the accepted norm, while soot is recognised by the World Health Organisation to be a cancer substance...”

The court confirmed this position even in the decision no 6 of 21 January 2009 which ruled “...to declare guilty the defendant X.Y for the criminal offence of air pollution foreseen in article 201/1 of the Criminal Code and impose the fine of 400.000 ALL. From the judicial investigation it resulted that the lime kiln in possession of the defendant X.Y during its work was releasing considerable amount of smoke and soot. The combustible substance used is wood waste and also car tyres. Because of the combustion of these substances for the production of lime, lacking the respective permit for the exercise of this activity, air is polluted by the release of smoke above the allowed limit and it has detrimental consequences on the health of the employees and the inhabitants of the area, thus distorting the natural environmental balance, flora and fauna. The environmental expertise confirmed environmental pollution and it identified the release of intoxicating substances such as smoke and soot 30 times higher than the accepted norm. During this activity, CO, NO2 and SO2 was released”<sup>496</sup>

#### V. Organised environmental crime – Ecomafia

Organised environmental crime refers to the entirety of well-defined and organised criminal offences. Organised criminal groups profit billion of Euros from this illegal activity. Organised environmental crime “Ecomafia” as it is known in Italy is even more serious from the perspective of the social menace because the criminal consequences fall on many states and societies.

<sup>495</sup> Article 122 of the Constitution of the Republic of Albania

<sup>496</sup> Similar positions of the Judicial District Court of Kruja in the decisions taken for the criminal offence of air pollution during the 2009-2010 period, caused by the illegal production of lime in the area of Kameronas Fushë Krujë, Halil, Borianë, Krastë, Makarësh, Aramerras, Zallë.

Consequently, even cooperation at international level has been strengthened as regards protection of environment, through the provision of concrete sanctions against the perpetrators. International bodies including United Nations Interregional Crime and Justice Research Institute (UNICRI), G8, INTERPOL, European Union and the United Nations Environmental Programme defined the following crimes as crimes falling under the category of international organised environmental crimes<sup>497</sup>:

- 1) *Dumping and illegal transport of various kinds of hazardous waste in contravention to the 1989 Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Other Wastes and their Disposal;*
- 2) *Illegal, unregulated and unreported (IUU) fishing in contravention to controls imposed by various regional fisheries management organizations (RFMOs)*
- 3) *Illegal trade in wildlife in contravention to the 1973 Washington Convention on International Trade in Endangered Species of Fauna and Flora (CITES);*
- 4) *Illegal trade in ozone-depleting substances (ODS) in contravention to the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer;*
- 5) *Illegal logging and trade in timber when timber is harvested, transported, bought or sold in violation of national laws*

Given the above-said, organised environmental crime emerges in illegal actions such as: international illegal transport in wildlife or toxic wastes (pesticides) or hazardous radioactive substances, air pollution, water and soil contamination (because of release in air, discharge in water or transportation to open areas (illegal plants or landfills for their depositing) of hazardous substances which bring negative changes to the environment and which have dangerous consequences on the life and health of the community, illegal exploitation of fish (illegal fishing), theft of natural resources (forest woodcutting, deforestation and illegal transportation of wood materials). Organised environmental crime is extended and affects even the marine areas (environmental crime related to the marine environment). In addition to illegal fishing and coastal pollution, there is a widely known criminal phenomenon of trade in marine species including whales, sharks, corals, etc.

Organised environmental crime is committed for instance in one of the following cases:

- An organised criminal group of country A imports illegally 8097 kg of R-12 or CFC to sell it to companies manufacturing electrical home appliances or sprays. From the country of origin, such substance is transported through sea channels to country B and then to country C. The importers have no import licence and either fail to declare or declare another substance of this quantity to the customs authorities by presenting forged certificates.
- Criminal groups commit the criminal offence of woodcutting in a forest area in country A. The criminal activity of illegal woodcutting and illegal transportation of forest wood is also known as forest mafia. The persons close to criminal groups cut wood illegally and transport it to a certain destination in country B where it is used for furniture manufacturing.
- Criminal groups through a network of collaborators of the country of origin commit the criminal offence of illegal fishing in the seas and lakes, and transport the fish to EU and USA markets.
- Criminal groups import and export illegally the exotic flora and fauna from the exotic countries towards Europe. Snake or crocodile skin from Africa is imported to be used for the manufacturing of bags and shoes. Criminal groups in addition traffic illegally tigers' skin from Asia to China to be used for bags and clothing.

Organised environmental crime is serious, international and well organised.

a) *serious* because it is characterized by sustainability and continuation of a clearly determined role structure and strict hierarchy. Environment becomes constantly "hostage" of organized crime. The sole purpose of such criminal activity is economic and financial profit.

b) *international* because it is committed in many states. For instance, criminal groups of country A in collaboration with other criminal groups of country B employ persons of this country to cut forest wood illegally in order to use it in the wood industry. The wood cut illegally is then transported to country A or traded to other countries D and F.

<sup>497</sup> See: Gavin Gayman and Duncan Brack "*International Environmental Crime-The nature and Control of Environmental Black Markets*". Workshop Report. (Royal Institute of International Affairs), 2002 p.5

c) *well-organised* because the trafficking groups consists of 5-10 persons who have ethnical links with the destination countries. This criminal activity is performed without any licence and contrary to the national or international legal norms.

EUROPOL report “Organised Crime Threat Assessment” (OCTA 2011), underlines that the focus of the activity of organised environmental crime is the illegal depositing of hazardous wastes (which may be pesticides, radioactive substances or e-waste, trading of substances that deplete the Ozone layer (for instance. CFC), illegal damaging of natural resources (illegal forest woodcutting, illegal fishing and protected wildlife).<sup>498</sup> Organised environmental crime, considered as an activity of “low risk and high profit” is “extremely attractive” for the mafia criminal groups in their money laundering, financing of crime and trafficking of narcotic substances in the European Union countries.<sup>499</sup> It means that criminal groups for purposes of financial profit may consider environment to be “an additional source” of profit as they may be involved for instance in trafficking of drugs and also illegal trafficking of hazardous wastes or illegal trafficking or trade in protected wildlife. The organised criminal groups do not act completely alone. In order to perform their criminal activity through their networks they corrupt the officials of the forest police, port officials, customs employees, officials of the Ministry of Environment etc in order to have long-term cooperation that facilitates their criminal actions. In most of the cases, the criminal offences committed against the environment in an organised way are offences linked to other criminal offences including: smuggling, fraud, money laundering, fiscal evasion, forgery of documents, specifically because of cooperation and corruption of state officials. This happens for instance in the issue and signing of forged certificates for the transportation of hazardous wastes (for instance the real name of the product is not declared but the certificate is issued under the name of another non-hazardous product). The officials are corrupted for instance for the issue of the forged licence for transportation of wastes, wood, species, etc. Similarly, the customs officials are corrupted and enable the smuggling of hazardous wastes, protected species or substances that deplete the ozone layer by the organised criminal groups. It is because of this situation that the risk of apprehending criminal groups is low. Roberto Scarpinato a well know Italian magistrate regarding to this issue explains that “*Criminal systems consist of politicians, entrepreneurs, traditional mafia, but the nervous system that establishes communication for this network consists of the white collar officials, without whose help the performance of the criminal activity could not even be imagined*”<sup>500</sup>.”

It is widely known the international trafficking of hazardous wastes from the European developed countries towards the Asian or African countries, including Somalia, Nigeria, Mozambique, Senegal, Tunisia and Pakistan. Criminal organisations take advantage from the economic weakness of these countries and their “incapacity” to protect the environment and human health because of lack of technology of recycling and processing. EUROPOL report of 2011 describes the geographical transportation of hazardous wastes. Toxic wastes are trafficked from the southern part to the countries of South-east Europe and also from the Western Balkan countries (Romania, Hungary and Albania) to the other EUMS. Italy is a transit country for the e-waste towards African and Asian countries. The north-western part of Europe serves as an export zone of wastes to the third countries mainly to the Western Africa and Asia. Toxic wastes (pesticides, radioactive substances) and also e-waste are transported to Western Africa through the ports of north-western Europe.<sup>501</sup> Organised environmental crime is a considerably present phenomenon especially in Italy (it employs for this crime the term *Ecomafia*<sup>502</sup>). The mafia criminal organisation Camorra or Ndragheta are known for the trafficking of drugs, but the illegal trafficking of industrial waste and cement constitute the second main source of their illegal profit.

“*Ecomafia involves those sectors of organised crime that have chosen as an illegal criminal activity the illegal trafficking and depositing of waste, illegal constructions as an increasingly developing business and also the illegal trafficking of stolen works of art and exotic animals*”.<sup>503</sup>

<sup>498</sup> See: EUROPOL Report “EU Organised Crime Threat Assessment” OCTA 2011 p. 40.

<sup>499</sup> Ibid.

<sup>500</sup> See: Roberto Scarpinato, *Ecomafia* 2011 “Le storie e i numeri della criminalità ambientale” p. 23

<sup>501</sup> EUROPOL Report “EU Organised Crime Threat Assessment”, OCTA 2011. p 30-31

<sup>502</sup> <http://www.legambiente.it/contenuti/articoli/ecomafia>

<sup>503</sup> Ibid.

The Ecomafia organised criminal groups perform criminal activity which cause serious harm to the environment and has a great impact on the environment and its components.

In Italy there are around 290 Ecomafia groups<sup>504</sup>. “*Hazardous waste is transported to the Asian and African countries including China, Hong Kong, Malaysia, South Africa from the ports of Gioia Tauros, Tarantos, Catania, Naples and Venice. Such waste mainly consists in polyethylene rubber, plastics which after transport to these countries are then re-transported to Europe in the form of various plastic products that are widely used by consumers including toys, feeding-bottle, vessels etc*”.<sup>505</sup> Income from Ecomafia in 2010 reached the amount of 20 billion Euros.<sup>506</sup>

The region of Campania, Calabria, Sicily, Puglia and Lazio<sup>507</sup>, are on the top position for their Ecomafia criminal activities during 2010. As regard to 2011<sup>508</sup> the situation in these regions remains the same. and 2011, focused mainly on illegal trafficking and depositing of wastes and also trafficking of cement (this is widely known as illegal cement cycle). Concerning the Ecomafia phenomenon in Albania there are no such cases except for any transit case. Organised criminal groups are mostly involved in trafficking in human being, trafficking of drugs, arms, money laundering etc. The perpetrators of criminal offences against the environment usually commit criminal offences foreseen in article 201-207 of the Albanian Criminal Code.

## VI. Jurisprudence of the European Court of Human Rights on environment

An important moment to be analysed is the position of the European Convention on Human Rights (ECHR) signed in Rome on 4 November 1950, about the environmental issues. As the most important corpus of the fundamental human rights and freedoms of man, this important legal document determines the entirety of rights and freedoms of man as a human being. The articles of the Convention and the relevant additional protocols have an important position in the legal systems and in the constitutions of the European countries. The European Convention on Human Rights in the framework of the legal regulations of these rights and freedoms does not contain, specifically defined or explicitly, any provision about the environment.

It is the case of a legal gap for the explicit regulation of environmental issues. It is for this reason that the first applications such as *Dr S. vs Federal Republic of Germany* (application no. 715/60, (decision for non-admissibility of 5 August 1969) and *X and Y vs Federal Republic of Germany* (application no. 7407/76 (non-admissibility decision of 3 May 1976), filed with the Court at the time were refused by the Court *ratione materiae* as it could not try the cases concerning any rights that were not foreseen in the Convention”.<sup>509</sup> Scholars and jurists argue that the Convention, even though not explicitly, it provides for the protection of environment indirectly by considering this protection as a general interest<sup>510</sup> of the society. Therefore, ECHR considering the superior interest of the society, i.e the protection of environment, started to admit such applications.

Arguing that environment falls under the “general interest of the society”, ECHR considers the fair balance between the applications of the general interest of community and applications for the protection of fundamental human rights.<sup>511</sup>

<sup>504</sup> Ecomafia 2011, *Le storie e i numeri della criminalità ambientale*. p.419-426

<sup>505</sup> Pietro Grasso. *Ibid.* p.8-9

<sup>506</sup> *Ibid.* p 45.

<sup>507</sup> *Ibid.* p.38-41

<sup>508</sup> *Ecomafia 2012, Le storie e i numeri della criminalità ambientale*”.p.16

<sup>509</sup> See: Daniel Garcia San José “*Environmental Protection and the European Convention on Human Rights*” Council of Europe Publishing 2005, p 7.

<sup>510</sup> See: Déjeant-Pons, M., “*L’insertion du droit de l’homme à l’environnement dans les systems régionaux de protection des droits de l’homme*”, *Revue universelle des droits de l’homme*, 1991, Vol. 3, No. 1, p. 461.

<sup>511</sup> See: Daniel Garcia San José , *Op.cit.*,p.53.



Therefore, notwithstanding the “lack” of a regulation explicitly foreseen for environment, the ECHR has settled the cases by applying the respective articles of the Convention including the general regulations concerning the protection and the entitlement to fundamental rights including the protection of environment and the right to a clean environment which is directly linked to the right to privacy, property, family life etc.

The applicants in their applications filed with the ECHR have claimed violation of article 1 of Protocol no 1 of the ECHR, article 9, 10, 11, 13 and especially article 8.

In the *Moreno Gomez vs Spain* case (Application no 4143/02 of 16 November 2004), the applicant complained of the noise caused by the night clubs in the vicinity of the residence. She claimed violation of article 8 of ECHR. In such case the Court underlined that the right of the applicant was seriously violated because the state authorities had failed to take the measures for the noise caused by the night clubs. Considering that such noise was beyond the allowed limit, and that it had been consistent for several years, the Court found violation of article 8 of the ECHR.

## VII. Conclusions

Criminal groups or individuals commit criminal offences with an “organisational maturity” acquired from the long criminal experience in the criminal activity against environment. The soft system of criminal sanctions has a considerable impact on such long criminal experience because the perpetrators of such criminal offences after being punished are involved again in this criminal activity. Considering the nature of organised crime in general and environmental crime in particular, it can be said that both investigation and prosecution of such criminal offences is more difficult because of their complexity and that makes their identification difficult. Sophisticated investigation techniques are required. Criminal groups manage to hide the profit deriving from this illegal activity by investing in other areas and objects or depositing such profit with different banking institutions all around the world. The investigation, prosecution and judicial cooperation for identification of environmental organised crime remains on the focus of the European Union Policy so as to ensure a clean environment for the community life.

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**WHAT IS EU CRIMINAL LAW? THE PRESENT AND THE FUTURE**

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**Abstract:**

*The controversial proposal, which as readers will presumably remember, suggested as a solution to the problem of frauds on the Community budget a special code of criminal offences, enforced by a European Public Prosecutor who could operate in all the Member States. At present, EU criminal law is a double mystery, because each of the two groups of people who ought to be interested in it firmly believes that it is exclusively a matter for the other. Criminal lawyers usually refuse to look at EU criminal law because they see it as a topic for the EU lawyers, and mainstream EU lawyers avoid it because they see it as a topic for the criminal lawyers.*

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**EU CRIMINAL LAW: WHY?**

The first question that arises in this context is why there should be such a thing as EU criminal law at all. The purposes of the EEC (as it originally was) were economic: to promote peace, first by linking the economies of the European nation states together in such a way that war between them would in future be unthinkable, and secondly, by diverting the energies of their inhabitants from national rivalry to national and collective economic growth – along the lines of Dr Johnston’s famous comment that “There are few ways in which a man can be more innocently employed than in getting money.” The corner-stone of this operation was the creation of a single economic area in which there would be free movement of workers, services, goods and capital. At first sight, it is not obvious to see where criminal law appears on this agenda – particularly as criminal justice is usually regarded as an area where national differences are particularly marked, national sovereignty is guarded with particular jealousy, and all talk of harmonisation is particularly unrealistic. To quote Harold Gutteridge, a famous comparator and Cambridge professor of an earlier age, studying the criminal law of other countries is interesting, but “... the unification of criminal law is either impossible or, if possible, would be undesirable ...”

However, a reflection quickly shows that EU law must necessarily impinge on the criminal law of the Member States in a negative sense; and experience over recent years shows a growing practical need for it to do so positively as well.

EU law impinges *negatively* on national criminal law because it takes precedence over national law, including national criminal law, and therefore nullifies rules of national criminal law that conflict with it. Thus, for example, EU law provides for free movement of capital, which means that it is not open to national criminal law to penalise the removal of money from one Member State to another.

Less obviously, it also negatively impinges on national criminal justice systems because it prohibits them being used (or selectively not used) in ways that frustrate the purposes and policies of the Union – including, first and foremost, its central policy of “free movement”. It is one of the central Treaty obligations of the Member States that they shall “take any appropriate measures, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union.” Situations sometimes arise in which the only effective “appropriate measure” is the use, by a Member State, of its criminal justice system: and a Member State that fails to bring its criminal justice system to bear in such a case will be in breach of this obligation. And so it was that, some years ago, France was condemned when the French authorities failed to use the criminal law to stop rioting French farmers physically blocking the import of agricultural products from other Member States.

EU law impinges on national criminal law *positively* when the EU consciously creates new rules at European level that force the criminal justice systems of the Member States to change their existing rules and practices and replace them by new ones: for example, by requiring them in future to co-operate with new bodies and organisations set up by “Brussels”, requiring their criminal courts to give automatic recognition to decisions of the criminal courts of other Member States, or requiring them to pass laws creating new criminal offences or to punish already-existing criminal offences more severely. The last fifteen years have seen a rapid growth of EU legislation of this type, the collective product of which is usually called “EU criminal law”. In the following pages, we shall see a number of practical examples of all of these.

The main reason for this rapid growth of EU criminal law is a practical one: the appearance of what might be called the “fifth freedom”. In the wake of the free movement of workers, services, goods and capital has come a form of free movement that was both unintended and undesirable, namely that of criminals and crime. At the simplest and most obvious level, open borders and cheap transport between Member States combine to make it far easier than it used to be for a crime to be committed in State A and the criminal to remove himself to State B, where the police and prosecutors of State A cannot catch him or her. In the face of this, the traditional process of extradition – by which the transfer of a wanted person across the Channel could be achieved, but it might take six years and cost the taxpayer £120,000 – obviously had to be replaced by a process that was quicker and cheaper; as it was, with effect from 31 December 2003, by the European Arrest Warrant, of which more later. The “fifth freedom” also means an increase in “trans-border” crimes – for example, smuggling, or carousel fraud – where part of the offence takes place in one Member State and part of it in another, and these also create a need for various forms of EU criminal law. The effective prosecution of a “trans-border” offence is likely to be dependent on the ability of one Member State to obtain evidence from another: whence pressure to replace the traditional process of “mutual legal assistance”, which is cumbersome and slow, with a new and swifter process, modelled on the European Arrest Warrant.

Criminal offences committed across borders also give rise to practical issues of co-ordination. Suppose a people-smuggling operation is planned in London, using a route that brings the illegal immigrants into Europe via Belgium, whence they are distributed to France, Germany and Italy with the help of associates operating there. In this situation, which Member State or States should be responsible for the investigation and resulting prosecution? It was to deal with issues of this sort that Eurojust was created in 2002. The fact that several different States have jurisdiction also raises the oppressive possibility of successive prosecutions, in different Member States, of the same people for the same offence. To deal with this concern an article on “double jeopardy”, alias *ne bis in idem* was included in Schengen Agreement, the interpretation of which has given rise to a series of cases before the ECJ; and with the same aim in mind, a Framework Decision was adopted in 2009.

Trans-border criminality also raises broader and more theoretical issues of co-ordination. To deal with certain types of it effectively it is necessary, first and foremost, that all the Member States should treat the behaviour in question as a criminal offence, and secondly, that they all should visit it with penalties that are broadly similar.

As Jean Pradel puts it, “It is necessary to discourage ‘criminal tourism’ which might encourage potential criminals to choose the country which is the least repressive.” It is this concern that lays behind a number of Framework Decision and other instruments which require Member States to criminalise certain forms of undesirable activity and to make them punishable with certain types of penalty – for example, the Framework Decision of 2002 on terrorism. Terrorism, obviously, is behaviour that directly threatens the interests of each Member State. In some cases, however, behaviour must be punished because it poses a threat, not to the Member States themselves, but to the interests of the European Union as an institution. An obvious example, since the arrival of the “single currency”, is counterfeiting the euro. Another example is fraud on the Community budget.

As well as practical reasons for the growth of EU criminal law there are ideological ones. In 1999, the Treaty of Amsterdam amended the Maastricht Treaty by proclaiming the objective of the European Union to be the creation of “an area of freedom, security and justice” – a commitment now reiterated in 67(1) of the TFEU. Though capable of being used by authoritarians as a pretext for the creation of “an area in which the authorities have *freedom* to bring those who threaten the *security* of the state to *justice*”, the “AFSJ” potentially conveys a message that is more positive: the idea of area in all parts of which citizens can be sure that the criminal justice system will treat those who come into contact with it with a certain minimal level of humanity, consideration and efficiency. It was in that spirit that, in 2001, a Framework Decision was adopted which guarantees certain minimum rights for victims in criminal proceedings. It is also in reality the spirit that animates the current move towards a series of instruments designed to guarantee various minimum rights for suspects and defendants; though as will be explained later in this chapter, these are officially justified on instrumental grounds, as being necessary to build “mutual trust” between the criminal justice systems of the Member States, in the absence of which “mutual recognition” measures, like the European Arrest Warrant, are unlikely to work smoothly.

#### EU CRIMINAL LAW – WHAT IS IT?

The phrase “EU criminal law” suggests a European criminal code and a European criminal procedure code, with a European public prosecutor to enforce them. Such were indeed the elements of the system that was proposed 13 years ago in the *Corpus Juris* project. Of this, no part has so far been implemented – although the TFEU does now provide a treaty basis for a European Public Prosecutor, should the Member States at some future point decide they want to have one.

At present, EU criminal law exists only in a looser sense, and in concrete terms comprises the following four elements. (a) A group of European organisations created to secure the better functioning of criminal justice; (b) a group of European instruments enacted with the aim of enabling the criminal justice systems of the Member States to tackle trans-border cases more effectively; (c) a group of European instruments prescribing uniform rules of substantive criminal law which the Member States are required to adopt; and (d) a smaller group of European instruments which, in a similar way, prescribe rules of criminal procedure. In the next section of this chapter each of these four elements will be examined in turn.

#### A. Organisations

##### (i) OLAF

The oldest of these specialist organisations is the European Anti-Fraud Office, usually known as OLAF, the acronym for its French name, *l'Office européen de lutte anti-fraude*. This started life in 1988 as UCLAF (*Unité de lutte anti-fraude*), and was relaunched in 1999 as OLAF, with greater independence, a bigger staff, more extensive powers and a supervisory body. Its powers and duties are set out in the Regulation adopted when it was reconstituted. Its office, like that of the Commission to which it is formally attached, is situated in Brussels.

As prescribed in the OLAF Regulation, the task of OLAF is to:

conduct administrative investigations for the purpose of fighting fraud, corruption and any other illegal activity affecting the financial interests of the European Community [and] investigating to that end serious matters relating to the discharge of professional duties such as to constitute a dereliction of the obligations of officials and other servants of the Communities...

To this end, it was given wide inquisitorial powers. It is thus an example of the 'vertical' approach to the problems of crime within the European Union – as against the 'horizontal' approach, in which the role of the Union is limited to coordinating the efforts of national authorities. The investigations that OLAF carries out are of two types: 'external' ones, where suspected fraud is investigated in Member States, and 'internal' ones, which target suspected frauds within the central organs of the Union. Having carried out an investigation, and found what it believes to be criminal offences, OLAF has no power to prosecute. It forwards its reports to the competent authorities of the Member State whose courts have jurisdiction, who are then free to act on them. The tendency of national prosecutors to ignore reports which OLAF believes to be well founded is, of course, a source of deep frustration within OLAF – a matter which explains why OLAF and its officials are staunch supporters of the proposal to create a European Public Prosecutor.

If OLAF's internal critics are mainly concerned about its inability to ensure that action is taken against the frauds that its investigations bring to light, its external critics have highlighted other and different matters. One of these is its awkward constitutional position, because OLAF is at once a part of the Commission, and the organ responsible for investigating frauds and improper practices within it. Another is the occasional heavy-handedness with which it has exercised its powers – which has led to several well-publicised pieces of litigation.

(ii) *Europol*

The origin of Europol, the European Police Office, was a 'Third Pillar' Convention concluded in 1995, which – after the usual delays for ratification which bedevil legislation by Convention – eventually came into force in 1998. After the Convention had been repeatedly modified, in April 2009 Europol acquired a new constitutional document: the Europol Decision, a Council decision, with effect from 1 January 2010. Under this document, as before, Europol comprises a Management Board with a representative from every Member State, a Director (with three Deputy Directors), and a Supervising Body. It has legal personality, and its seat is in The Hague.

By Article 3 of the Europol Decision, the objective of Europol is 'to support and strengthen action by the competent authorities of the Member States and their mutual cooperation in preventing and combating organised crime, terrorism and other forms of serious crime affecting two or more Member States.'

Though the idea of a 'European FBI' has had its vocal supporters, Europol bears little resemblance to the Federal Bureau of Investigation in the United States. It is a 'horizontal' body, which has no operational powers, the basic task of which is the collection, storing, analysis and exchange of information about criminals and crimes. To this end, it runs the Europol Information System. Much of the Europol Decision is concerned with the management of this Information System, and the issues of data protection that arise from its existence.

However, Europol can become involved in operational policing to some limited extent. First, by Article 6 of the Decision, Europol staff may participate in 'joint investigation teams' set up groups of national police forces. And secondly, by Article 7 Europol has the power to make a formal request to a Member State to take action in respect of a particular case. A Member State that receives such a request is obliged to consider it, but is not required to act on it. If it decides not to act on it, however, it must give Europol its reasons, unless to do so would 'harm essential national security interests', or 'jeopardise the success of investigations under way or the safety of individuals'.

*(iii) Eurojust*

Eurojust is another manifestation of the 'horizontal' concept: an organisation designed to co-ordinate the activities of public prosecutors in the different Member States. As such, it actually represents the last in a line of three attempts to do so. The first, which began in 1996, was a scheme under which Member States lent one another '*magistrats de liaison*' – prosecutors from one Member State who are seconded to another, in order to provide help and advice. The second, which was launched two years later, was a more ambitious scheme for a 'European Judicial Network' – a network of public prosecutors who, as 'national contact points,' are available to advise one another, and who meet all together at least once a year, usually in the Member State which currently holds the Presidency of the Council. Perhaps surprisingly, both of these earlier schemes have continued after the creation of Eurojust, the EJM even acquiring a new constitutional document by a Council Decision in 2008.

Eurojust came into being by a Council Decision in 2002, its constitution being amended by a second Council Decision seven years later, and its legal position then being further regulated by Articles 85 and 86 of the TFEU. The body that results from this jig-saw of legislation is bigger, heavier and much more formal than the two schemes for ensuring cooperation between prosecutors that preceded it, and in broad terms it does for public prosecutors what Europol has done for the police.

The structure of Eurojust is rather similar to that of Europol. Eurojust, like Europol, is a legal entity and, like Europol, it has its official seat in The Hague. Again, like Europol, it consists of representatives sent by Member States. At a formal level, it is composed of 'one national member seconded by each Member State in accordance with its legal system, being a prosecutor, judge or police officer of equivalent competence.' The resulting 'college' elects a President and Vice-Presidents. Eurojust has a permanent staff, headed by an Administrative Director. Like Europol, it also has an external Supervisory Body.

According to Article 85(1) of the TFEU,

Eurojust's mission shall be to support and strengthen coordination and cooperation between national investigating and prosecuting authorities in relation to serious crime affecting two or more Member States or requiring a prosecution on common bases, on the basis of operations conducted and information supplied by the Member States' authorities and by Europol.

- A set of objectives which are elaborated in greater detail by the 2002 Council Decision. In the pursuit of its objectives Eurojust, like Europol, has no power, as such, to require a Member State to investigate a case or institute a prosecution; much less does it have the power to do either of these things itself. By Article 6 of the Decision it has the power 'ask' a Member State to do either of these things, and indeed a range of other things as well. Among these other things, Eurojust may ask a Member State to set up a joint investigation team together with another Member State, and, in cases where two Member States are both engaged in investigating or prosecuting the same person, it may also invite one of them to 'keep off the grass' and leave it to the other. As when Europol issues an invitation of this sort, where Eurojust asks a Member State to take a course of action the Member State is at liberty to refuse. Though as when a Member State refuses to accede to a request from Europol, it must give its reasons, unless to do so would 'harm essential national security interests or would jeopardize the safety of individuals'.

If Eurojust's powers are limited, its practical significance is considerable. As one commentator puts it:

The improvement which the establishment of Eurojust has brought to international co-operation is twofold. First, it provides practical assistance at prosecutorial level for the transmission and execution of requests for international assistance. Second, it creates a forum in which decisions on the best place for the prosecution can be made. Eurojust does not have a formal competence to decide upon matters of plural jurisdiction.

However, the very fact that prosecutors with expertise in the international co-operation of the relevant member States can take up consultations on a specific case is *de facto* of enormous importance. The permanent structure should be conducive to the prevention of jurisdictional conflicts, and to multiple prosecutions and to *ne bis in idem* problems.

The politics that lay behind the creation of Eurojust are closely connected with public reaction to the *Corpus Juris* project, and in particular, to its central proposal for the creation of a European Public Prosecutor. Though this idea was strongly supported by the Commission, and by UCLAF (later OLAF), this ‘vertical solution’ to the problems of trans-border crime, and to trans-border frauds on the Community budget in particular, was strongly opposed by many Member States – in the forefront of the opponents being the United Kingdom. To solve the current problems, whose existence the opposing Member States did not deny, they came up with an alternative solution: a ‘horizontal’ solution the twin elements of which were ‘mutual recognition’ – of which more is said below – and improved co-ordination between the prosecution services of the different Member States, to which end Eurojust was rapidly created. But this solution was to some extent a compromise, and like many compromises, meant different things to different people. Whereas for some, Eurojust was the end of the process, for others it was a beginning. Among those who supported the creation of Eurojust there were some who hoped that, in time, it would grow from being a body that merely co-ordinates the efforts of the prosecutors of the different Member States to become a body that actually does the job itself: an independent European Public Prosecutor.

When the Lisbon Treaty was drawn up this point of view prevailed, to the extent of the inclusion in the Treaty of what is now Article 86 of the TFEU. This provides that, by a decision that is unanimous, the Council ‘may establish a European Public Prosecutor’s Office from Eurojust’; and it further provides that, where the Council is not unanimous, it is open to a group of at least nine Member States to ‘go it alone’.

### **B. European instruments on ‘mutual recognition’**

‘Mutual recognition’ is when the courts of two different legal systems recognise and enforce each other’s rulings and decisions automatically, and without any examination of the factual basis upon which they were made. It is the arrangement that has long existed between the criminal courts of the different parts of the United Kingdom. But until recently it was not at all the system that operated between the criminal courts of the EU Member States. In the European context the basic principle was that the judges in criminal courts did not normally recognise each other’s orders and decisions, although they might sometimes do so exceptionally, and as a special favour. In those exceptional cases where the criminal courts of one Member State might be able to invoke the help of those of another to enforce its order, the procedure would typically involve the making of a formal request, transmitted from court to court indirectly, via the two countries’ governments. The executive of the requested State would usually screen incoming requests and, in some cases, might not allow them to proceed. Where the request did eventually reach the court system of the requested State, the court would usually grant it only where a number of conditions were met. Typically, these were two: first a ‘double criminality’ requirement, i.e., a requirement that the behaviour should be criminally punishable in the requested State as well as in the requesting State, and secondly a requirement that the requesting State produce enough evidence to show a ‘prima facie case’ justifying the measure asked for. And in some situations, the executive of the requested State would then exercise a further control at what might be called the ‘output stage’. This was so, in particular, with extradition in its traditional form, where the final removal of the requested person required the consent of the executive of the requested State – in the UK, the Home Secretary. All this tended to make the prosecution of trans-border crimes where the wanted person, or the evidence, or some of it, was in another Member State slow, costly and uncertain. It was in reaction to this problem that the team that drafted *Corpus Juris* project proposed, for offences of budgetary fraud, the ‘vertical’ solution of a European Public Prosecutor, armed with powers that could be exercised in any part of the territory of the European Union.

Not wishing to go down this route, the Member States, led by the UK, proposed ‘mutual recognition’ as part of an alternative solution.



First publicly floated, in outline only, at the Cardiff Council in June 1998, it was then proclaimed with greater force at the Tampere Council in October 1999. In section IV of the Presidency Conclusions it was stated that:

[35] ... The European Council therefore endorses the principle of mutual recognition which, in its view, should become the cornerstone of judicial co-operation in both civil and criminal matters within the Union. The principle should apply to both judgments and to other decisions of judicial authorities...

The first concrete step in this direction was, of course, the European Arrest Warrant (EAW), created by a Framework Decision adopted in the summer of 2002. This replaced traditional extradition within the EU by a system under which, if certain basic conditions are met, the transfer of the wanted person takes place automatically, without the intervention of the executive, and within a stated set of time-limits. If the offence for which the person is wanted is one of the 32 listed in Article 2(2) of the Framework Decision, the traditional 'dual criminality' requirement is suppressed: the requested State must hand the wanted person over, provided the offence carries at least three years' imprisonment in the requesting State. If the offence is not on this 'Framework Decision list' the EAW is still available if the offence carries a maximum penalty of at least 12 months, or (in the case of a convicted person) a sentence of at least four months has been imposed; though here, the requested State may insist upon 'dual criminality'. The implementation date fixed by the Framework Decision was 31 December 2003: a date which many Member States complied with, though for various reasons some were late. The new measure eventually survived constitutional challenges in several Member States, and a further challenge before the ECJ.

Though widely criticised in the popular press (at least in the UK) as forcing our courts to send Britons to face unfair trials for offences of which they are innocent, the governments of the Member States (including ours) view the European Arrest Warrant as a big success. And this has led to moves to create further 'mutual recognition' measures to replace the existing leisurely and uncertain 'mutual legal assistance' regime that currently applies when the courts of one Member State wish to obtain evidence from another, or make other dispositions in the case ahead of trial. But once the political pressure resulting from the attack on the World Trade Centre on 9 September 2001 had died down, progress was much slower. In 2003 a Framework Decision was adopted that sought to impose a 'mutual recognition' regime in respect of 'freezing orders'. Eventually, after lengthy negotiations, in December 2008 a further Framework Decision was adopted providing for a so-called 'European Evidence Warrant', which Member States are required to implement by January 2011; but as the scope of this is limited, its new 'mutual recognition' regime being applicable to some types of evidence but not others, it is widely seen as half-measure of questionable utility. The restricted scope of this instrument, and the generally slow progress in producing others, arose from an underlying political difficulty: Framework Decisions required unanimity, which with 27 Member States had become hard to achieve. Once the Lisbon Treaty was in force, under which the EU can now legislate in the area of criminal law by means of Directives, adopted by a qualified majority vote, there were moves to replace this Framework Decision with a new Directive creating a 'European Investigation Order', the scope of which would be much wider. At the time of writing, a Draft Directive emanating from a group of Member States, led by Belgium, is under discussion; and the UK government – despite the protests of the eurosceptic press, which reported the proposal in usual alarmist terms – has decided to opt in.

Meanwhile there have been parallel moves to extend 'mutual recognition' to sentences – so that the sentence imposed by a criminal court in one Member State will be automatically recognised by the others, and in some cases may even be enforced in another Member State. These began over ten years ago with a Convention on the mutual recognition of driving disqualifications. After a substantial gap, this was followed by a rapid series of Framework Decisions dealing with other types of sentence. In 2005 a Framework Decision extended the principle of mutual recognition to 'financial penalties' – i.e. fines, so enabling a fine imposed by a court in one Member State to be enforced in another. The following year a further Framework Decision did the same for confiscation orders.

In 2008 two further Framework Decisions were adopted, one to enable prison sentences to be enforced in other Member States and another to enable the same to be done with probation orders and other 'alternative sanctions'. And to round it off, the same year produced a further Framework Decision requiring all Member States to give, within their own systems, the same official status to previous convictions imposed by the courts of other Member States as they give to previous criminal convictions imposed by their own courts.

This 'mutual recognition' policy raises important issues which it is not possible to discuss fully here, but which nevertheless should be mentioned. One is whether mutual recognition, in its present form, is really workable. It was introduced, as everybody knows, as an expedient to avoid 'vertical solutions', but the view has been expressed that mutual recognition can only work when the laws of the countries concerned are broadly similar; and thus to make it work properly some radical and centrally-directed harmonisation will be required – which is one of the things that mutual recognition was intended to avoid. Another big issue is whether the mutual recognition programme, taken as a whole, is excessively authoritarian. Defence lawyers often say that it is unfairly favourable to prosecutors. If by this they really mean that prosecutors can now secure the conviction of guilty clients who would otherwise go free, and then this is a matter for rejoicing, not dismay. But if the criticism is that mutual recognition means that innocent people are more likely to be convicted wrongly, then – if this is really so – it is obviously worrying. A third big issue is whether the mutual recognition programme is actually effective. Apart from the Framework Decision on the European Arrest Warrant, the implementation of these instruments has been distinctly patchy and we are moving in the area of 'virtual law'. A fourth and final comment is how complicated this area of EU law has now become. In the previous paragraphs no less than nine different EU legal instruments have been examined. There is a strong case, surely, for pruning and simplification.

### **C. European instruments relating to substantive criminal law**

The last 15 years have seen an explosive growth of European instruments requiring Member States, if they have not already done so, to make various uniform adjustments to their substantive criminal law. In every case, the obligation so imposed is to make a given type of anti-social behaviour punishable; and typically but not invariably, further duties are also imposed about the severity of punishment, the categories of person to whom the law applies, and extra-territorial jurisdiction.

The range of matters covered by these instruments is wide and broadly speaking covers all the matters which, in the last few years, have agitated public opinion in the Member States to the point where the media are demanding action and the politicians are promising to provide it. They include commercial fraud, corruption and money-laundering; terrorism; organised crime; drug-trafficking; illegal immigration; people-trafficking; environmental pollution; computer hacking; child pornography and paedophilia; and racism and xenophobia. In all those cases, the interests affected by the behaviour in question are primarily those of the Member States; but instruments have also been adopted in order to strike at behaviour which primarily threatens the interests of Union itself – fraud against the Community budget, and counterfeiting the Euro. The type of instrument used has varied according to the date and to the subject-matter. In the pre-Lisbon era, 'Third Pillar' instruments were mainly used – Conventions, and then after Amsterdam, Framework Decisions. But in some cases 'First Pillar' instruments were used, and occasionally both types were used simultaneously, as a sort of legislative 'belt and braces'. Post-Lisbon, the instrument of choice is likely to be the Directive.

In every case, these instruments begin by defining a type of behaviour and requiring Member States to make it criminally punishable. Very commonly, they continue by requiring a 'minimum maximum penalty'; the Framework Decision on organised crime, for example, requires Member States to take the necessary measures to ensure that involvement in a criminal organisation 'is punishable by a maximum term of imprisonment of between two and five years'. These instruments usually require Member States to ensure that incitement and complicity are also punishable, and invariably require Member States to ensure that criminal liability extends to 'legal persons'.

(Corporate criminal liability, though ‘old hat’ to common lawyers, to Continental lawyers is an exciting new development; and those responsible for drafting EU instruments clearly see it as a panacea.) Finally, they usually also require Member States to legislate so that the behaviour is punishable when committed on its national territory, or by one of its nationals, or ‘or for the benefit of a legal person that has its head office in the territory of that Member State’. (If corporate criminal liability shows of the influence of the common law on Europe, these provisions about jurisdiction demonstrate the opposite trend. The common law has traditionally assumed that criminal jurisdiction should be based on territoriality alone, rejecting extensions such as ‘active personality’.)

The most obvious point to make about this department of EU criminal law is that it is uniformly repressive. The tendency of every one of these instruments is to extend the scope of criminal liability, or increase the severity of punishment; we have yet to see a European instrument that requires Member States to decriminalise behaviour, or to limit the penalties applicable. But this has posed few problems at the political level for the UK, where ‘criminal policy’ in recent years has been to extend the number of criminal offences, and where already maximum penalties for offences are invariably far higher than those these EU instruments require.

#### **D. European instruments relating to criminal procedure**

At present there is just one EU instrument that potentially requires Member States to modify their criminal procedure, and this is the Framework Decision of 2001 on the standing of victims in criminal proceedings. As previously mentioned, it was this instrument that gave rise to the *Pupino* case. This instrument sets out a list of guarantees that Member States undertake to provide for the victims of criminal offences. Under Article 3, ‘Each Member State shall take appropriate measures to ensure that its authorities question victims only insofar as necessary for the purpose of criminal proceedings’. And under Article 8 (4),

Each Member State shall ensure that, where there is a need to protect victims – particularly the most vulnerable – from the effects of giving evidence in open court, victims may, by decision taken in open court, be entitled to testify in a manner which will enable this objective to be achieved, by any appropriate means compatible with its basic rights.

Mrs Pupino, a teacher at an infant school, was accused of acts of cruelty to children in her care. As Italian criminal procedure then stood, for the children’s evidence to be received it was necessary for them to attend the trial and give their evidence orally. This state of affairs was inconsistent with obligations imposed by the Framework Decision.

Though this is the only instrument of this sort that currently exists, others are under serious discussion.

Of these, one is a proposal for an instrument requiring the criminal courts of all the Member States to treat as admissible evidence any material gathered in another Member State, provided that the laws of that Member State were respected when the evidence was collected. The background to this proposal is the previously-mentioned difficulty that OLAF sometimes has in persuading the authorities of Member States to take action on its reports. One of the recurrent reasons Member States refuse to prosecute, it seems, is that the evidence OLAF provides was not gathered according to the procedures laid down for the collection of such evidence in their own criminal procedure codes – even though it was lawfully collected according to the rules of the Member State where it was gathered. To deal with this, a proposal for the ‘free movement of evidence’ was put forward at Tampere in 1999. Three years later it surfaced again in a Commission Green Paper, and again in another Commission Green Paper in 2009.

What exactly is meant by this proposal is not clear. On a narrow interpretation, it merely means that where local formalities for evidence-gathering were complied with, the resulting evidence should not be rejected by the courts of another Member State merely because, had the evidence been gathered there, different formalities would have been required. This '*locus regit actum*' rule is a sensible one which already prevails in a number of Member States, including (it seems) the United Kingdom, and to generalise it would not be revolutionary. But on a wider reading, it could mean that any piece of evidence gathered lawfully in one Member State becomes automatically admissible in criminal proceedings in another Member State, irrespective of any rule of evidence that would otherwise exclude it, and whether that rule is concerned with formalities or based on some broader principle. On this interpretation, a written statement lawfully taken from a witness in State A, where written statements of absent witnesses are generally admissible in substitution for their oral testimony, would be automatically admissible in State B, under the law of which written statements from absent witnesses are generally excluded and oral evidence is normally required. The implications of this are worrying, to put it mildly.

Another is a proposal – or to be more exact, a series of proposals – to ensure that all Member States introduce measures to secure certain minimum safeguards for defendants.

Moves in this direction began in 2003, shortly after the creation of the European Arrest Warrant. Their overt justification was the need to build the 'mutual trust' that is necessary for the proper functioning of 'mutual recognition'. The courts in Member States whose criminal procedure provides proper safeguards against the mistreatment of suspects and defendants, and against the risk of wrongfully convicting the innocent, will (so it is said) be unwilling to execute European Arrest Warrants, and other 'mutual recognition' instruments, if they suspect that these safeguards are missing in the Member State whose order they are expected to enforce. But, as suggested earlier in this chapter, in the background also laid another and more fundamental reason: the notion that, in an 'area of freedom, justice and security', all citizens deserve a criminal justice system that is civilised, and in which certain basic safeguards are guaranteed.

In 2006, progress towards a new Framework Decision on Defense Rights was abruptly halted when, to its shame, the British government, initially in favor, used its political muscle to block it. For this change of mind no coherent reason was ever given. But the reason was probably that the government had just published a White Paper announcing its intention of 'Rebalancing the criminal justice system in favor of the law-abiding majority', which it feared would lose its impact with the electorate if it appeared alongside headlines saying 'Brussels Forces UK to Give Criminals Yet More Human Rights.' By the autumn of 2009 the British government had changed its mind again, and it was actively backing new moves from the Commission towards EU instruments guaranteeing rights for criminal defendants.

These new moves consist of a 'Roadmap' of intended future measures designed to safeguard the position of suspects and defendants during the police investigation and preliminary stages of a prosecution, which was approved by the Council in a Resolution on 30 November 2009. These proposed new measures concern (a) provision of adequate interpretation and translation, (b) information to suspects about their legal rights, (c) legal aid and advice, (d) a right for persons detained to communicate with relatives, employers and consular authorities, (e) special safeguards for suspected or accused persons who are vulnerable and – eventually – (f) a Green Paper on pre-trial detention. At the time this chapter is written, the Commission is working on all of these, and an instrument designed to give effect to 'measure (a)' – interpretation and translation – is already in the legislative pipeline, in the form of a Draft Directive, which looks set to be adopted shortly.

## Conclusions

As all reader will be well aware, the Lisbon Treaty has radically changed the previous constitutional arrangements for the making of what was earlier described as 'positive EU criminal law'.

First, gone is the ‘Third Pillar’, the special system under which legislation in the area of criminal justice was made by the Council using a special set of instruments (in particular, Framework Decisions), which could only be adopted by unanimity; and instead, the EU now legislates in criminal justice matters by the same processes, and using the same instruments, as it does for everything else. The instruments are now Regulations, Directives, Decisions, Recommendations and Opinions. The legislative process now involves the European Parliament, but no longer requires, as it used to, unanimity in the Council from all Member States. If push comes to shove, the legislation may proceed by a qualified majority vote; though to compensate for loss of their veto, the UK and the Republic of Ireland managed to negotiate set of ‘opt outs’ of labyrinthine complexity. Furthermore, in future, EU criminal law measures, like all other EU measures, will be subject to full ‘judicial control’, including enforcement proceedings against recalcitrant Member States which fail to implement them.

Secondly, the powers of the EU to legislate in criminal justice matters have been restated by new provisions which are, fortunately, rather clearer than the arcane provisions of the TEU which they replace.

Article 82 TFEU deals (in effect) with criminal procedure. Having proclaimed the principle of ‘mutual recognition’, it provides that, to the furtherance of this end, the EU may (inter alia) ‘lay down rules and procedures for ensuring recognition throughout the Union of all forms of judgments and judicial decisions’, and further provides that, ‘to the extent necessary to facilitate mutual recognition’, it may also ‘establish minimum rules’ in relation to a number of criminal procedure matters: ‘mutual admissibility of evidence between Member States’, ‘the rights of individuals in criminal procedure’, ‘the rights of victims of crime’, and ‘any other specific aspects of criminal procedure’ which the Council has agreed upon by unanimity, with the consent of the European Parliament.

Article 83 TFEU deals (in effect) with substantive criminal law. It provides that the European Parliament and the Council may enact Directives establishing ‘minimum rules concerning the definition of criminal offences and sanctions in the areas of particularly serious crime with a cross-border dimension resulting from the nature or impact of such offences or from a special need to combat them on a common basis’. ‘Particularly serious crime’ is defined as ‘terrorism, trafficking in human beings and sexual exploitation of women and children, illicit drug trafficking, illicit arms trafficking, money laundering, corruption, counterfeiting of means of payment, computer crime and organised crime’, plus other types of crime in future determined by the Council, acting unanimously and with the consent of the European Parliament. In addition the EU may also adopt Directives defining crimes and prescribing punishments where ‘the approximation of criminal laws and regulations of the Member States proves essential to ensure the effective implementation of a Union policy in an area which has been subject to harmonisation measures’.

As regards the impact of all this on the United Kingdom, public attention has mainly focussed on wide powers the UK has secured to ‘opt out’ of those measures it does not like. But no less important, I believe, is the fact that, where the UK has ‘opted in’ to a new measure, the government now has much wider powers than previously to implement it by using secondary legislation. Previously, where the implementation of a ‘Third Pillar’ measure required a change in the law, primary legislation would usually be necessary. But the European Union (Amendment) Act 2008 has extended the scope of section 2(2) of the European Communities Act 1972, which previously allowed the government to implement ‘First Pillar’ measures by means of secondary legislation, so that in future all ‘EU obligations’ can be implemented by this method, including those in the area of criminal law. As before, this power cannot be used so as to create new criminal offences that are punishable with more than two years’ imprisonment; but at least in theory, secondary legislation could now be used to implement EU measures requiring rearrangements of criminal procedure, however radical they might be.

So against this background, what will be the ‘big issues’ in the future? There could be many, but here I propose to close this chapter by briefly mentioning only two.

The first is ‘what will be the future shape of EU criminal law? Vertical or horizontal?’ As we have seen, this tension between these two rival models is already present. It is evident in the institutions: of the three EU organisations that exist to handle criminal law, one of them – OLAF – is ‘vertical’, carrying out its own investigations into EU fraud, and the other two – Europol and Eurojust – are ‘horizontal’, their essential tasks being to co-ordinate the crime-fighting efforts of the national authorities in the Member States. Thirteen years ago, the *Corpus Juris* project produced a blue-print for a ‘vertical’ future, in the form of a European Public Prosecutor, albeit within the limited area of budgetary fraud, which would enforce a single, unified code of criminal offences by using a single, unified code of criminal procedure. As already mentioned, this solution did not please the Member States, which reacted by producing a rival ‘horizontal’ solution – mutual recognition and improved co-ordination through Eurojust – as a means to solve the problems of trans-border crime. The tension, though temporarily buried, is present in the criminal justice articles of the TFEU. Article 82, as we have seen, proclaims the principle of mutual recognition. But Article 86 provides a mechanism by which, in the future, a European Public Prosecutor could evolve from Eurojust; and there is pressure from within the Commission, and OLAF, to see that it eventually does. In the next few years, we shall see whether, with a Union of 27 Member States and others keen to join, co-ordination between national police and prosecuting authorities plus mutual recognition of decisions can really cope with the issues of budgetary fraud and trans-border crime.

The second big issue, I believe, is whether the EU can secure a decent deal for suspects and defendants in those Member States where it seems that present arrangements are seriously deficient. Every criminal justice system makes occasional mistakes, and our own (alas) is no exception. But, regrettably, there are strong reasons to believe that the criminal justice systems of some Member States have problems that are systematic. In a press communication launching its ‘Justice in Europe’ campaign, Fair Trials International – a serious organisation – said this:

Sadly, our own casework repeatedly demonstrates the human cost of existing cooperation measures. Under the European Arrest Warrant, for example, people from all across Europe are being sent to other EU Member States for the most minor offences, or to serve prison sentences imposed after unfair trials ... we also have compelling evidence of the need to improve fair trial rights across the Union.

Some of the English case-law relating to the European Arrest Warrant reinforces this disquieting impression.

That they will exist to do this is shown by the adoption of the ‘Roadmap’ that was described earlier. But unfortunately, is not entirely clear that the EU has the legislative powers to see that its good intentions are carried through. As we have seen, Article 82 of the TFEU subordinates the competence of EU to legislate in the area of criminal procedure to the need to promote ‘mutual recognition’; the EU has no power, as such, to pass legislation requiring Member States to clean up their systems of criminal procedure, just because their current state of hygiene is questionable. There is an obvious difficulty about trying to gear an improvement in the position of suspects and defendants to the enhancement of mutual recognition, and this is the essential nature of mutual recognition; which is ‘We’ll enforce your courts orders without asking awkward questions, provided you will do the same for ours.’

The ‘vertical solution’ of a single European Public Prosecutor, using everywhere a single set of European rules, has been widely attacked, at any rate in the UK, as potentially authoritarian – often in language that is extraordinarily violent. But paradoxically, it could provide better safeguards for defendants than the horizontal solution of mutual recognition, ‘You scratch our national prosecutor’s back, and we’ll do the same for yours.’

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**THE IMPLEMENTATION OF THE EUROPEAN CONVENT OF HUMAN RIGHTS AS AN INTERNATIONAL OBLIGATION AND ITS STATUS IN ALBANIAN LEGISLATION.**

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**Abstract:**

*Respecting the international agreement is one of the main obligations that the international law sets for its subjects and one of the ancient principles of this right. The European Convention of Human Rights is not only one of the mainly international agreements for its impact but also for the status that our acts of domestic law attributes to it. This paper aims to analyze from qualitative methodology point of view based on the research of literature and on the respective legislation, that how the obligations of European Convention of Human Rights are realized in our country and how it is implemented in the domestic law. The purpose of this paper is to explain what we understand with concept of international legal obligations, the principle of pacta sunt servanda, how Albania has fulfilled her obligations that derive from European Convention of Human Rights and if there is room for improvement, what is the status of this convention in our domestic law treating briefly the relationship in this case of our law with the international law.*

*Conclusion: Albania as a developing country has made maximal efforts to fulfill the international legal obligations that derive from European Convention of Human Rights creating a legal framework that aims to respect the individuals fundamental rights and freedoms.*

**Keywords:** *international agreement, European Convention of Human Rights, international legal obligations, juristic status, respecting the human rights and freedoms.*

**JEL Classification:** K 309.

ECHR is an international treaty implemented from EC and is one of the most important acts regarding the protection of human rights, which is signed and ratified by all the members of EC.

The signature and the ratification of an international agreement are two of the most important stages of the conclusion of an international agreement. The ratification moment is mainly related to the time when the agreement signed by the representatives of the State enters into force definitively. This means that the state can exercise the rights arising from such agreement and in the same time have to implement the obligations laid down by it.

The obligations assumed by a state under an international agreement are called international legal obligations and based in one of the oldest principles of international law *pacta sunt servanda* they have to be fulfilled by the State party to the agreement<sup>xlvi</sup>

The membership in the Council of Europe, the signature and ratification of the ECHR and later on of the SSA brought Albania in front of the obligation to approximate its legislation in the field of human rights. The section 2 of the SAA provides that "Respect for democratic principles and human rights as defined in the Universal Declaration of Human Rights, the European Convention on Human Rights, the Helsinki Final Act and the Charter of Paris for a New Europe, the respect for the principles of international law, as well as the principles of market economy as reflected in the Document of the CSCE Bonn Conference on Economic Cooperation, form the basis of internal and external policies of the Parties and constitute essential elements of this Agreement. "



So the obligation to respect the ECHR is reinforced in this case by a very important document as SSA, further contribution to the future integration of Albania into EU. To this regard the rights and the fundamental freedoms of the individual as enshrined in the ECHR are firstly implemented in the fundamental law of the state, Constitution of the Republic of Albania.

Specifically in the second part, immediately following the basic principles, are envisaged the rights and freedoms divided into several chapters such as general principles, freedoms and personal rights, liberties and political rights, freedoms and economic, social and cultural social objectives and the ombudsman.

At this point it is worth to be treated the role of international law in domestic law and in particular the position of this convention in our domestic right. The Constitution of the Republic of Albania of 1998 reserves to the international law a very important place, and perhaps privileged, which is an worth achievement of the Albanian state and society, as well as a valuable contribution in the context of efforts for the development and democratization of the country and its faster integration<sup>xlvii</sup>.

Article 116, (paragraph 1) of the Constitution of the Republic of Albania ranks international agreements immediately after the constitution and before the laws and other legal acts<sup>xlviii</sup>. While Article 122 states that ratified international agreements are part of the legal system after their publication in the Official Journal. They have direct application and have supremacy over the national laws that are not compatible to the international agreements<sup>xlix</sup>.

"In view of the place on international agreements in the Constitution of the Republic of Albania, is worth mentioning in particular the second paragraph of Article 117, which, when it comes to the possibility of restricting the rights and freedoms of the individual, notes that they... can not violate the essence of freedoms and rights, and in any case cannot exceed the limits laid down in the European Convention on Human Rights. "As can be seen, we repeat that in the case of determining the criteria on the possible limitations of these rights, the European Convention on Human Rights as an integral part of international law, extending its effects on the territory of the Republic of Albania, not only is rests upon the laws passed by Parliament (under Article 116 of the Constitution), but it is over, or at least in the same level superior to the Constitution itself! "

So from the wide range of the international law, the ECHR makes the only exception and is equal to the Constitution which gives it privileged status in our domestic law.

Going back to the implementation of the ECHR in domestic law I think we should make a distinction or separation into two different issues that are approaching or adaptation of legislation in conformity with the Convention and its implementation. The second issue relates mostly with the need for improvements in our practice.

Regarding the adoption of legislation, we can say that the EC membership and the ratification of the Convention brought a number of changes such as the amendment of the penal legislation and the abolition of the death penalty, providing due process together with all rights derived from it, etc.

Other changes can be mentioned referring to the right to work, mainly in the context of equality and non-discrimination, the creation of professional organizations, the establishment of national employment strategies etc., which go parallel with the requirements for membership in the European Union.

Significant changes were reported to the electoral legislation which has constantly changed in recent years, but it is intended to retain the right to vote along with a series of rights and related principles, enshrined in the Convention and its additional protocols in our constitution.

Other legislative changes in accordance with the aforementioned acts have been reported as well in the Family Code, in the provisions for education, the protection of privacy and personal data, the freedom of movement, ensuring the right to appeal, the right to address to the European Court of Human rights and the recognition and implementation of its decisions, etc..

As regards the second issue, which refers to the implementation of the legislation for the protection of human rights and fundamental freedoms, is positively estimated the fact that Albania continues to sign and ratify other international instruments in this field, and also if we refer to EU-progress report for 2011 it is remarkable the fact that there has been progress in the prevention of torture and ill-treatment of persons in custody, as well as in the prison system, particularly in treating sick people, disabled and economically inactive<sup>i</sup>.

What from this progress report is generally regarded as a secured right, but with a limited development is freedom of expression, as there are positive developments in enhancing the role of investigative journalism in the detection and reporting of corruption, continuous monitoring of the media in 2011 local elections and as well light efforts in breaking away the influence of political parties, but unfortunately the freedom of writing continues to be affected by the interests of political parties, and the media is still under pressure on regards to the implementation of disproportionate fiscal and financial sanctions and fines that have been made by the media courts to cases of defamation or interference with private life.

While freedom of assembly and association is provided and this is shown by the fact that there is no denunciation of violations of this right, even though according to the report there is still a question mark given the events of 21 January 2011. The role of organizations and NGOs in Albania is still low, as in most cases they remain dependent on donors, and their consultation in the legislative process is still in its infancy<sup>iii</sup>.

There have been developments with regard to freedom of thought, conscience and religion, such making protestantism the fifth religion besides Sunni Muslim, Bektashi, Catholics and Orthodox, and the same is expected for evangelicals too.

EU progress report also mentions new developments on the protection of women's rights and gender equality. The implementation of the National Strategy for Gender Equality and the Fight against Domestic Violence in July 2011 marked a turning point in this direction. The establishment of national mechanisms for victims of domestic violence, the creation of specialized centres to support these victims and legal changes on this issue, as well as awareness campaigns to prevent such phenomena represent important developments which show that Albania is in a process of continuous improvement in respecting and protecting human rights and fundamental freedoms of the individual.

Another remarkable development mentioned in the progress report of 2011 regards the protection from discrimination with the establishment of the Commissioner for Protection from Discrimination which directly examines complaints of discrimination but also drafts laws in this area.

The protection of children's rights with the implementation of new international acts signed by the Republic of Albania and the establishment of centres dealing with child protection, prevention of violence, trafficking and sexual exploitation are experiencing a good progress in Albania but the prohibition of child labour still remains a controversial issue which must continuously be assessed.

## Conclusions

Albania, as a developing country has made its best efforts to fulfil the international legal obligations arising from the ECHR by establishing a legal framework which aims to respect the rights and freedoms of the individual.

European Convention on Human Rights plays a special role and has a privileged position compared to other international agreements, in our domestic legislation, as it is the only agreement which equates to the Constitution.

The implementation of laws, regulations and strategies in almost all areas that relate to the protection of human rights has ensured full implementation of the Convention, but also the fulfilment of the obligations for the EU integration.

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**JURISDICTIONAL RELATIONS OF ALBANIA**  
**WITH THE EU COUNTRIES IN THE CRIMINAL PROCESS**

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**Abstract:**

*The general development of society brought about the creation of the modern and sovereign states. This development was followed by the birth of interstate relations, part of which, the juridical relations among different states in the criminal process are. After the abolition of the communist regime, the democratic orientation of the state and the integration process of Albania in Europe, were followed by general reforms, among others, the reformation of the legislation. The juridical relations with foreign states in the criminal process have been known in Albania since the period between the two World Wars, where among other things some agreements with other states were signed for the extradition of the criminals. How have the juridical relations with foreign states in the criminal process changed in Albania? Which is the role of these relations in the European integration of Albania? These are the questions that tend to be analyzed in this study, which is based on a detailed observation, using scientific descriptive and comparative research methods, analyzing the connections between the legal acts of the internal Law and international legal acts, through the historical development of the Albanian State, concluding: Due to historical conditions, Albania quite by chance has remained outside Europe. Albania has been part of Europe, where it belongs to be.*

**Keywords:** *jurisdictional relations, foreign states, criminal process, European integration, international legal act, law.*

**JEL Classification:** *K19.*

**Introduction**

The general development of the society brought about the formation of modern and sovereign states, which was accompanied by the birth of international relations. These states gained their identity after the First World War and brought about the development of cooperation among different countries in the field of Law, resulting in the birth of International Law, part of which Criminal International Law is. The International Law in general and the Criminal International Law in particular are composed of *jus gentium* (State Law, which includes the inner law) and *jus inter gentes* (the agreements among states, which include international acts). Jurisdictional relations with foreign states in the criminal process are a special area where the cooperation among different states is obviously seen.

Jurisdictional relations with foreign states in the criminal process are exercised in accordance with the requirements, procedures and from the institutions foreseen by law. Here we may mainly mention: Extradition, International Requests and the Execution of Foreign Criminal Sentences. These are of great interest to be studied in-depth, taking into consideration the free movement of the citizens from one country to another, the integration of many countries in EU, which brings about the breaking of barriers and borders in between states, and the aspiration of Albania to become part of this Union.

This study tends to analyze the steps that Albania has followed through years in the jurisdictional relations with other states in the criminal process, with the aim of showing that Albania has been part of Europe, a place where it belongs to be. This analysis will include the international acts ratified by the Republic of Albania in the field of jurisdictional relations with foreign countries in the criminal process, at the same time the way how these are implemented in the inner legislation.

## 1. History of the Development of Jurisdictional Relations of Albania with the EU Countries in the Criminal Process

Jurisdictional relations of Albania with other countries in criminal process, as part of the Criminal Law, started and developed in accordance with the development of the Albanian State.

*[Being a product of the development of human society, born and developed together with the state, the penal law has historic character and is subject to continuous changing process, ... It always takes that form and content that respond to the interests of the social system of the corresponding historical era.]*<sup>512</sup>

Original version:

(Duke qënë produkt i zhvillimit të shoqërisë njerëzore, e lindur dhe e zhvilluar sëbashku me shtetin, e drejta penale ka karakter historik dhe i nënshtrohet procesit të përpunimit e të ndryshimit të vazhdueshëm, ... Ajo merr kurdoherë atë formë e përmbajtje që u përgjigjet interesave të sistemit shoqëror të epokës historike përkatëse.)

The development of the Albanian State, and Criminal Law as part of it, has been similar to those around the world. In the period of primitive community, there was no Criminal Law, as long as the creation of states hadn't begun yet. Unbundling of primitive communities was accompanied by the creation of the first slave states and the first beginnings of criminal justice. There are no documentary resources of Criminal Law regarding Illyrian - Albanian States of this period, but it was based on Albanian customary (traditional) law and the laws of occupators, such as: Code of Justinian. The Criminal Law of Illyrian slave states in Albania represents mostly the same features as those of the slave states worldwide. During feudalism, Albania was invaded by Slavs and Ottomans. However, except the Criminal Law of invaders, the Albanian customary law norms of different regions acted as well, such as: Kanun of Lekë Dukagjini, Kanun of Scanderbeg, etc. Even in this period, the characteristics of Criminal Law in Albania were similar to those of the feudal states of the world. The beginnings of the Criminal Law in Albania as a branch of the Law in general are closely connected with the formation of the Independent Albanian State and the Vlorë Government in 1912. The period 1912 – 1944 is one of the most important periods of Albanian State, because of the great historic events of that time, which had a great influence in the Criminal Law field. Due to the obstacles which came as a result of the First World War, territorial claims of Albania from some foreign states and the disruption within the country, the efforts of Vlorë Government for the organization of the new Albanian State were unsuccessful until 1920.

*[The full meaning of the concept of Criminal Law system in Albania can be mentioned only after the approval of the Statute of Lushnja (1920) and the Extended Statute of Lushnja (1922), continuing to the year 1939.]*<sup>513</sup>

Original version:

(Për sistemin të drejtësisë kriminale në Shqipëri, në kuptimin e plotë të fjalës, mund të flitet vetëm pas miratimit të Statutit të Lushnjës (1920) dhe Statutit të zgjeruar të Lushnjës (1922) e në vazhdim deri në vitin 1939.)

When King Zog came to power, during the period 1920 – 1928, the organization of justice system was made possible, and the legal framework was completed as well. These were accomplished through the approval of some important laws, among which were the Criminal Code, and the Criminal Procedure Code. The laws approved in this period were orientated towards the principles of European Law.

In the period between the two World Wars, the beginnings of jurisdictional relations between different countries started in the world. It's exactly in this period that the juridical relations with foreign states in the criminal process were introduced to Albania too, where among other things some agreements with other states were signed for the extradition of the criminals.

<sup>512</sup> Muçi, Sh. (2007), E drejta penale (Pjesa e Përgjithshme) (*Penal Law – General part*), Botimet Dudaj, Tirana, pg.12

<sup>513</sup> Elezi, I. (2001), Vështrim i Shkurtër Historik i Drejtësisë Penale në Shqipëri dhe sfidat para saj (*Short Historic Overview of Criminal Law in Albania and its Challenges*), seen on <http://drejtesiashqiptare.com/>, accessed on April 20, 2011

After the Second World War, with the establishment of the totalitarian communist regime, Albania was in complete isolation, following the principle 'relying on our own forces'. Criminal legislation was considered as a powerful weapon of the dictatorship of proletariat in class struggle according to article 1 of the Criminal Code of the year 1977. According to this article, the criminal legislation was led by the Party of Labor of Albania policy, and at the same time it was based on the ideology of the working class, on Marxism-Leninism. Starting from what we just mentioned, nothing can be said for jurisdictional relations with foreign countries in criminal process during this time. The Constitution of People's Socialist Republic of Albania, Criminal Codes and in the Criminal Procedure Codes of this period didn't contain or foresee anything connected as far as jurisdictional relations with foreign countries were concerned.

The democratic changes that happened at the beginning of the 90's in Albania and the transition from a totalitarian system to a democratic system marked a complete turn in the history of the Albanian State and its institutions. The democratic orientation of the state required the implementation of general reforms, among which the democratic transformation of building the State of Law. In the framework of these institutional reforms, in the new democratic Albanian State that was just emerging, the Albanian lawmakers were obliged to undertake changes in the penal legislation of the Republic of Albania. In 1995 the new Criminal Code and the new Criminal Procedure Code were approved, which have an important place in the jurisdictional relations with foreign states in criminal process. These codes are built according to the models of contemporary criminal codes of some European democratic states (mainly Italy, France and Germany). For the time they were approved, those codes were to some extent according to international standards.

*[Criminal Law is not static and unchangeable; on the contrary it can be changed and completed depending on social, economic and political situation of a certain country and on the objective requirements of juridical practice as well.]*<sup>514</sup>

Original version:

(Ligji kriminal nuk është statik dhe i pandryshueshëm, përkundrazi ai ndryshohet e plotësohet në varësi nga kushtet social ekonomike e politike të vendit dhe nga kërkesat objektive të praktikës gjyqësore.)

So, after the year 1995, with the rapid development of the Albanian society, these Codes changed, aiming at their improvement and making them look like and come close to international levels. In the field of jurisdictional relations with foreign states in the criminal process, these Codes were followed by the approval of other laws, after the ratification from Albania of a series of international acts. Albania signed and became part of some agreements with various states of the world, among which there were a lot of EU states, thus improving and completing the legal framework in this area.

## 2. The Juridical Concept of the Relations with Foreign Countries in the Criminal Process

International relations, among other things, include relations among different states. These relations are studied by the theory of the Law, thus creating a separate discipline, which is defined as:

*[The discipline that gained its identity after the First World War, which studies the interactions among states ...]*<sup>515</sup>

Original version:

(Disiplina që fitoi identitetin e vet pas luftës së parë botërore, që studion ndërveprimet midis shteteve...)

Legal issues for regulating relations among different countries cannot be limited within the national framework, but they have always acquired an international perspective.

*[The principal reason of this new dimension is the increasingly great and strong will of states to cooperate with each other in mutual plan and beyond in function of peace and international security and the guarantee of a sustainable development in all the sectors of life in the country.]*<sup>516</sup>

<sup>514</sup> Elezi, I., Kaçupi & S., Haxhia, M. (1999), Komentari i Kodit Penal të Republikës së Shqipërisë (Commentary on Criminal Code of Albania), SHBLU, Tirana, pg.16

<sup>515</sup> Uka, Nj. (2011), Fjalori i drejtësisë (Justice Vocabulary), "ILARI" P.F., Tirana, pg. 437.

Original Version:

(Arsyeja kryesore e këtij dimensionit të ri të saj është vullneti gjithnjë e më i madh i shteteve për të bashkëpunuar me njëri – tjetrin në planin dypalësh dhe më gjerë, në funksion të paqes dhe sigurisë ndërkombëtare dhe garantimit të një zhvillimi sa më të qëndrueshëm në të gjithë sektorët e jetës së vendit.)

In the framework of globalization of the world, the cooperation among states in the field of International Criminal Law, as in other fields of Law, has been developing with every passing day. The jurisdictional relations with foreign states in the criminal process are exercised in accordance with the requirements, procedures and from institutions foreseen by law. They are a good possibility for interaction among various countries in Criminal field, having as the final aim the effective fight against crime, giving justice and penalizing the authors of criminal acts, which is one of the duties of the Albanian criminal legislation, according to the article 1/b of Criminal Code and article 1 of Criminal Procedure Code. They are developed in two directions:

- 1- Prosecution and judging of criminal acts;
- 2- The execution of criminal Court decisions everywhere in the world.

### 2.1. Proceeding of criminal acts

As a result of the extension of free movement of the citizens from one state to another, it often happens that any person in his/her everyday life may commit a criminal act in the territory of a foreign state. According to criminal legislation all over the world, the foreign citizens are responsible for the criminal acts done by them. Article 7 of Criminal Code of Republic of Albania foresees:

*[The foreign citizen, who commits a criminal act in the territory of the Republic of Albania, is responsible for this criminal act based on the criminal Law of the Republic of Albania]*<sup>517</sup>

Original version:

(Shtetasi i huaj, që kryen veprë penale në territorin e Republikës së Shqipërisë, përgjigjet në bazë të ligjit penal të Republikës së Shqipërisë.)

On the other hand, committing a criminal act may be presented in various complex forms and more organized cooperation, covering several states and brings as a necessity the carrying out of investigating actions at the same time from various states. This could be realized only through jurisdictional relationships among various states in the criminal process. During the criminal proceeding, the jurisdictional relations with foreign authorities are exercised through international requests, not only from those abroad but also for those abroad as well. The conditions and the procedure of international relations are foreseen in articles 505 – 515 of the Criminal Procedure Code. These dispositions are referred and completed with other national special laws and international acts, as treaties agreements.

### 2.2. The execution of criminal Court decisions

The proceeding and the criminal sentence of foreign citizens is often done in their absence, thus the execution of the criminal court decisions from the states which give this sentence, is impossible. This way, it is logical that the execution of the criminal sentence has to be done by the country of residence of the convicted person. The execution of criminal Court decisions is connected with such institutes of law, as: “Execution of foreign criminal Court decisions”, “Recognition of foreign criminal Court decisions” and “Extradition”.

The conditions and the procedure of the execution of foreign criminal Court decisions and extradition in Albania are foreseen in the articles 512 – 523 and 488 – 504 of the Criminal Procedure Code, which are completed with other legal acts of internal and international law.

## 3. The Legal Basis of Jurisdictional Relations in the Criminal Process of Albania with the EU Countries

<sup>516</sup> Zaganjori, Xh. (2012), Jurisprudencë dhe praktikë ndërkombëtare (*International Jurisprudence and Practice*), Adelprint, Tirana

<sup>517</sup> Law 7895 date 27.01.1995, “Kodi Penal i Republikës së Shqipërisë” (*Criminal Code of Republic of Albania*), Tirana.

As it is mentioned above, the International Criminal Law is composed of *jus gentium* and *jus inter gentes*. Referring to these main sources of the International Law, the Constitution of Republic of Albania<sup>518</sup> foresees that:

- The Law is the basis and limits of state activity (article 4/1);
- Republic of Albania applies the binding International Law (article 5);
- The normative dispositions, which act in the entire territory of the Republic of Albania are: the Constitution, the ratified international agreements, laws, etc. (article 116)

This fundamental constitutional principle, at the same time is expressed in the article 1/a of Penal Code, where the bases of the penal legislation are foreseen:

*[The Criminal Code is based on the Constitution of the Republic of Albania, general principles of the International Penal Law, and international acts ratified by the Albanian State.*

*The penal legislation is composed by this Code and other laws which foresee criminal acts.]*<sup>519</sup>

Original version:

(Kodi Penal bazohet në Kushtetutën e Republikës së Shqipërisë, parimet e përgjithshme të së drejtës penale ndërkombëtare, si dhe në marrëveshjet ndërkombëtare të ratifikuara nga shteti shqiptar.

Legjislacioni penal përbëhet nga ky Kod dhe ligje të tjera që parashikojnë vepra penale.)

Based on this, the international relations of Albanian State with other countries in the criminal process are regulated with a series of dispositions of inner Albanian Penal Law, and the international penal acts as well, as agreements, conventions, etc.

### 3.1. Inner Legislation

Parts of the inner legislation of the Republic of Albania, that regulates the jurisdictional relations of Albania with other foreign countries in the criminal process are:

- The Constitution
- The Criminal Code
- The Criminal Procedure Code
- Other Laws

#### 3.1.1. The Constitution

The Constitution of the Republic of Albania is the highest law. This is foreseen in its article 4/1. Judging from this fact, all juridical – penal norms are based on the main constitutional principles, thus making the Constitution the basic source of the Criminal Law, as well as for all the Albanian Law in general, as a whole.

After the change of the political system in Albania, the democratic principles of the state of Law firstly were embodied in the law 7491, date 29.04.1991, “*For the main constitutional dispositions*” and the law 7561 date 29.04.1992 “*For some changes and supplements in the Law 7491 date 29.04.1991 /For the main constitutional dispositions*”, which served as the basis for the Constitution in use, approved in the year 1998. These laws gave an end to the long-term isolation of Albania and opened the road towards the development of jurisdictional relations of Albania with foreign states.

A lot of norms of the Constitution of Republic of Albania are directly connected with the International Law and the Criminal Law, among which, even with the jurisdictional relations with foreign states in the criminal process.

- The article 39/2 of the Constitution foresees, that extradition might be allowed only in those cases when it is foreseen in international agreements, in which the Republic of Albania is a party, and only with a court decision.

- The article 117/3 foresees the way of notification and publishing of the international agreements, which are applied for international relations of Albania.

<sup>518</sup> Law 8417 date 21.10.1998 “Kushtetuta e Republikës së Shqipërisë” (*The Constitution of Republic of Albania*), Tirana

<sup>519</sup> Law 7895 date 27.01.1995, “Kodi Penal i Republikës së Shqipërisë” (*Criminal Code of Republic of Albania*), Tirana



- The article 121/b foresees that the ratification and denouncing of international agreements from the Republic of Albania is done through the law, in cases when they have to do with the freedom and human rights, and when they have to do with the obligations of the citizens, which can be found in the criminal process too.

- The article 122 foresees, among other things, that each ratified international agreement is part of the inner system and is implemented in a direct way or is ratified by law. A ratified international agreement by law has priority over the laws of the country.

### 3.1.2. Criminal Code

The basic principles upon the Criminal Law are foreseen in the general part of the Criminal Code of Albania. Here are also included the general principles of the jurisdictional relations with foreign countries in the criminal process. Meanwhile, the legal procedures of these relations are regulated by the Criminal Procedure Code and other special laws.

The article 1/a of the Criminal Code defines that, this code is based on general principles of the international Criminal Law, and on the international agreements ratified by the Albanian State. The Criminal Code foresees regulations even for the implementation of the Criminal Law for penal acts committed by Albanian citizens in foreign territories (article 6/2); for the implementation of the Criminal Law for penal acts committed by foreign citizens (articles 7 and 7/a), or penal acts committed by a person without citizenship (article 8), and for persons that have immunity (article 9).

Concerning the jurisdictional relations with foreign countries in the criminal process, article 10, "The power of criminal sentences of foreign courts" and article 11, "Extradition" of the Criminal Code, define:

*[The criminal sentences given by the foreign courts for the Albanian citizens that prove the commitment of a penal act are valid in Albania within the boundaries of the Albanian Law, when it is not foreseen differently in bilateral or multilateral agreements ...*

*Extradition may be allowed only when it is foreseen in the international agreements in which the Republic of Albania is a party ...]*<sup>520</sup>

Original version:

(Vendimet penale të dhëna nga gjykatat e huaja ndaj shtetasve shqiptarë që vërtetojnë kryerjen e një vepre penale, kur nuk është parashikuar ndryshe nga marrëveshjet dy ose shumpalëshe, vlejné në Shqipëri brenda kufijve të ligjit shqiptar...

Ekstradimi mund të lejohet vetëm kur është parashikuar shprehimisht në marrëveshjet ndërkombëtare në të cilat Republika e Shqipërisë është palë...)

### 3.1.3. The Criminal Procedure Code

The Criminal Procedure Code is the basic law that regulates the jurisdictional relations with foreign countries in the criminal process. In its general dispositions, exactly in article 10, it is foreseen:

*[The relations with foreign authorities in the penal area are regulated by international agreements, accepted by the Albanian State, by generally accepted principles and norms of the International Law, and by the dispositions of this Code as well.]*<sup>521</sup>

Original version:

(Marrëdhëniet me autoritetet e huaja në fushën penale rregullohen nga marrëveshjet ndërkombëtare, të pranuar nga shteti shqiptar, nga parimet dhe normat përgjithësisht të pranuar të së drejtës ndërkombëtare, si dhe dispozitat e këtij Kodi.)

In its title X, the Criminal Procedure Code has a series of dispositions where the jurisdictional relations with foreign authorities are foreseen. The first Chapter of this Title defines regulations on 'extradition', not only to another country (articles 488 – 503), but also from another country (article 504). Article 488 defines the meaning of extradition, as: "Giving a person to a foreign state to execute a decision sentenced with jail or the execution of an act that certifies his/her prosecution for a penal act ..."

<sup>520</sup> Law 7895 date 27.01.1995, "Kodi Penal i Republikës së Shqipërisë" (Criminal Code of Republic of Albania), Tirana

<sup>521</sup> Law 7905 date 05.04.1995 "Kodi i Procedurës Penale i Republikës së Shqipërisë" (Criminal Procedure Code of Republic of Albania), Tirana

In this code the procedures that should be followed by the organs of justice in the case of extradition are defined; the conditions when this extradition is allowed; the coercive measures and seizures in cases of extradition; and the expenses of extradition as well. Following, in the second Chapter, the international requests are foreseen, not only from another country (articles 505-508), but also to another country (articles 509-511).

In the meaning of these dispositions, the international requests consist of interstate actions, connected with the communication of acts, announcements and gathering the data in the criminal process. These dispositions define: cases when could be proceeded with an international request directed to foreign authorities; competences of the Ministry of Justice, which is the only organ through which requests directed to foreign authorities are sent and vice versa; and the validity of the acts taken from the international requests.

Lastly, in the third chapter, the execution of the foreign criminal Court sentences (articles 512-518) is foreseen, and also the execution of Albanian criminal sentences in other countries (articles 519-523) is foreseen as well. In these dispositions are defined: legal procedures and competent organs for the acknowledgement of the criminal sentences; the criteria that should be fulfilled for the acknowledgement of criminal sentences; obligatory coercive measures that could be undertaken during the process of the acknowledgement of criminal sentences; the way of deciding the punishments; and the way of their execution.

#### **3.1.4. Other laws**

Besides what is mentioned above, the legal framework of jurisdictional relations with other countries in the criminal process is fulfilled with other additional special laws in this field.

The Law no.10039, "*For juridical help*", approved on 22.12.2008, foresees the conditions, the types, the way and the procedures for giving juridical help from the state, for defending of freedom and basic rights of the individual, and of other legitimate interests of this individual (article 1). In this law are defined: the fundamental/basic principles of juridical help (article 2); the responsible organs of administrating this juridical help, the duties and their way of functioning (articles 3 – 10); the type of juridical help that is offered, forms and ways of this offer, the beneficiaries, and the procedures of giving this help as well.

The Law no.10193, "*For the jurisdictional relations with foreign authorities in criminal cases*", approved on 03.12.2009 has as its object the definition of additional procedural rules and regulations in the field of jurisdictional relations with foreign authorities in the criminal cases (article 1). In accordance with this definition, this law foresees more detailed rules and regulations, compared to those foreseen by the Criminal Procedure Code, mainly: international requests from and to another country, extradition in and out of Albania, the acknowledgement of the foreign criminal sentences in Albania and the acknowledgement of the Albanian criminal sentences abroad; the transfer of penal proceeding to a foreign country. In spite of all these regulations defined by this law, in article 1 of this law is defined, that the dispositions of this law are not implemented, when it is foreseen differently in the international agreements, in which the Republic of Albania is a party. This is a statement of the constitutional principle mentioned above, for the priority of international acts.

In other laws in the field of jurisdictional relations with foreign states in the criminal process a series of other laws are included, laws on the ratification of conventions or international agreements, which will be treated in details in Chapter 4.

### **3.2. Jurisdictional relations in the criminal process of Albania with the EU countries after 90's**

After the democratic changes of 1990, the opening of Albania, the constitutional changes of 1991, followed by other general legal reforms, brought about the ratification of bilateral or multilateral Conventions in the field of international relations with other countries in the penal process, among them some EU countries. Thus, Albania has ratified the Conventions of Council of Europe, which deal with interstate relations in the penal process. Albania has also ratified Conventions on cooperation agreements in the penal process with different EU countries.

#### **3.2.1. Ratification of the Conventions of Council of Europe**

Albania has ratified the Conventions of European Council, as followed:

With **law 8322, date 09.04.1998** it is ratified the Convention of European Council “On Extradition” of December 13, 1957 and its two additional protocols of October 15, 1957 and March 17, 1978. These international acts are ratified with some declarations and reserves, which deal with: the cases of refusal of the extradition of Albanian citizens, the cases of prohibition of extradition of the persons; etc. In spite of these declarations and reserves foreseen in this law, it foresees as exception the cases when the international agreements foresee differently by this law. After that, with law 10426, on June 6, 2011 it is ratified the third additional protocol of the European Convention “On Extradition” of Strasbourg November 10, 2010. This protocol intended to achieve a greater unity between EU members, with the desire to strengthen their individual and collective ability to fight the crime. This protocol fulfills the Convention in some aspects to facilitate and accelerate the procedure of extradition. When the person agrees with the extradition, it can be done with simplified procedures.

With **law 8497, date 29.06.1999** it is ratified the Convention of European Council “*For the transfer of the proceedings of the criminal cases*”. This law foresees declarations and reserve dealt with the refusal of transfer of some kind of criminal cases:

- Criminal cases of a religious nature;
- Cases which are based on the Albanian law can be proceeded by administrative organs;
- Criminal cases of political or military nature.

These reserves are allowed by the Convention itself by articles 30, 31 and 41, and its first appendix.

With **law 8498, date 29.06.1999** it is ratified the Convention of Council of Europe “*On mutual legal assistance in the penal field*” of April 20, 1957 and its additional protocol of March 17, 1997. This law foresees reserves also for the seizures and confiscation of the objects, which is a right of the contractual party foreseen in the article 5, point 1, letters “a” and “c” of the Convention dealt with:

- The conviction based on the Albanian Criminal Law of the crimes for which is made an international request;
- The execution of international requests based on the Albanian law.

With **law 8499, date 29.06.1999** it is ratified without any reserve the Convention of European Council “*On the transfer of the convicted persons*” of March 21, 1983.

Despite of the above mentioned international acts are ratified after the year 1995 when the Criminal Code and the Criminal Procedure Code came in use, these codes fulfill in general the requests of the international acts. This is why the dispositions on international relations with other countries in the criminal process haven’t been changed (except some small changes). After that, the content of these international acts is materialized in the special inner laws of Albania.

### **3.2.2. Other International Acts**

Despite these conventions, Albania has ratified a series of other international acts on: the fight of different crimes (for e.g.: transnational organized crime, terrorism, money laundering, narcotics, illegal trafficking, cybernetic crimes, etc); Statute of Rome on International Criminal Tribunal; the European Convention “On Witness and collaborators of justice protection”, etc. These acts aren’t object of this study.

### **3.2.3. Cooperation agreements with EU countries**

After the political changes in 1991, Albania has ratified cooperation agreements in judicial system and in fight against crimes, especially its organized forms, with some EU countries, among which: Greece (1993), Slovenia (1998), Bulgaria (1999). With the Law 9590 date 27.07.2006 Albania ratified the “*Stabilization and association agreement between the Republic of Albania and the European Communities and their states*”. This is an important agreement in the framework of the stabilization and association of the countries of Eastern Europe to a stabilized Europe where a European Country has the most important role. Through this agreement the parties had the aim to strengthen the cooperation in a wide range of areas, particularly in justice. One of the commitments of Albania through this agreement is the development of common interest projects, particularly those related to fight against organized crime, corruption, money laundering, illegal migration and trafficking. This commitment constitutes a key factor on cooperation between the parties, thus contributing to regional stability. In accordance with this commitment, Albania had to actively promote the cooperation with EU countries and the other European countries which are candidates for EU. To fulfill this commitment Albania has ratified a series of bilateral or multilateral agreements on cooperation in the fight against crime, especially its organized forms, which affect the issues



6. Law 8497 date 29.06.1999 “For the ratification of European Council of Europe /For the transfer of proceedings of criminal cases/”, Tirana
7. Law 8498 date 29.06.1999 “For the ratification of the European Council Convention “On mutual legal assistance in the penal field”, Tirana
8. Law 8499 date 29.06.1999 “For the ratification of the European Council Convention “On the transfer of convicted persons”, Tirana
9. Law 8733 date 24.01.2001 “For some additions and changes in law 7895 date 27.01.1995 /Criminal Code of Republic of Albania”, Tirana
10. Law no.10039, date 22.12.2008 “For juridical help”, Tirana
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**THE CHANGES IN THE PENAL CODE OF THE REPUBLIC OF ALBANIA  
IN THE CONTEXT OF THE ALBANIAN INTEGRATION IN THE EU**

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**Abstract:**

*After the democratic changes in the early 90-s that took place in Albania, the integration process of Albanian State in Europe, demanded the implementation of legal reforms, part of which is the Penal Code of Republic of Albania. "How did the Penal Code of the Republic of Albania has changed in the context of the country's European integration?" is one of the crucial questions posed in this study. The new Penal Code was approved by law no.7895 date 27.01.1995. It is based on the models of modern contemporary penal codes of western democratic countries, such as: France, Germany, Italy etc. and it was in full accordance with the international juridical standards at that time. This presentation aims to analyze the changes that this code was subjected to, due to the signing and implementation of several European Conventions. It is based on a detailed observation and the use of scientific research and comparative methods to highlight the connection between the European Conventions ratified by the Republic of Albania, as important international documents which are sources of the Penal Code of the Republic of Albania, as part of Internal Law. The conclusion of the study claims that the changes in the Penal Code have played a crucial role in the European integration of Albania*

**Keywords:** *The Penal Code of the Republic of Albania, changes, European Conventions, integration, ratification, law, article.*

**JEL Classification:** *K19.*

**Introduction**

After the downfall of the totalitarian regime and the shift to political pluralism, the Albanian State found itself in front of new challenges in all aspects of life, including the Penal Law. The new orientation of Albanian politics aimed to transform the former system of Penal Justice and reshape it on democratic and Western-oriented basis. In the framework of these changes, the Constitution of 1976 was abolished, and a new law "On the Main Constitutional Dispositions" was approved. This law provided new juridical basis for the whole new legislation and Penal Justice System. The new Penal Code was drafted upon "The Main Constitutional Dispositions" according to the democratic principles, and after the patterns of the Western democratic countries codes. It was approved in 1<sup>st</sup> June of 1995.

The Penal Code of the Republic of Albania is a material penal law which constitutes the main source of the Albania Penal Justice. It is a highly important act which serves as a powerful weapon in the struggle against crime, in order to protect the citizens. Since the time of its approval to nowadays, the Albanian Penal Code has undergone a lot of changes due to the criteria demanded for each country aspiring to become part of the EU.

Reforms in the Justice System is one of the necessities which importance is continually emphasized from the international observes, especially the European Commission. In the short term objectives of partnership, the European Commission demands:

[...the finalization, adoption and implementation of reforms in the Justice System].

The purpose of this study is to analyze “**How has the Penal Code of the Republic of Albania changed during the European Integration Process?**” This analysis will be made by highlighting the changes of Penal Code, alongside with the European Conventions signed by Albania, which conditioned the changes in the Penal Code, as one of the main factors leading Albania towards EU integration.

- **A brief historic overview on the develop of the Penal Code in Albania**

The Albanian Penal Code, as a crucial part of the Penal Justice, has been drafted and developed parallel to the evolution of the Albanian State. The History of the Penal Justice in Albania begins with the foundation of the Independent Albanian State and the Government of Vlora in 1912.

*[The period between 1912-44 is very short compared to the ancient history of our nation, though if we consider its developments and dynamics, we can call it one of the most important ones.]*

The great changes that took place during 1912 – 1944 had a huge effect on the field of Penal Justice. Because of several obstacles such as the beginning of the First World War; claims of neighboring countries over the Albanian territory, and the social disputes within the country, the efforts of the Government of Vlora for the foundation of the new Albanian state were not successful till 1920. The Government of Vlora has passed a number of different laws in the attempt to organize the Penal Justice in Albania, but it could not issue a Penal Code. After Ahmet Zogu came to power, 1920-28, new laws, among which a penal Code, were approved.

In the same time, the presence of the Traditional Right (the Kanun) was strongly felt, especially in the mountainous regions of the country. The Albanian Penal Code which was created based on the Italian Penal Code (1889) was approved on 01.06.1928. The approval of this Code marked the division of the Albanian Penal Justice from the Ottoman influence, and its orientation to Western European democratic principles. During 1939 – 1944 Albania was under foreign invasion and the Penal Justice was an instrument of the invaders. During 1945-1990, Albania was under the Dictatorship of the Proletariat and the War of Social Classes. The penal Justice and the Penal Code served to the State-Party. The Penal Codes of 1952 and 1977 had some dispositions which protected the principle of law, but they were far from meeting the democratic standards.

In 1990 the totalitarian regime collapsed and it was replaced by a democratic system. This change was reflected also in the country's laws. For the first time after the totalitarian era, the fundamental principles of a democratic law state were reflected in the law 7491, approved on 24.01.1991 ‘*The main Constitutional Dispositions*’ which was partly changed with the law 7561, approved on 29.04.1992. Based on these principles, the new Penal Code was approved by the law 7895 date 27.01.1995. The Code was drafted according to the patterns of some democratic European states such as: Italy, France, and Germany. For the time speaking, they corresponded to some extent to the international standards. One the main characteristics of this Code was the innovation of a new concept concerning the relationship between the state and the individual. If the law had hitherto protected the interests of the State-Party, now the individual was in the focus. Since the approval of the Penal Code in 1995, Albania has made a series of important legal reforms. One of the most important ones is the Constitution of the Republic of Albania, passed in 1998, the fundamental act of the Albanian State. There were also a lot of ratified international agreements and treaties which brought about eventual amendments in the Penal Code.

*[Legal and Institutional reforms in the Albanian Justice System began in 1998 and are still continuing to be implemented aiming at the improvement and the alignment of the Albanian legislation with the Western European one, and the establishment of a contemporary and democratic legal and judicial system.]*

The Penal Code has been amended with 12 laws which changed 115 of its articles, while 7 articles are abolished and 107 are changed. New dispositions have been added and existing ones have been amended.

To put it in other words, 50 % of the Penal Code is amended due to the tendency to bring it as close as possible to the models of the Penal Codes of the Western Countries, with the final purpose to fulfill the EU standards and achieve the integration of Albania.

- **The international acts ratified by Albania which are applied in the Penal Code**

Following the transition into a democratic system in the early 90-s, Albania ratified a series of international acts, which were also incorporated in the country's legislation, and brought about the amendment of the existing laws or the approval of new ones. The Penal Code approved in 1995 made use of the democratic principles by following the example of European countries. After the 1995, Albania ratified a series of international acts related to the Penal Justice:

- The Convention "Against all Forms of Discrimination to Women" (CEDAW) 1978 ratified by the law 7767, date 09.11.1993 and the additional protocol of this convention (2003) by the law 9052 date 17.04.2003;
- The European Convention of Human Rights (04.11.1951) and its additional protocols 1;2;4;7 and 11 ratified by Albania by the law 8137, date 31.07.1996;
- The Convention "On the Prohibition and Prevention of illegal Import, Export and Transfer of Cultural Assets" approved by the 16<sup>th</sup> session of the General Conference in Paris on November 14<sup>th</sup> 1970 UNESCO. Albania adheres to this convention since 09.09.1999 by the law 8523;
- "Hague Convention" On Protection of Children and Co-operation on Adoptions abroad, ratified by law 8624 date 24.06.2000;
- The European Convention "Against Terrorism" (Strasbourg 27.01.1977) ratified by Albania by law 8642 date 13.07.2000;
- The European Convention "On the Confiscation of Crime Products" (Strasbourg 08.11.1990) ratified by Albania by law 8646 date 27.07.2000;
- The UN convention "Against the illegal Trafficking of Narcotics and Psychotropic substances" (1988) in which Albania adhered by law 8722 date 26.12.2000;
- International Convention "On Mutual Assistance for the Prevention of Customs Violations" Nairobi (09.06.1977), in which Albania adhered by law 8759 date 26.03.2001;
- Convention No. 182 "Worst Forms of Child Labor" (1999) of 'International Labor organization" ratified by law 8774, date 23.04.2001;
- Convention "Against Criminal Corruption" (Strasbourg 27.01.1999) ratified by law 8778 date 26.04.2001, amended by law 9369, date 14.04.2009;
- The UN Convention "Against International Organized Crime" and its two additional protocols, ratified by law 8920, date 11.07.2002;
- The optional protocol of the Convention Against Torture and Cruel, Inhumane and Humiliating Treatment and Punishment" ratified by law 9094 date 03.07.2003;
- European Convention "On Relationship with Children" ratified by Albania by law 9359, date 24.03.2005;
- Convention of The Council of Europe "Against Trafficking of Human Beings" ratified by law 9642, date 20.11.2006;
- Convention of The Council of Europe "On Searching, Identifying and Confiscating the Assets of Organized Crime Financing Terrorism" ratified by law 9646 date 27.11.2006;
- International Convention of UN "Protection of all Individuals against Forced Exile" (Paris December 20<sup>th</sup> 2006) ratified by law 9802 date 13.09.2007;
- Convention of The Council of Europe "Protection of Children Against Sexual Abuse and Exploitation" ratified by law 10071 date 09.02.2009.

Some of these acts have a particular importance and effect on the Penal Code and are worth mentioning.



- **“The European Convention of Human Rights” (04.11.1950)**

It was ratified by law 8137 date 31.07.1996 and it constitutes an international act of particular importance. The protection of the fundamental rights and freedoms listed in this convention has been foreseen in the Albanian Penal Code and there are dispositions that foresee violation of Human Rights as criminal acts, which are punished by law. For instance: The right to life (articles 73-85); Prohibition of torture (articles 85-86); Prohibition of slavery and forced labor (articles 74-75); The right to freedom and security (articles 109 – 111. 261-293); The right to a regular process in court (articles 300-324); There is no punishment unless predicted by law (articles 2-3); Freedom of speech, opinion and faith (articles 131-132); Freedom of expression (article 261); Freedom of coming together and being part of an organization (article 261); The right of marriage (article 130); Prohibition of discrimination (articles 119/a, 253, 265).

- **The Convention “Against Criminal Corruption”**

It was ratified by law 8778 date 26.04.2001 and amended by law 9369 date 14.04.2009. The phenomenon of corruption is seen in this convention as a serious threat to a lawful state, to the democracy in general and Human Rights, to the honest competition, economical development and the stability of the democratic institutions and fundamental moral values. Corruption is an increasingly problematic phenomenon in our society due to the recent social and economical transition in Albania. With the approval of the new Penal Code, it was necessary to strengthen the dispositions against this penal offense.

The law 7895 date 27.01.1995 in the articles 259, 260 states that bribing is an offense punishable by law. The later relevant articles 244/a, 259/a, 319/a, 319/b, 319/c, 319/d and 319/dh, completed the legal framework in order to identify and punish corruption in all its forms. The amended articles offer a more definite view of the potential subjects of this offense, but the dispositions of punishment are more moderate than they used to be.

### **2.3 The Convention “Against all Forms of Women Discrimination” (CEDAW) 1978**

This convention was ratified by the Albanian Parliament by law 7767 date 01.11.1993, whereas its additional protocol (2003) by law 9052 date 17.04.2003. The article 1 of the Convention states:

*“Every deliberate distinction or gender-based limitation that aims to hamper a woman, in spite of her marital status, from cherishing the Human Rights and her engagement in politics, economy, cultural or whatever social field, constitutes a penal offense.”*

This principle is one of the most important constitutional factors and it extends to all the dispositions of the Penal Code which applies to all citizens regardless of their gender.

### **2.4 The Convention on the Rights of Children**

The Declaration of Children Rights defines “A child is physically as well as intellectually immature, therefore he/she needs special care and protection, including the juristic aspect, before and after birth.” The juridical protection of children materializes in the articles 124-129 of the penal Code. Since children were often victims of physical and psychological violence, the respective changes have been applied to the Penal Code.

- **The changes of the Penal Code due to the international acts ratified by Albania**

The approval of the Constitution (1998) and the ratification of a series of international acts after 1995 brought about the necessary adjustments in the Penal Code in order to bring the legislation closer to the standard of the democratic countries of the EU and help the integration of Albania in it. These changes included new modern criminal acts, such as: organized crime, illegal trafficking, corruption, and terrorism, computer hacking and domestic violence

- **Law 8175 date 23.12.1996**

This is the first law which brought a change in the Penal Code after the ratification of several acts, including the Convention of the Human Rights. This law made some changes related to the reduction of the punishment below the limits foreseen by law; suspension of the execution of imprisonment and release on parole. On the other hand, the law brought some changes in the dispositions related to the heavy crimes, such as: murders, sexual crimes, kidnapping, by predicting a fixed punishment for the criminals, regardless of the circumstances. This step prevented the personalization of the punishment, by violating the “Right of a regular process”, foreseen in the article 6 of the Convention of Human Rights. These irregularities brought about the decision 13 date 29.05.1997 of the Albanian Constitutional Court, which disabled these dispositions as unconstitutional, and induced the lawmakers to do the necessary adjustments in the Penal Code. This decision was followed by law 8733 date 24.01.2001, which constituted the relevant changes in the Penal Code.

- **Law 8204 date 11.04.1997**

By means of this law, the article 89/a was added to the article 89 in Chapter II of the Session III of the Penal Code, stating that the illegal trafficking of human organs is an offense punishable by law. There was a gap in the Penal Code hitherto and therefore, it was necessary to have this addition made, to better protect the Human Rights and Freedoms. These kind of offenses had been widespread in the other democratic countries before finding their way into to the inexperienced Albanian terrain.

- **Law 8733 date 24.01.2001**

This law played a key role in changing and amending the Penal Code to complete the legal framework in the struggle against penal acts in accordance with many newly ratified international acts. One of the most important changes was the abolition of the Death Penalty, in article 79 of the penal Code. This change was made in respect to Protocol 6 of the European Human Rights Convention, and was passed through the decision 65 of the Albanian Constitutional Court on 10.12.1999.

This law brought about the following additions to the Penal Code:

- Article 1/a which accepts the concept of orientation according to the general principles of International Justice and the international acts ratified by the Albanian State.

- Article 1/b ranks among the duties of the penal legislation the following tasks: the protection of the country's independence and territorial integrity; the human dignity; the constitutional order; private property; environment; coexistence and positive attitude to the national minorities and religious freedom.

- Article 1/c defines as part of the Penal Code such principles as “Equality before law”, “Justice in pledging one as guilty and the given sentence” and “Humanism”. All these principles are set in accordance to “The right of a regular process” foreseen in the European Convention of Human Rights.

- In the article 7, point “d” was added to charge with penal responsibility each foreign citizen who commits the following felonies in the Republic of Albania: organization of prostitution; human trafficking; the production and trafficking of weapons and narcotics or psychotropic substances, the production or trafficking of nuclear substances; the trafficking of works of art or other objects of historical, cultural or archeological value.

- In the article 50/b of the Penal Code it was added that committing a penal offense with purpose of material gain was an aggravating circumstance.

In the special part of the Penal Code there were added new dispositions related to: the right of life (articles 83/a, 298/2); personal health (articles 88/a, 88/b, 96/2), personal freedom (article 109/a), human trafficking (110/a, 114/b, 128/b); children's rights (article 128/a); trafficking of works of art and culture (article 138/a), trafficking of vehicles (article 141/a); the right of property (article 143/a); smuggling (articles 175, 178); forging of coins, banknotes and checks (articles 183, 184, 185/2); the concealment or stealing of documents (192/a); computer hacking (192/b); money laundry (287/a); justice (313/a); 320/a).

This law also changed the penal approach to offenses related to crimes against humanity (article 74); murder (articles 77, 78, 79); personal freedom protection (articles 109, 110); thefts (articles 134,136,137,138,140); narcotic substances (articles 238,236).

Furthermore, in respect to the personal private life, the term “Sexual Relationship” was replaced with “Sexual or Homosexual Relationship” in the articles 100-107 of the Penal Code.

All these amendments were made in coherence with the developments of the democratic system and with the spreading of new kind of offenses, which had not been popular in Albania. They were also the direct outcome of a series of international acts ratified by Albania after the approval of the penal Code in 1995, for instance: The European Convention of Human Rights; the Convention “On prevention of illegal trafficking of cultural property”; the European Convention “Against terrorism”; The UN Convention “Against illegal trafficking of narcotic or psychotropic substances”; the International Convention “On mutual assistance for the identification and preventions of customs violations”.

- **Law 9030 date 24.01.2001**

With this law it was added the article 257/a according to which, employees of the administration, or elected politicians, commit a penal offense if they fail to declare their financial wealth or attempt to conceal it by fraud. This change is an outcome of the Convention against corruption.

- **Law 9086 date 19.06.2003**

By means of this law new dispositions were added to the Penal Code in relation to: concealment of the products of a penal offense (articles 7/h, 179/a, 287/a) and the financing of terrorism (article 230/a). These changes were an enhancement of the Penal Code in accordance with the European Convention “On the identification and confiscation of crime products”. It was also a better involvement of the UN convention against the international organized crime together with its two additional protocols.

- **Law 9188 date 16.09.2004**

By means of this law several dispositions were added: article 110/a “Trafficking of Persons”; 114/b “Trafficking of Women”, and 128/b “Trafficking on Children”. The articles 297 and 298, in relation to illegal crossing of the border, were changed. These changes and additions reflected the UN Convention against international organized crime and its two additional protocols.

- **Law 9275 date 16.09.2004**

By means of this law, several approaches to some penal offenses were added or changed. For instance: There were added some dispositions in relation to the active and passive corruption in the public as well as in the private sector (articles 164/a, 164/b, 245/1); the article 170/a “Dishonest and violent competition”; some dispositions on terrorism and its financing (articles 230/b, c); article 234/a “On criminal organizations”; article 234/b “On armed bands”; some dispositions related to witness protection (articles 312/a, 313/a); “Passive corruption of judges, prosecutors, and other functionaries of the Organs of Justice” article (333/a.) There were also changes in: article 28: where new specifications of criminal co-operation were added: criminal organizations; terrorist organizations; armed bands and structured criminal groups; some dispositions on the active and passive corruption in the public sector as well as legislative one (articles 244, 245, 259, 260, 319); article 312 “The active corruption of the expert, or the translator”. These changes brought about further improvement of the domestic penal law in respect to the Convent of Fundamental Human Rights; the Convent on Corruption; The European Convention “Against Terrorism”; the UN Convention against international organized crime and its additional protocols.

- **Law 9686 date 26.02.2007**

By means of this law, it is added the article 7/a “Universal Jurisdiction” according to which, the penal law of the Republic of Albania is applicable even to the foreign citizens within the territory of Albania and not under the procedure of extradition, who have committed crimes against humanity; war crimes; genocide; terrorism or torture. This change was made in accordance to the optional protocol of the Convent “Against Torture and Cruel, Inhumane and Humiliating Treatment and Punishment”; the European Convent “Against terrorism” the UN Convent against International Organized Crime and its two additional protocols. In the article 50, the motives of gender, race, religion, nationality, language and political convictions were added as aggravation circumstance to the penal offense. An innovation of this law was the addition of the penal offense “Urge someone to kill for blood feud” (article 83/b), in protection of the right to life. In accordance with the optional protocol of the Convention “Against Torture, Cruel and Inhumane Treatment”, the article 86/b was also amended.

Changes were made to the title of Chapter VII "Terrorist Acts", along with a series of dispositions related to the penal offenses this title encompasses (articles 230-232). These changes were the outcome of the ratification of the Convention of the Council of Europe "On the Identification and Confiscation of Products of Crime and Financing of Terrorism".

Changes were made to the dispositions of the penal offenses against Justice (315) and to the articles 295/a; 305/a; 305/b; related to the revealing of secrets and false testimonies. These changes were made in favor of the right to a regular process, predicted in the European Convention of Human Rights.

- **Law 9859 date 21.01.2008**

This law was subjected to the addition of the article 124/b which predicts the penal offense of physical or psychological abuse to the minor, or the enforcement of the later to work, to beg, or to do whatever activity that hampers normal growth by his tutor. This change is attributed to the ratifications of the European Convention "On the relations with Children".

- **Law 10023 date 27.11. 2008**

By means of this law, a series of new dispositions were added in favor of the right to property (articles 137; 156; 159) and discrimination prevention such as "Web Threatening based on racism or xenophobia" (article 84/a); "Distribution of racist or xenophobic materials through the Web" (article 119/a).

- **Law 23 date 01.03.2012**

Many penal dispositions have been changed by this law. They are mostly related to the right of property and election. There have been also some additions such as: article 9 "On International Protection of Individuals" related to the procedural warranties of the foreigners; article 121/a "Persecution" in favor of the right to security; some dispositions related to domestic violence, (articles 143/a/1; 143/a/2; 143/a/3; 149/a); some dispositions related to the active or passive corruption of domestic or foreign public functionaries such as: domestic or foreign judges or jurors, in favor of the right to a regular process (articles 326/a; 327/a; 328/1; 330/a). All these changes are enhancements of the Penal Code according to the European Convention for the "Protection of Children against Sexual Abuse and Exploitation" ratified by law 10071 date 09.02.2009.

- **The effect of the changes to the Penal Code in the EU integration of Albania**

One of the priorities of Albania for the period 2011-13 is the reformation and the improvement of the Justice System in terms of efficiency and transparency in the service to the community. Thanks to its amendments, the Penal Code has played a key role in the struggle against criminality, especially the organized crime.

*[The legal reform in the Penal Justice has been extended in the legislative system also, by having as a focal point the Constitutional principle and the orientations of the European Council for the preservation of the independence of the legislative power; the struggle against corruption and the further improvement in the organization of the Prosecution Office and the Judicial Police. These laws have been a subject to multiple reforms. As a matter of fact, the realization of the reform is still in process, and to carry it on, is one of the crucial criteria for the integration of the country in the EU.]*

Another strategic objective of Albania is to consolidate the public's trust in the Justice System, parallel to the performance of the government and the functioning of the Law State, through fighting the corruption as well as the other negative phenomena which hamper the country's path towards EU. In the framework of international acts ratified by Albania, there have been also changes in the inner legislation, including the Penal Code. It has been often the case when the implementation of these acts in the amendments of the Penal Code, has been unjustifiably long. This has led to a violation of the principles of International Acts.

*[With all the positive changes made with respect to legislation, there is still need for the legal modification and amendments. What is more important, laws and convention approved and ratified by the Republic of Albania need to be better implemented in the field.]*

There are cases when these acts have not been incorporated in the Albanian inner Law. Nevertheless, the Albanian Constitution clearly states the importance of the international agreements by giving them priority through the articles 4/1; 5 and 116 of the Constitution. In the cases when the amendments have been included, still it is sometimes difficult for the judges and other officials to be up to date because of eventual gaps in their professional competence. In spite of all the modifications made so far, there is still room for improvement concerning the reformulation of different dispositions of the penal Code with the purpose to have them as clearly set as possible. All these steps are significant factors in the fulfillment of the conditions of integration of Albania in EU.

### **Conclusions:**

- After the downfall of the totalitarian Communist Regime in the early 90-s, Albania adopted a democratic system after the pattern of democratic states throughout the World. This shift brought about considerable changes in the Albanian law, including the Penal Code.
- The democratic principles of a Law State and a series of international acts ratified by Albania were implemented in the Penal Code of Albania, approved in 1995.
- In the framework of institutional reforms, even after 1995 Albania kept ratifying numerous international acts, which brought about the relevant amendments in the Penal Code.
- The amendments to the Penal Code have often been subjected to further changes, which indicates a defect in the stability of the law, and violates the right of security recognized by the European Convention of Human Rights.
- The institutional reforms carried out during the recent years, including the changes in the Penal Code, have been oriented towards the European standards in order to consolidate the democratic system and the respect of the fundamental Human Rights.
- The update of the Penal Code with the European Standards brought about the involvement of new penal offenses such as: organized crime; illegal trafficking; corruption; terrorism; domestic violence; computer hacking and so on.
- Sometimes the amendments in the Penal Code were not in accordance with the Constitution. Therefore the Constitutional Court took the matter in hand.
- In some cases, the principles of the international acts aren't included in the Penal Code, nevertheless, the Albanian Constitution gives absolute priority to the international acts versus the domestic law.
- The level of implementation of the international acts by the Albanian court is not satisfying. This is largely due to the lacks of information and professionalism.
- The amendments of the Penal Code, as a part of the multilateral reforms in the Albanian Society, are very important for the integration of the country in the EU.
- In spite of the changes made so far, there is still a lot to be done concerning the formulation of new dispositions because they are often unclear.

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**THE NEW YORK CONVENTION VERSUS ALBANIAN LEGAL FRAMEWORK ON THE RECOGNITION AND ENFORCEMENT OF INTERNATIONAL ARBITRAL AWARDS**

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**Abstract:**

*The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) is described as the most successful treaty in private international law. For more than half a century this document has contributed to the protection of incomparable values of free trade. In this way it served well also to the interests of human society, providing a valuable contribution to the world economic development. Legal instruments of recognition and enforcement of foreign arbitral awards in the Republic of Albania do not justify the rightful place of arbitration mechanism in resolving international commercial disputes. The domestic normative framework that governs the enforcement of such awards is not fully sufficient. Albania has ratified the New York Convention more than 40 years after its entry into force, but that's not enough. In fact, the enforcement of arbitral awards which resolve international commercial disputes is facing with the lack of a modern legal framework and an unconsolidated jurisprudence. Since last 10 years, the New York Convention is part of albanian legal order, but its implementation is not appropriate. Mostly this is due to the lack of approaching process of the albanian legislation to the international standards in this field. Adoption and implementation of legal instruments in accordance with the international legal framework, for the recognition and enforcement of foreign arbitral awards, will be a good service to the integration process of the Albanian economy.*

**Keywords:** arbitration, convention, enforcement, award, disputes, international.

**JEL Classification:** K33.

**Introduction****International arbitration and its values in the global economy.**

In recent years, globalization has brought the spirit of breaking down cultural and social barriers between people and particularly has accelerated communication and economic cooperation between states. In this context, legal issues regulating these relations can not remain within national frameworks but have received more and more an international prospective. A clear example of this context is the international commercial arbitration. The great increase of the international trade and companies investment in foreign countries is associated with the tendency to transform the international commercial arbitration into a mechanism used increasingly to settle disputes arising from these relationships.

What is international arbitration?



International arbitration is a consensual way or means by which international disputes can be definitively resolved, pursuant to the parties' agreement, by independent and non-governmental decision-makers, which produce a final decision, legally binding and enforceable through national courts<sup>523</sup>.

There is a principle in the heart of this method, which has been described by Mr. Michel Gaudet<sup>524</sup>, honorary president of the International Court of Arbitration at ICC: "**The purpose of arbitration is not to provide from the relevant law a decision against parties involved in the dispute, but to clarify, together with the parties, what should be done in a given situation, to achieve justice in collaboration**". The arbitration method creates understanding between the parties to the dispute, without leaving trace of intolerable bitterness behind<sup>525</sup>. Above all International Arbitration avoids the difficulties and uncertainties created eventually by the submission to the jurisdiction of the court of another country.

Unease at playing in the other side's home court begins in childhood. For international business lawyers, it never goes away. Global deal makers are very wary of the home court advantage, harboring mistrust of each other's legal systems, where the rules are unfamiliar and the results are at best unpredictable and at worst actively hostile.

When the parties come from different political systems, there also is mistrust of the underlying substantive law; mistrust of the procedural fairness of the forum where that law is to be invoked; and mistrust of the enforceability of judicial or arbitral decisions.

As a transnational tool for dealing with conflict, international arbitration is a way to create trust between foreign entities and their local business partners, even in the face of vastly different legal systems and laws. Arbitration is a way to resolve disputes according to internationally accepted norms, promising a fair process. In other words, it avoids either side's home court<sup>526</sup>.

The popularity of arbitration as a means for resolving international commercial disputes has increased significantly over the past several decades<sup>527</sup>. Number of cases resolved, for example from the world's leading international arbitral institution – the International Chamber of Commerce<sup>528</sup> – is large enough to justify the statement that actually judicial system has a worthy opponent.

#### **New York Convention<sup>529</sup>, a success of private international law.**

Although arbitration is consensual, the enforcement of the arbitral awards is not.

<sup>523</sup> Gary B. Born, *International Commercial Arbitration in the United States: Commentary and Materials* (The Netherlands: Kluwer Law and Taxation Publishers, 1994), p.1.

<sup>524</sup> Former Chairman of the ICC International Court of Arbitration.

<sup>525</sup> International Arbitration and National Courts: The Never Ending Story. [A.J. van den Berg, Permanent Court of Arbitration. International Bureau, International Council for Commercial Arbitration.](#) Kluwer Law International, 2001.

<sup>526</sup> How International Arbitration Bridges Global Markets in Transition Economies, CPR Institute for Dispute Resolution VOL.22 NO.9 October 2004, by Lucy V. Katz.

<sup>527</sup> Gary B. Born, *International Commercial Arbitration in the United States: Commentary and Materials* (The Netherlands: Kluwer Law and Taxation Publishers, 1994), p.7.

<sup>528</sup> [Court of Arbitration of International Chamber of Commerce](#) - is renowned for its unmatched experience and expertise in international commercial dispute resolution. Established in 1923 as ICC's arbitration body, the International Court of Arbitration pioneered international commercial arbitration as it is known today, initiating and leading the movement that culminated in the adoption of the New York Convention, the most important multilateral treaty on international arbitration.

<sup>529</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards - was prepared and opened for signature on 10 June 1958 by the United Nations Conference on International Commercial Arbitration, convened in accordance with resolution 604 (XXI), of the Economic and Social Council of the United Nations adopted on 3 May 1956. The Conference met at the Headquarters of the United Nations in New York from 20 May to 10 June 1958.

Nothing worries the parties on dispute more than discovering, after a long and costly procedural "battle", that the arbitrator's decision can not be applied. Parties want money and not a piece of paper stating the fact that they are right. Perception for the applicability of the decision is likely to influence the decision of a businessman to choose arbitration or court jurisdiction to resolve his dispute and also the decision to determine the place of arbitration. It can even influence the decision to fund or to make business.

An empirical study of why parties choose international arbitration to resolve disputes found that the two most significant reasons were (1) the neutrality of the forum (that is, being able to stay out of the other party's court) and (2) the likelihood of obtaining enforcement, by virtue of the New York Convention<sup>530</sup>.

Convention on the Recognition and Enforcement of Foreign Arbitral Awards, adopted in New York, 10 June 1958 (hereinafter the New York Convention), is described by an eminent personality of the field - Albert Jan van den Berg<sup>531</sup> - as the most successful treaty on private international law. It is being applied today in 145 countries worldwide, becoming part of their national legal framework<sup>532</sup>. This Convention has been defined as the "super-oil for the complex machine" (international commercial arbitration), which has made the explosion of global trade possible over the last fifty years.<sup>533</sup> In short, the New York Convention directly affects the lives of billions of people around the world, every minute of every day, in both seen and still more unseen ways<sup>534</sup>.

Impact of the New York Convention on the development of international commercial arbitration has been phenomenal, consolidating the two basic pillars of the regulatory framework in this field. First it ensured the mandatory implementation of any foreign arbitration award in the member States of the Convention. Second, the Convention fundamentally altered the relationship between arbitration agreements and jurisdiction of ordinary national courts, because the contracting states agreed that valid arbitration agreements constitute a sufficient legal reason for the ordinary courts to declare their lack of competence in favor of arbitration<sup>535</sup>.

These two important pillars give to arbitration the value of a serious institute which provides non-judicial resolution of commercial disputes. So the New York Convention is probably the main reason why arbitration is the most preferred method for resolving international business disputes. The increasing number of Convention signatory countries has affected the international trade development and has attracted foreign investment.

## **I. The mechanism established by the New York Convention**

### **1. Historical factors determining the birth of the Convention.**

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<sup>530</sup> The Principles and Practice of International Commercial Arbitration; Margaret L.Moses 2008, Cambridge University Press, f.3.

<sup>531</sup> Albert Jan van den Berg, Brussels, Belgium. President, Netherlands Arbitration Institute, Rotterdam. Professor at law (arbitration), Erasmus University, Rotterdam. General Editor, Yearbook: Commercial Arbitration.

<sup>532</sup> Website - <http://untreaty.un.org/cod/avl/ha/crefaa/crefaa.html>.

<sup>533</sup> The Review of International Arbitral Awards, editor.E.Gaillard; V.V.Veeder "Is There a Need to Revise the New York Convention?" (Keynote Speech, IAI Forum, Dijon, 2008), p.185, par.4

<sup>534</sup> The Review of International Arbitral Awards, editor.E.Gaillard; V.V.Veeder "Is There a Need to Revise the New York Convention?" (Keynote Speech, IAI Forum, Dijon, 2008), p.186; par.1.

<sup>535</sup> New York Convention, art.II (3) - *The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article at the request of one of the parties, refer the parties to arbitration.....*

After the second world war, the countries need for economic development affected the expansion of international trade. International arbitration at that time was regarded as a successful means for resolving disputes in this field. But the effectiveness of this mechanism had been put in question, because of the difficulties raised in connection with enforcement of arbitral awards in different countries.

The rapid growth of international trade would increase more and more the requirement for prompt and effective resolution of related disputes. But the system established under the 1927 Geneva Convention on the Execution of Foreign Arbitral Awards no longer corresponded to these requirements. Consequently, the conclusion of a new Convention on more liberal terms than the Geneva Convention of 1927 was generally regarded as the most urgent task in the field of international commercial arbitration<sup>536</sup>.

The initiative to replace the Geneva treaties came from the International Chamber of Commerce (ICC)<sup>537</sup>, which issued a preliminary draft convention in 1953. The ICC's initiative was taken over by the United Nations Economic and Social Council<sup>538</sup>.

The Convention was prepared and opened for signature on 10 June 1958 by the United Nations Conference on International Commercial Arbitration, which met at the Headquarters of the United Nations in New York. At the end of the conference, after 4 years of effort<sup>539</sup>, the New York Convention<sup>540</sup> was born. It would spell the end of the Geneva Convention and the start of a new spirit of international commercial arbitration.

## 2. Features of the New York Convention.

### 2.1. Convention's field of application.

The Convention's title and its first article refer to the recognition and enforcement of "foreign arbitral awards" arising out of differences between persons, whether physical or legal<sup>541</sup>. Which arbitral awards are to be considered as "foreign", and hence which fall under the Convention's field of application, is defined in Article I of the Convention.

Paragraph 1 of Article I contains two definitions for a foreign award. The first definition, set forth in the first sentence of paragraph 1, is an award made in the territory of a State other than the State where recognition and enforcement are sought. The second sentence of the paragraph also provides that it applies to the recognition and enforcement of an arbitral award which is not considered as a domestic award in the State where recognition and enforcement are sought (second sentence). With this second definition of "foreign arbitral awards", the convention drafters took the view that parties can agree to arbitrate in one country under the arbitration law of another country.

<sup>536</sup> Memorandum by the UN Secretary General: "Recognition and enforcement of foreign arbitral awards" – document of the United Nations Economic and Social Council, no. E/2840, 22 March 1956, p.3, par.5.

<sup>537</sup> The International Chamber of Commerce (ICC) is the largest, most representative business organization in the world. Its hundreds of thousands of member companies in over 130 countries have interests spanning every sector of private enterprise. It was founded in 1919 to serve world business by promoting trade and investment, open markets for goods and services, and the free flow of capital. The organization's international secretariat was established in [Paris](#) and the ICC's [International Court of Arbitration](#) was created in 1923.

<sup>538</sup> The Report of the "ad hoc" Committee on the Enforcement of International Arbitral Awards – document of the United Nations Economic and Social Council, no. E/2704, E/AC.42/4/Rev.1, p.1, par.1,2.

<sup>539</sup> The "Ad hoc" Committee on the Enforcement of International Arbitral Awards, was set up on April 6, 1954.

<sup>540</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards - New York, 10 June 1958. Entry into force: 7 June 1959, in accordance with article XII. Registration: 7 June 1959, no. 4739. Status: signatories: 24. parties: 146. text: United Nations Treaty Series, vol.330, p.3.

<sup>541</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art.I, par.1..

In this way the Convention makes the award nationality or national associations of the parties to the award immaterial for the purposes of its implementation<sup>542</sup>. This is because arbitration awards will be recognized and enforced regardless of the country where the award was made and the nationality of the parties in dispute.

## 2.2. Convention obligations to a contracting state (a state who has adopted the Convention)

### a. Recognition and enforcement of foreign arbitral awards

Any country that accepts the Convention (it means any state that has signed, ratified or accede to the Convention after the entry into force), is legally obliged, under international law principles (inter alia, the principle of *pacta sunt servanda*), to recognize and enforce all kinds of arbitration awards that in terms of the Convention are considered as “foreign arbitral awards”.

The Convention also provides limits for this obligation, because when signing, ratifying or acceding to the Convention any state has the right to two reservation<sup>543</sup>: **Reciprocity reservation** and **Commercial reservation**. The first reservation permits contracting States not to be bound to apply the Convention to awards made in a State that does not accept the Convention. The second reservation permits a State to reserve the applicability of the Convention only to differences arising out of legal relationships, which are considered as *commercial* under the national law of the State making such reservation.

### b. Recognition of international arbitration agreement

The second obligation for any state accepting the Convention lies in the recognition of written arbitration agreement. Under the provisions of the Convention we can use this definition: “An arbitration agreement is an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration<sup>544</sup>.”

The same sense to the arbitration agreement is drawn from the UNCITRAL Model Law<sup>545</sup>. This definition confirms the validity and effect of a commitment by the parties to submit to arbitration an existing dispute (“*compromis*”) or a future dispute (“*clause compromissoire*”) <sup>546</sup>.

### c. Exclusion of jurisdiction of the National Court

The court of a Contracting State, when seized of an action in a manner in respect of which the parties have made an agreement within the meaning of this article at the request of one of the parties, refer the parties to arbitration unless it finds that the said agreement is null and void, inoperative or incapable of being performed<sup>547</sup>. This important clause repeats the guarantee given by the first paragraph of article 2 of the Convention to the legal value of the expressed willpower of the disputing parties for submission to arbitration. This willpower exclude the jurisdiction of a national court to resolve the dispute between the parties, forcing also the court to address this dispute in the arbitration forum selected.

<sup>542</sup> The United Kingdom comments on the draft Convention on the Recognition and Enforcement of International Arbitral Awards - document of the United Nations Economic and Social Council, no.E/2822, Add.4, 3 April 1956, p.3, par.2

<sup>543</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art.I, par.3.

<sup>544</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art.II, par.1.

<sup>545</sup> UNCITRAL Model Law on International Commercial Arbitration 1985, with amendments as adopted in 2006 (United Nations documents No.A/40/17 and No.A/61/17, annex I), art.7, par.1: “Arbitration agreement” is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not”.

<sup>546</sup> Explanatory note by the UNCITRAL Secretariat on the model law on International Commercial Arbitration, p.28, par.19.

<sup>547</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art.II, par.3.

*d. Not applying differential procedures in the effective implementation of awards.*

There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards to which this Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards<sup>548</sup>. A state that has adopted the Convention should treat equally and not differently, in terms of procedural bureaucracy, the recognition and enforcement of domestic arbitral awards against foreign ones.

### 3. Grounds for refusal of enforcement of an arbitral award.

Article IV is set up to facilitate enforcement by requiring a minimum of conditions to be fulfilled by the party seeking enforcement of a Convention award<sup>549</sup>. That party has only to supply the duly authenticated original award and the original arbitration agreement, or duly certified copies thereof<sup>550</sup>. By meeting these conditions, the party seeking enforcement produces *prima facie* evidence<sup>551</sup> entitling it to obtain enforcement of the award on all contracting states of Convention. It is then up to the other party to prove that enforcement should not be granted on the basis of the grounds enumerated exhaustively in the subsequent Article V(1). It should be emphasized that the conditions mentioned in Article IV are the only conditions with which the party seeking enforcement of a Convention award has to comply.

Article V, which is divided into two paragraphs, includes the grounds for refusal of enforcement of an arbitral award. The first paragraph lists the refusal grounds which are to be proven by the respondent (the party against which enforcement of the award is sought)<sup>552</sup>. That party has the burden of proving that one or some of these grounds exists in the present case. This exhaustive list of grounds for refusal is as follows:

- Lack of a valid arbitration agreement (Article V(1)(a))<sup>553</sup>;
- Violation of due process (Article V(1)(b))<sup>554</sup>;
- Excess of the arbitral tribunal's authority (Article V(1)(c))<sup>555</sup>;
- Irregularity in the composition of the arbitral tribunal or arbitral procedure (Article V(1)(d))<sup>556</sup>;
- The award "has not yet become binding", the award "has been set aside", or the award "has been suspended" (Article V(1)(e))<sup>557</sup>.

<sup>548</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art.III, second sentence.

<sup>549</sup> Albert Jan van den Berg – "The New York Convention of 1958:An Overview".

<sup>550</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art.IV, par.1.

<sup>551</sup> *prima facie* evidence - evidence that is sufficient to raise a presumption of fact or to establish the fact in question unless rebutted.

<sup>552</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art.V, par.1.

<sup>553</sup> The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made;

<sup>554</sup> The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case.

<sup>555</sup> The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognised and enforced.

<sup>556</sup> The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place.

The second paragraph of Article V, which concerns violation of public policy under the law of the forum, lists the grounds on which a court may refuse enforcement on its own motion (*ex officio*)<sup>558</sup>. This second group of grounds for refusal is as follows:

**a. Arbitrability** (article V(2)(a)). This clause permits a court to refuse enforcement of an award on its own motion if the subject matter of the difference is not capable of settlement by arbitration under its law. The non-arbitrability is generally regarded as forming part of the general concept of public policy and thereby the non-arbitrable subject matters differ from country to country<sup>559</sup>.

**b. Other cases of public policy** (article V(2)(b)). This clause allows a court to refuse enforcement of an award on its own motion if the enforcement of the award would be contrary to the public policy of the country where the enforcement is sought. There are a number of diverse cases in which the question of public policy was raised. Cases that are regularly (but almost always unsuccessfully) invoked in practice are the following: *Due process* (the parties have an equal opportunity to be heard); *Procedure* (Irregularities in the arbitral procedure); *Impartiality* (The arbitrator's impartiality); *Reasons* (the award must contain the reasons on which the arbitral decision is based).

The overall scheme of Articles IV-VI is the facilitation of the enforcement of the award. The scheme reflects a "pro-enforcement bias" as certain courts have said. This is also the manner in which Articles IV-VI are generally interpreted by the courts<sup>560</sup>.

The main features of the grounds for refusal of enforcement of an award under Article V are the following:

-The first main feature is that the grounds for refusal of enforcement mentioned above, are exhaustive. Enforcement may be refused "only if" the party against whom the award is invoked is able to prove one of the grounds listed in Article V(1) or if the court finds that the enforcement of the award would violate its national or international public policy (Article V(2)).

-The second feature of the grounds for refusal of enforcement, which follows from the first feature, is that the court before which the enforcement of a Convention award is sought, may not review the merits of the award because a mistake in fact or law by the arbitral tribunal is not included in the list of grounds for refusal enumerated in Article V.

-The third main feature is that the party against which enforcement of the award is sought has the burden of proving the grounds for refusal of enforcement listed in the first paragraph.

-Finally, it is arguable that in a case where a ground for refusal of enforcement is present, the enforcement court nevertheless has a residual discretionary power to grant enforcement in those cases in which the violation is *de minimis*.

These main features are almost unanimously affirmed by the courts<sup>561</sup>.

## II. New York Convention *versus* Albanian legislation on Recognition and Enforcement of Foreign Arbitral Awards

### 1. Legal instruments that provide recognition and enforcement of a foreign arbitral award in Albania.

<sup>557</sup> The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

<sup>558</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art.V, par.2.

<sup>559</sup> Albert Jan van den Berg – "The New York Convention of 1958:An Overview".

<sup>560</sup> Albert Jan van den Berg – "The New York Convention of 1958:An Overview".

<sup>561</sup> Albert Jan van den Berg – "The New York Convention of 1958:An Overview".

Recognition and enforcement of foreign arbitral awards in the Republic of Albania is regulated by two legal instruments: provisions of the New York Convention and the Code of Civil Procedure.

The Albanian parliament has approved the accession of the Republic of Albania in this Convention by law no.8688 dated 09.11.2000 "On accession of the Republic of Albania in the "Convention on the Recognition and Enforcement of Foreign Arbitral Awards". Based on the Constitution of the Republic of Albania<sup>562</sup>, the provisions of the New York Convention after ratification by law have become part of the internal legal system of our country. They are applied directly and prevail over national laws that disagree with them. So the provisions of the New York Convention prevail, in case of conflict, over the provisions of the Code of Civil Procedure, in terms of legal regulations applying for recognition and enforcement of foreign arbitral awards.

The second instrument that regulates the recognition of foreign arbitral awards is the National Law. The provisions relevant to arbitration are found in the "Code of Civil Procedure of the Republic of Albania"<sup>563</sup> (the "CCP"). Part II, Title IV ("Arbitration", art. 400 – 439) is a special title in the Albanian CCP regulating arbitration. The provisions of Title IV are applicable to arbitration procedures when: (i) the participants in the case have their place of residence in Albania and (ii) when the place of arbitration is within the territory of Albania<sup>564</sup>. The arbitration chapter of the CCP focuses on the procedures for domestic arbitration and fails to provide rules of arbitral proceedings and court proceedings related to international arbitration. The CCP states that rules on international arbitration shall be established by a separate law<sup>565</sup> - a law which has yet to be adopted in Albania.

Other important provisions in the field of international arbitration are contained in Title III, Chapter IX, regulating recognition and enforcement of foreign arbitral awards in Albania. These provisions treat recognition of foreign arbitral awards as a *special judgment* regulated by this Code<sup>566</sup>. The judicial decisions of the courts of foreign states and final awards of a foreign arbitration are recognized and enforced in the Republic of Albania according to the same rules, under the terms provided in CCP<sup>567</sup>.

Within the framework of recognition of foreign arbitral awards, the provisions of the Code of Civil Procedure take a dual character, containing both material and procedural legal norms. Material norms are the ones providing for the circumstances in which foreign awards may or may not be recognized and enforced in Albania. Whereas procedural norms are those that provide the procedure for recognition and granting power to a foreign award, and those that provide the competence of the judicial authorities for recognition and the form of the recognition judicial decision<sup>568</sup>.

## **2. The provisions of the domestic law that do not meet the requirements of the New York Convention (analytical overview).**

**In general**, the CCP provision that legal arrangements for the recognition of foreign state courts decisions will apply equally for recognition of foreign arbitral awards is not adequate. Especially the grounds for refusal of enforcement of a foreign court decision shouldn't be equally applied to refuse the enforcement of a foreign arbitral award.

It is true that the legal effects of foreign arbitral awards are the same as those of final decisions of foreign ordinary courts, but the processes providing these two kind of decisions have very distinct features.

<sup>562</sup> The Constitution of the Republic of Albania, art.116 (1); art.122(2).

<sup>563</sup> Law No.8116, dated 29 March 1996, as amended.

<sup>564</sup> Code of Civil Procedure of Albania, art.400

<sup>565</sup> Code of Civil Procedure of Albania, art.439

<sup>566</sup> Code of Civil Procedure of Albania, Part II, Title III, Chapter IX "Recognition of judgments of foreign states", art.393 – 399.

<sup>567</sup> Code of Civil Procedure of Albania, art.399.

<sup>568</sup> Civil Procedure, the first edition, Alban Brati, Dudaj Editions 2008, p.413, paragraph 4.

An important feature that distinguishes them, is the profoundly public character of ordinary courts proceedings on the one hand and the private nature of arbitration processes on the other. Likewise, the exclusive right of the agreement between the parties in dispute to determine the jurisdiction of an arbitral forum, or the parties' right to select the arbitrators are other distinguishing features of the arbitration versus judicial process.

The aforesaid distinguishing features between these two processes, justify the necessity for approval of **distinct criteria** for recognition and enforcement, which means **different grounds** for refusal of enforcement, for each kind of decisions - judicial decisions or arbitral awards.

For example, one of the grounds for refusal of enforcement of an arbitral award, provided by the New York Convention but not included on the grounds listed by the CCP of Albania<sup>569</sup> is: *The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties*<sup>570</sup>. It is understandable that such a ground for refusal of enforcement can not be anticipated from the provisions of the CCP, as long as this code provides the same grounds for refusal of enforcement of arbitral awards with those of judicial decisions.

Moreover, considering the approximation of national law with the New York Convention requirements, the provisions of the Code of Civil Procedure pose some problems, which deserve to be analyzed.

**a. The first problem** occurs with the content of Article 399 of the Code of Civil Procedure, which does not clearly explain whether the application of the provisions of chapter "On recognition of decisions of courts of foreign countries"<sup>571</sup> will also be applied to foreign arbitral awards respecting strictly the provisions of this Chapter, or only to the extent that the content of these provisions does not fall in contradiction with the features of an arbitral process (application according to the "*mutatis mutandis*" principle).

**b. The second problem - the excess of "obstacles" of the Code of Civil Procedure for the recognition and enforcement of a foreign arbitral award.**

Recognition of a foreign arbitral award represents the judicial procedure for verifying the legal requirements, through which the arbitral award is given the legal power to be enforceable on the albanian territory<sup>572</sup>. In fact the Code of Civil Procedure do not expressly provide the conditions for the recognition of a foreign arbitral award, but on the contrary it provides the conditions that are considered as "barriers" for recognition, known as the "grounds" for refusal of enforcement. It is understood that in any other circumstance not included in the framework of these legal restrictions, foreign arbitral award can and should be given executive powers.

Specifically, a foreign arbitral award is not given effect (that means it is not recognized and enforced) in the Republic of Albania, on the circumstances or under the following conditions:

- i) *When, under provisions in force in the Republic of Albania, the dispute concerned by the decision (award) might not be in the competence of the court of arbitration of the state that has issued the decision (award)*<sup>573</sup>.
- ii) *When the lawsuit and the summons have not been notified to the defendant in absence on the default and orderly time, to give him the opportunity to be defended.*<sup>574</sup> (the principle of due and equal process to the parties).

<sup>569</sup> See *infra* p.13: The grounds for refusal of enforcement of an arbitral award, according to the CCP provisions.

<sup>570</sup> Article V(1)(d) of the New York Convention.

<sup>571</sup> Code of Civil Procedure of Albania, Part II, Title III, Chapter IX, art.393 – 399.

<sup>572</sup> Civil Procedure, the first edition, Alban Brati, Dudaj Editions 2008, p.414, paragraph 2.

<sup>573</sup> Code of Civil Procedure of Albania, art.394, par.1.

<sup>574</sup> Code of Civil Procedure of Albania, art.394, par.2.



iii) *When, between those same parties for the same subject and the same reason, a different decision has been given by the Albanian court.*<sup>575</sup> (the "res judicata" principle).

iv. *When the foreign arbitral award has become final in contradiction with the law under which the award was made.*<sup>576</sup>.

v. *When the foreign arbitral award is not in accordance with basic principles of the Albanian legislation*<sup>577</sup>. (the "public policy" principle).

vi) *When the Albanian court is examining a lawsuit that is filed before the foreign arbitral award has become final.*<sup>578</sup>. **This legal ground seems redundant in the group of grounds which may justify the refusal to enforce a foreign award, arguing as follow:**

**First of all**, such a provision laid down on the article 394/(4) of CCP to prevent the recognition of foreign arbitral awards exceeds the conditions known as the grounds for refusing the recognition and enforcement of a foreign arbitral award, provided by the New York Convention<sup>579</sup>.

**Secondly**, such a final obstacle to the recognition of the award, provided by the CCP, falls in contradiction with the obligations imposed by the ratification of the New York Convention, specifically with the obligation to exclude the jurisdiction of a national court when it is seized of an action in a matter in respect of which the parties have made an arbitral agreement<sup>580</sup>. In implementing this obligation, the Albanian court if it's examining a lawsuit (action), should declare the lack of jurisdiction when there is an arbitral agreement between the parties. The submission of the arbitration agreement by an interested party should be enough for the court to declare the lack of jurisdiction.

In these circumstances, the fact that the Albanian court is examining a lawsuit in a matter in respect of which the parties have made an arbitral agreement, means that this court is acting in the lack of jurisdiction and this fact should not prevent the recognition and enforcement of an foreign arbitral award, as currently provided from the article 394/(4) of CCP.

**Thirdly**, the provision of article 394/(4) reopens the issue of verification of competence or incompetence of the arbitration forum. As already mentioned, the Code of Civil Procedure makes a specific prediction about the competence of the arbitral forum, when it provides as an "barrier" to recognition of foreign arbitral award the fact that *the dispute concerned by the award might not be in the competence* of the court of arbitration that has issued the award (CCP, art.394(1))<sup>581</sup>. The confirmation of the validity of the arbitration forum competence implies indirect proof of incompetence of the Albanian court to examine a lawsuit over the dispute. It seems that we are dealing with the same ground for refusal of enforcement, as provided from the article 394(1), but repeated in another form in the provision of article 394(4).

**Fourthly**, the refusal of enforcement of an arbitral award due to the submission of a lawsuit in an albanian court, before the moment of time that the award has become final, as provided by the article.394 (4), may be used intentionally as an artificial barrier to the enforcement of an award from the party against whom it is invoked. This party may file a lawsuit in an Albanian court deliberately to refuse later the enforcement of the foreign arbitral award issued over the dispute, in our country.

<sup>575</sup> Code of Civil Procedure of Albania, art.394, par.3.

<sup>576</sup> Code of Civil Procedure of Albania, art.394, par.5.

<sup>577</sup> Code of Civil Procedure of Albania, art.394, par.6.

<sup>578</sup> Code of Civil Procedure of Albania, art.394, par.4.

<sup>579</sup> New York Convention, art.5.

<sup>580</sup> New York Convention, art.2, par.3 "The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article at the request of one of the parties, refer the parties to arbitration unless it finds that the said agreement is null and void, inoperative or incapable of being performed".

<sup>581</sup> See *supra* p.13, Code of Civil Procedure of Albania, art.394, par.1.

This would be contrary to the spirit of the New York Convention, whose aim is to facilitate the conditions for recognition and enforcement of foreign arbitral awards.

**c. The third problem – the burden of proof.**

Provisions of the CCP does not predict **who** has the burden of proving to the court of appeal that one or more legal grounds of refusal, mentioned above, are met. In fact, article 397 of CCP stipulates that "the court of appeal examines whether the present award applied for enforcement does not contain provisions that conflict with article 394". In general interpretation of this provision, the court of appeal may examine the existence of the grounds of refusal on its own motion (*ex officio*), without request of the interested party.

Whereas the New York Convention is very clear at this point, when stipulates the obligation of the party against whom the award is invoked: **first to make a request for refusal** of the arbitral award applied for enforcement and **second to submit evidences to the competent authority to prove the grounds of refusal**<sup>582</sup>. There are only two grounds on which a court may refuse enforcement on its own motion. These two grounds for refusal of enforcement are limitatively listed in the second paragraph of Article V, which concerns violation of public policy under the law of the forum<sup>583</sup>.

**d. The 4<sup>th</sup> problem – The Code of Civil Procedure does not provide for submission of the arbitration agreement as a condition for recognition and enforcement of foreign arbitral awards.**

According to the CCP provisions, the formal request for recognition and enforcement of a foreign arbitral award should be attached to **some documents**, in order to be considered regular. Specifically the following documents are required to be submitted: (a) copy of the foreign arbitral award, which is subject of the application for enforcement; (b) certificate of the arbitral forum, which issued the award to certify that this award has become final; (c) power of attorney, if the application is filed by a representative of the interested party<sup>584</sup>. These documents are required to be duly translated and authenticated.

As above, the provisions of the Code of Civil Procedure do not require as a condition the submission of "arbitration agreement" by the party applying for recognition and enforcement of the award. Such a prediction does not comply with the provisions of the New York Convention<sup>585</sup>, where the application for enforcement of the award is provided to be accompanied by the "arbitration agreement". This written arbitration agreement, under the Convention, should be submitted along with the foreign arbitral award, subject of the application for enforcement, otherwise the formal request for enforcement is not considered regular.

**3. Consideration of application for recognition and enforcement by the court of appeals.**

The court of appeals does not review the merits of the case, therefore does not examine how the dispute between the parties is resolved through the foreign arbitral award. The court of appeals simply controls whether the award submitted contains elements that, according to the law, are considered legal obstacles (barriers) for the enforcement of foreign arbitral awards<sup>586</sup>. At this point the provision of the CCP is consistent with the predictions of the New York Convention.

**CONCLUSIONS AND RECOMMENDATIONS**

<sup>582</sup> Article V(1) of the Convention: *Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:....*

<sup>583</sup> Article V(2) of the Convention: Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: ....

<sup>584</sup> Code of Civil Procedure of Albania, art.396.

<sup>585</sup> New York Convention, art.IV(1)(b).

<sup>586</sup> Code of Civil Procedure of Albania, art.397.

### Concluding Reflections

Regardless that the Republic of Albania has ratified the New York Convention, the recognition and enforcement of international arbitral awards in Albania is being carried out through a non-contemporary national legal framework.

**a.** A group of provisions of the Albanian Code of Civil Procedure governs the recognition and enforcement of foreign (international) arbitral awards for reference of the recognition of the foreign state courts decisions. The national law does not provide a direct adjustment for the recognition and enforcement of foreign arbitral awards. The complete conformity of the grounds for refusal of enforcement of these two different categories of decisions (judicial decisions and arbitral awards) can not be considered the best choice.

**b.** The provisions of the CCP are not fully in accordance with the provisions of the New York Convention, regarding the recognition and enforcement of foreign arbitral awards. These discrepancies, which may create obstacles to judicial procedures for enforcing foreign arbitral awards in practice, are mentioned briefly as follow.

-The New York Convention clearly provides to the interested party the **right to refuse** the enforcement of a foreign arbitral award, but also the **burden of proving** the grounds for refusal. Provisions of the CCP does not make such a prediction and consequently the court of appeals **on its own initiative** (without request of the interested party), controls whether foreign arbitral award contains elements that constitute the legal grounds for refusing its enforcement.

-The provisions of the CCP do not require the submission of "arbitration agreement" from the party concerned, as a validity condition of the request for enforcement, in contrast to the New York Convention which provide as mandatory the presentation of "arbitration agreement" in order that the request for recognition and enforcement to be acceptable by the competent authority.

-The article 394 of CCP provides a legal ground for refusal of the enforcement of a foreign arbitral award, which not only exceeds those provided by the New York Convention but also may become an obstacle in practice to implement the spirit of the Convention<sup>587</sup>.

### Recommendations.

Albanian legislation needs to be updated, aiming the approach to the contemporary spirit and principles of international legal framework. In this regard, the legal regulation of recognition and enforcement of foreign arbitral awards by the provisions of a special law, would be a good option. A hypothetical law, for example "On arbitrage" or "On commercial arbitration", could be the proper act to consolidate the legal framework, regulating both the internal and international procedures of arbitration<sup>588</sup>. In this way the obligation that derives from the article 439 of Albanian Code of Civil Procedure will be fulfilled<sup>589</sup>.

A good option would have been to make part of domestic law the UNCITRAL Model Law provisions, which on one side do not conflict with the provisions of the New York Convention and in turn improve the recognition procedures of international arbitration awards<sup>590</sup>.

<sup>587</sup> See *supra* the explanation of the ground for refusal, provided by Article 394(4) of Albanian CCP – *a foreign arbitral award can not be enforced in the Republic of Albania, when the Albanian court is examining a lawsuit that is filed before the foreign arbitral award has become final.*

<sup>588</sup> The International Comparative Legal Guide "On the international arbitration 2008", ed.Global Legal Group Ltd. London, with the contribution of "Kalo & Associates, Attorneys at Law", p.86, par.14.1.

<sup>589</sup> See *supra* p.10.

<sup>590</sup> Let's mention here the provision of the UNCITRAL Model Law for clarifying the form of arbitration agreement - Article 7, option I and II of the UNCITRAL Model Law.

A similar pattern which can be applied to reference is the Arbitration Act - English Law of Arbitration - which in its third section regulates the recognition and enforcement of foreign arbitral awards<sup>591</sup>.

Another possible version of a contemporary regulation of the recognition and enforcement of foreign arbitral awards is to amend the provisions of the Albanian Code of Civil Procedure. For analogy, our domestic law might be referred to the provisions of the Italian Code of Civil Procedure, which directly govern the international arbitration<sup>592</sup> and the recognition of foreign arbitral awards in Italy<sup>593</sup>.

For Albania, the adoption of a special law on arbitration, or the amendment of the provisions of CCP, is becoming a necessity in the present conditions when the Albanian economy is increasingly oriented towards her integration, putting on the spotlight the expansion of trade relations, particularly international ones. To meet the needs of a more open economy, its actors (businesses and individuals) naturally will be looking for more effective legal instruments of conflict resolution. At this point, special attention should be paid by the domestic law to those legal instruments that serve to the recognition and enforcement of foreign arbitral awards.

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<sup>592</sup> Italian Code of Civil Procedure (Codice di Procedura Civile - Dei procedimenti speciali - Parte 2), Chapter VI (dell'Arbitrato Internazionale), art. 832 – 838.

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