Economy

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An Interdisciplinary Approach to Contemporary Economic Challenges

edited by Piotr Urbanek

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ŁÓDŹ 2016

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COVER DESIGN
Stämpfli Polska Sp. z o.o.
Photo on the cover by Tomasz Kostecki

Printed directly from camera-ready materials provided to the Łódź University Press

NBP Narodowy Bank Polski

This publication is not for sale

Published by Łódź University Press
First Edition. W.07303.16.0.K

Publisher’s sheets 18.5; printing sheets 20.125

ISBN 978-83-8088-012-2
e-ISBN 978-83-8088-013-9
https://doi.org/10.18778/8088-012-2
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The book fits into a multidisciplinary research approach. The articles are the result of research conducted by eminent international economists, authors representing academic centres in different countries. The articles address current phenomena observed in the global economy. The authors do not aspire to comprehensively explain all the very complex and multi-dimensional economic developments, but illustrate many of these phenomena in an original way. The multi-threaded and multi-dimensional nature of the discussion in particular articles deserves attention. These include theoretical and methodological articles as well as the results of empirical research presented by the authors.

The book is addressed to those persons interested in issues of economics, finance, regional economy, and the management sciences. It can be valuable for economic practitioners, members of management and supervisory boards of companies, and financial analysts, and the articles may also be useful for academicians and students.

Piotr Urbanek, University of Łódź

Table of contents

Introduction

The dynamic changes in the economy have created new challenges for academia. The new economic reality is shaped by the combined effects of factors taking place in the economic environment of enterprises and in the very companies themselves. These are firstly, the processes of globalization and integration of the world economy, and secondly, knowledge and information as key factors leading to the achievement of competitive advantages. These objective processes, observed in both global and regional markets, have been affected by the outbreak and course of the recent financial crisis. This forces the world of science to rethink theories and models describing the functioning of the economy, markets, and businesses. This is the challenge facing representatives of various disciplines of science involved in the study of economic and social aspects of the complex economic reality. **Today's economy** requires an **interdisciplinary approach to contemporary economic challenges**.

This book fits into such a multidisciplinary research approach. The book includes 19 original studies. The articles are the result of research conducted by eminent international economists, authors representing academic centres in different countries. The articles address current phenomena observed in the global economy. The authors do not aspire to comprehensively explain all the very complex and multi-dimensional economic developments, but illustrate many of these phenomena in an original way. The multi-threaded and multi-dimensional nature of the discussion in particular articles deserves attention. These include theoretical and methodological articles as well as the results of empirical research presented by the authors.

The articles demonstrate the very broad spectrum of the authors' scientific interests. At the same time the issue of contemporary economic challenges, viewed from different perspectives, is interwoven in many studies. The first approach refers to the **process of economic integration and economic growth**, which on the one hand is the result of, and on the other determines the position of, national economies on the world market. At the same time the share of the economy in the international division of labour is determined by phenomena occurring at the level of **economic regions** and domestic markets, including the **financial markets**, which reflect the attractiveness of the economy as a place to invest capital. Most studies comprise an assessment of the sources of competitive advantages, **management processes and processes of creating value** which are taking place in enterprises. This is based on the assumption that the competitiveness of enterprises decides the competitiveness of economies and regions. At the same time the economic processes taking place in the business environment have an impact on the competitive position of companies on both the domestic and foreign markets. Therefore there is an interaction of interrelated factors which together create a multidimensional space. The authors of the studies included in the book undertook this type of research primarily with reference to the phenomena related to the processes of economic integration and economic growth, regional policy, the functioning of financial markets and issues of business management, with particular emphasis on the determinants of values and social and ethical aspects of management.

The book consists of five parts. The chapters in thefirstpart of the monograph are devoted to theissuesof economic integration and economic growth. Integration in the global economy can take different forms, the World Trade Organization being one such example. **Chapters 1 and 2** present the process of economic integration of the Chinese economy. The first chapter is devoted to the WTO, which is a member-driven international trade organization composed of governments and customs territories. Nowadays the WTO is an important platform for the development of triangle relationships between China, Taiwan and the EU. The author puts special emphasis on the Economic Cooperation Framework Agreement (ECFA) under the WTO and analyses its significance for the triangle trade relation both now and in the future. The second chapter presents and analysis of the Chinese economy, which takes a closer look at the role of the state (and political actors) in economic development from the socio-economic and macroeconomic perspectives. It is argued that China's system is hardly a Nash-like equilibrium and correction in the growth distribution pattern is required. The author points out that: "combining the standard macroeconomic approach with insights from new institutional economics, the paper argues that while the government's actions were mostly growth-enhancing, the nature of this development was biased toward the Party-state and in the long-term unsustainable".

The Visegrad (V4) countries – the Czech Republic, Hungary, Poland and Slovakia – are another example of economic integration. They joined the European Union in 2004 as rather weak economies, and since then they have recorded an economic development benefiting from a better business environment, new business opportunities, and access to EU structural funds. **Chapter 3** examines the impact of EU membership for the Visegrad countries' economic development and the labour market developments after their EU accession. The author explores the employment opportunities for V4 countries in the field of the green economy. Economic integration can take on the form of institutional structures like the EU. But it occurs also as a result of international trade, which makes a significant contribution to economic growth, especially nowadays when globalization is becoming a widespread phenomenon. Chapter 4 describes the phenomenon of a country's trade openness and the impact of economic growth of importing countries and effective exchange rates to the growth of a domestic economy. The empirical results presented in the chapter, based on annual data collected for the Albanian economy for the period 2000 to 2013, indicate that exports can increase intra-industry trade, help a country to integrate into the world economy, and reduce the impact of external shocks on the domestic economy.

The processesof economic growthare inextricably linkedwith the phenomenon ofthe business cycle and economic fluctuations. Grasping the pattern behind the cyclical nature of the economy is one the most challenging tasks for economists and economic theories. **Chapter 5** focuses on this issue. It examines the economic cycles in Poland in the years 2000–2013 to verify how the cycle's morphology changed after the crisis of 2008 and whether the changes match the theoretical characteristics of classic or modern cycles. The results, based on the analysis of the Polish GDP, show that the positive growth rate has been lower since the crisis, that cycles last for approximately 3.5–4 years, and their length and turning points suggest that in terms of morphology they match the characteristics of modern cycles.

The second part of the book contains three chapters dealing with the issue of regional policy. **Chapter 6** introduces an interdisciplinary assessment of urban patterns as a factor of socio-economic development, presenting selected examples of how different urban patterns influence family economics, risk management for city dwellers and entrepreneurs, the labour market and social inclusion or inequality. The author provides an assessment of the way in which the durability or flexibility of the business environment influences the sustainable urban development. He concludes, that "it is not possible to identify one spatial pattern that in the best way meets the need to adapt to new challenges and threats. However, case studies can point to certain features of cities, especially their diversity, as being the most important for their proper functioning (…)". An alternative approach to regional policy can be seen in **Chapter 7**, taking into account Poland'sthree-tier division of the country into basic administrative units. Local government units play an extremely important role when it comes to the management of public funds. This is related to the broader decentralization of public tasks and also to some extent to local governments' autonomy in shaping their own fiscal policies. The chapter analyses the issues of control and reduction of local government debt in connection with new restrictions implemented at the Polish local government level. Social housing policy is one of the most important areas of local authority's responsibility. The author of **Chapter 8** points out that "the disregard for social housing has reached its particularly acute level in post-socialist countries which have mass privatized, resulting in outstanding levels of home ownership (…)". She describes the linkage between housing re-privatization and the lack of social housing policies and displacement in Bucharest, Romania. These considerations areconducted inthe broader context ofhousing policy in Romania, its devolution from the central government to the local administration and the possibility of having an endemic discriminatory attitude towards those people who are at risk of becoming homeless.

The dominantthemein the thirdpart of this book is the functioning ofthe financial sector. Competitive pressure in the banking sector causes banks to introduce new financial investments, products, and services that are designed to generate additional income. They should also focus on current customers, who can spend more money when they are properly encouraged by a bank. **Chapter 9** is the methodological text, describing the application of the taxonomic measure of investment attractiveness (TMAI), which is an element of multidimensional comparative analysis. The aim of the paper is to verify the usefulness of the TMAI method for creating short-sell portfolios. Such statistical techniques might help investors to make long-term accurate decisions, but as the author highlights "there should also be used other methods which would confirm its indications (…)".

The market comparison method is one of the methods most widely used by practitioners to estimate the fair value of the equity of a company. This justifies the attempts of further research to improve the efficiency of the estimators of a company employed in this method. In **Chapter 10** the author presents a critical review of practical approaches to consider the one-off events in the comparative method. The author recommends including resistant indicators – P/E and P/S – which will not change due to one-off events in the final estimate of the value of a company. **Chapter 11** is the final chapter in this section of the book and analyzesthe risk reduction mechanisms used by mortgagors. The author identifies two basic types of mortgage borrowers: those with low creditworthiness and those with high creditworthiness. The analysis mainly deals with credit risk reduction mechanisms that are used by real estate purchasers. The results make it possible to identify several basic risk reduction mechanisms that were used by the mortgage borrowers under study. But as the author concludes "the strategies and effects which are identified in this paper and which lead to a reduction in mortgagors' level of risk consciousness not only do not protect consumers against the risk but may also significantly increase this risk (…)".

The two last parts of the book are devoted tovarious aspects of corporate management. There are two research perspectives of special interest to the authors: determinants of an organization's value and social and ethical issues in management. One can use many methods to carry out a competitiveness assessment. Such an analysis gives the opportunity to identify companies' strengths and weaknesses and allows them to adopt a successful competitive strategy, which determines a company's position in the marketplace. According to the author of **Chapter 12** "methodology and techniques of assessment are not sufficiently developed (…)". They require complex calculations and obtaining and using the necessary information, which significantly reduces the possibility of their practical application. Such restrictions can be overcome by an original methodology for quantifying the attractiveness of the goods to the client in relation to the other goods,as presented in the paper. As the author writes, "(T)his approach allows us to obtain a complete understanding of the advantages and disadvantages in the enterprise, as the company's competitiveness takes the form of goods and affects the competitiveness of technological, organizational and economic aspects of the enterprise market (…)". Another approach to the problem of competitiveness can be found in **Chapter 13**. The purpose of this paper is to identify the key competences of global managers in the cross-cultural management of multinational corporations, which "have become one of the most important drivers of continuous globalization and constant developments in the global economy (…)". The review of the literature presented in the paper reveals that cultural self-awareness, intercultural communication and a global mind-set should characterize successful global managers. Such managerial competences seem to be a very important source of success for multinational corporations. The issue of management in a global multicultural organisations is continued in **Chapter 14**. This paper presents management tools which can be useful, especially in the environment of multicultural organisations, to manage the process of change. The choice of these tools is based on personal work experience and interviews with those leaders who have been managing changes in such organisations. As the author emphasizes, the key factor of success is flexibility and modification of the implemented tools, as they must be adjusted to the culturally diversified environment of the world's organisational and national cultures. Chapter 14 also describes the process of communication within an organization, while **Chapter 15** focuses on the problem of a corporation's communication with its business environment, especially with investors. This is an important component that shapes and builds organizational image. Such communication is a crucial factor in the process of building relationships of listed companies with stakeholders and may significantly affect a company's value. As the author underlines "intangible assets can become a sustainable source of competitive advantage more than technology or patents in the long term. Companies' strategies need to include a strong foundation for building the reputation or image (…)".

The last part of the book consists of four chapters. The author of **Chapter 16**points out three basic dimensions of corporate activities: economic, environmental and social. The concept of corporate social responsibility presented in the paper tries to alleviate the inadequate relation between them. A case study of the Norwegian Government Pension Fund is used to show the growing awareness of the role of balance in sustainable development, which is necessary to achieve economic success, while respecting the environment and the needs of the individual. **Chapter 17** presents another social perspective of management processes. The aim of the paper is to indicate the opportunities for practical implementation of social engineering in company management. According to the author, social engineering "is a practical science which is based on techniques offered by science (sociology, praxeology, juridical studies, psychology, logic, political science, management) and methods aimed at influencing the reality, relying on acquiring the desired behaviour of individuals or social groups to pursue adopted aims (…)". Knowledge of such rules and methods of making an impact on people, as well as basic sociotechnical models on the highly competitive market, are nowadays necessary for managers to increase an enterprise's functionality and competitiveness. A corporation's cultural and ethical values are becoming important aspects of economic efficiency. This is especially visible in the banking sector. **Chapter 18** presents an analysis of the impact of social and individual values on the profitability of Czech banks. The authors demonstrate that domestic banks tend to focus on the person and client codes of ethics aremore individualistic. The final **Chapter 19** also emphasizes the social aspect of economic processes. The authors focus on the social and individual impacts of the economic crisis, because as they argue "global economic processes directly influence and severely touch individual human being. Their repercussions can be observed not only at the economic level, but also analysed in a sociological and psychological sense (…)". That is why "the economy should be understood in terms of the social order, being only one of its dimensions (…)".

The book is addressed to those persons interested in issues of economics, finance, regional economy, and the management sciences. It can be valuable for economic practitioners, members of management and supervisory boards of companies, and financial analysts, and the articles may also be useful for academicians and students.

http://dx.doi.org/10.18778/8088-012-2.01

Processes of global integration and the economic growth

1. Triangle trade relation among China, the EU and Taiwan under the aspect of the WTO

Li-Jiuan Chen-Rabich, LL.M*

Abstract

The WTO is a member-driven international trade organization composed of governments and customs territories. It sets the legal framework for trade among the members. The EU as successor of the EC is the founding member since the establishment of the WTO in 1995. With the gradual enlargement process, the EU has been also one of the super members with the strong economic power within the WTO. Since the open and reform towards the world economy, China has taken a rapid step for the economic development in the 1980s. China has accessed into the WTO in Dec. 2001. The Taiwan's economy strongly depends on export. Therefore, trade plays a very important role for Taiwan. Taiwan has become the 144th member of the WTO since 2002. Nowadays the WTO is an important platform for Taiwan in the international community, especially the Cross-Straits trade relation between China and Taiwan. With the trend of globalization, the trade relation between China

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and Taiwan is unavoidable and inevitable. The Cross-Straits trade relation has rapidly developed after their access into the WTO. As a result, the WTO has become an important platform for the interaction between China and Taiwan. Furthermore, China and Taiwan have concluded in 2009 the Economic Co-operation Framework Agreement (ECFA) under the WTO.

This thesis firstly works on the ECFA as basis to explain its content and its impact on the both-side development. Secondly, it deals with the triangle relation among China, the EU and Taiwan within the WTO. Furthermore, it focuses on the signification of the ECFA for the triangle trade relation and its future. Finally, it draws a conclusion as finding of this research.

1.1. EU's position in the WTO

The WTO is a member-driven international trade organization composed of governments and customs territories since the establishment of the WTO in 1995. It sets the legal framework for trade among the members. The European Union (EU) as legal successor of the European Community (EC) is the founding member since the establishment of the WTO in 1995. With the fifth enlargement process in 2004, the EU has been also one of the super members with the strong economic power within the WTO.

The EU has currently 28 member states and its economic power can't be ignored. The EU is one of the most important members of the WTO and plays a leading role within the WTO. The Commission is on behalf of the EU with one voice in the WTO (Meunier, 2005). The EU has a very dynamic development in its history from the customs union, and then common market finally to the economic and monetary union. The EU is the largest economic power in the world. The size of its internal market and its share of world trade invite WTO members to seek deals with the EU, and increasingly to try to adapt to its standards and rules (Meunier and Kalypso, 2006). The EU's leadership role in multilateral negotiation and in shaping the new order is a main channel to direct export its model of regional governance, and to consolidate itself as an important player on the global stage (Santander, 2014).

The Lisbon Treaty has concretely provided the legal personality of the EU. The EU can better than ever participate in the international affairs (Weber, 2008). The Lisbon Treaty has reformed the EU's Common Commercial Policy to contribute to a comprehensive and effective trade policy. Good global governance has become a general model under the multilateral framework of the WTO, especially through the conclusion of the international trade agreement (Pitschas, 2007). The EU has exclusive competence relating to the Common Commercial Policy after the Lisbon Treaty. The Common Commercial Policy includes GATT, GATS and TRIPS within the

WTO (Hermann et al., 2006). To sum up, the WTO plays an important role in the global governance. The EU has taken part in the global governance by way of the WTO to establish rules for international trade.

1.2. Global impact on the development of Cross-Straits relation

The Cross-Straits relation was hostile and in tension since the end of civil war in 1949. Since the open and reform towards the world economy in 1979, China has taken a rapid step for the economic development and introduced a series of reform measures. Due to the open and reform policy, China has established Special Economic Zones[1] to attract foreign direct investment and introduced many promotion measures for the foreign investments. On the other side, Taiwan has also abolished its Martial Law in 1987. This action has moderated tensions between both sides of the Cross-Straits. It also improved the Cross-Straits trade relation and political peaceful development.

China has accessed into the WTO in Dec. 2001. The Taiwan's economy strongly depends on export. Therefore, trade plays a very important role. Taiwan has become the 144th member of the WTO since 2002. Nowadays the WTO is an important platform for Taiwan in the international community, especially the Cross-Straits trade relation between China and Taiwan. Currently, China is one of the most important trade partners of Taiwan. The WTO has become an important platform for the Cross-Straits trade relation. The two-way trade and investment have rapidly developed.

1.3. ECFA – New milestone for the Cross-Straits trade relation

Both China and Taiwan are members of the WTO. Hence, the trade relation has fast developed and additionally contributed to better improving the overall relationship. Furthermore, China and Taiwan[2] have concluded in 2009 the Economic Cooperation Framework Agreement (ECFA) under the basic principles[3] of the WTO in order to gradually reduce or eliminate barriers to trade and investment for each other and create a fair trade and

1 The most prominent Special Economic Zones in China are Shenzhen, Xiamen, Shantou and Zhuhai. All are on the southern coast of China where sea is very accessible for transportation of goods.

2 Due to the one-China policy, the Straits Exchange Foundation and the Association for Relations Across the Taiwan Straits are separately representatives for the Chinese Government and the Taiwanese Government who signed the ECFA.

3 Namely principles of equity, reciprocity and progressiveness.

investment environment, further advance Cross-Straits trade and investment relations[4]. The ECFA contains 16 articles and 5 annexes (Table 1.1).

Chapter 1	General Principles
Article 1	Objectives
Article 2	Cooperation Measures
Chapter 2	Trade and Investment
Article 3	Trade in Goods
Article 4	Trade in Services
Article 5	Investment
Chapter 3	Economic Cooperation
Article 6	Economic Cooperation
Chapter 4	Early Harvest
Article 7	Early Harvest for Trade in Goods
Article 8	Early Harvest for Trade in Services
Chapter 5	Other Provisions
Article 9	Exceptions
Article 10	Dispute Settlement
Article 11	Institutional Arrangements
Article 12	Documentation Formats
Article 13	Annexes and Subsequent Arrangements
Article 14	Amendments
Article 15	Entry into Force
Article 16	Termination
Annex I	Product List and Tariff Reduction Arrangements Under the Early Harvest for Trade in Goods
Annex II	Provisional Rules of Origin Applicable to Products Under the Early Harvest for Trade in Goods
Annex III	Safeguard Measures Between the Two Parties Applicable to Products Under the Early Harvest for Trade in Goods
Annex IV	Sectors and Liberalization Measures Under the Early Harvest for Trade in Services
Annex V	Definitions of Services Suppliers Applicable to Sectors and Liberalization Measures Under the Early Harvest for Trade in Services

Table 1.1. Tables of Contents
Source: ECFA.

4 Preamble of the ECFA.

The ECFA is by nature a stage agreement what provides a frame of contents and schedule for the future negotiation. China and Taiwan are politically still in a state of hostility, but in reality they have very close trade relation. It is inevitable to have a further cooperation framework agreement under the WTO. Therefore, the ECFA plays a very important role for the development and improvement of the Cross-Straits relationship. The ECFA has crested a cooperation mechanism between China and Taiwan. In other words, the ECFA is a basic agreement for the economic cooperation between China and Taiwan. The ECFA is also mutual beneficial to the Cross-Straits relationship.

To strengthen Cross-Straits economic exchange and cooperation, following measures are taken (Art. 2 of the ECFA):

1. Gradually reducing or eliminating restrictions on a large number of sectors in trade and in services.
2. Providing investment protection and promoting two-way investment.
3. Promoting trade and investment facilitation and industry exchanges and cooperation.

The ECFA has come into force on the Sep. 12th, 2010. Due to the nature of framework agreement with overall objectives, China and Taiwan have continued negotiations relating to trade in goods and in services, investment protection and so on. The agreement on trade in goods includes modalities for tariff reduction or elimination, rules of origin, customs procedures, non-tariff measures[5] and trade remedy measures (Art. 3 II of the ECFA). The agreement on trade in services shall seek to (1) gradually reduce or eliminate restrictions on a large number of sectors in trade in services; (2) further increase the breadth and depth of trade in services; (3) enhance cooperation in trade in services (Art. 4 II of the ECFA). The agreement on investment includes (1) establishing an investment protection mechanism; (2) increasing transparency on investment-related regulations; (3) gradually reducing restrictions on mutual investments; (4) promoting investment facilitation (Art. 5 II of the ECFA). The both – side economic cooperation relates to following areas (Art. 6 I of the ECFA):

(1) Intellectual property rights protection and cooperation;
(2) Financial cooperation;
(3) Trade promotion and facilitation;
(4) Customs cooperation;
(5) E-commerce cooperation;
(6) Discussion on the overall arrangements and key areas for industrial cooperation, promotion of cooperation in major projects, and

5 Such as technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures.

coordination of the resolution of issues that may arise in the course of industrial cooperation;

(7) Promotion of small and medium-sized enterprises cooperation and enhancement of the competitiveness of these enterprises;

(8) Promotion of the mutual establishment of offices by economic and trade bodies of the two parties.

It is worthy to mention the establishment of appropriate dispute settlement procedures, namely a Cross-Straits Economic Cooperation Committee has been established to settle any dispute arising from the interpretation, implementation and application of the ECFA (Art. 10 and Art. 11 of the ECFA).

To sum up, the ECFA covers an overall economic cooperation between China and Taiwan. The application scope of the ECFA is comprehensive including industrial production, investment, services (banking, financial industry, insurance etc.) and intellectual property protection.

1.4. Impact of the ECFA on the European enterprises

The ECFA plays a role of new milestone for the Cross-Straits trade relation. China has shown its economic power after the transition since its entry into the WTO in 2001. China is currently a mega partner in the world trade, but it has still communist regime. On the other hand, Taiwan has a democratic system with rule of law. Especially, Taiwan has adopted the German legal system and also a typical continental legal system.

The role of EU's investment is not only as assistance for economic development, but also extension of market and promotion of economic growth. The EU is nowadays a strong economic unit in the international community. The EU is one of the most important foreign investors for both China and Taiwan. The peaceful atmosphere between the Cross-Straits is also very positive and advantageous for the European enterprises. In particular, the European enterprises need an export market for the economic recovery and growth after the global financial crisis.

After the 10-year transition period, China has transformed into a trade-driven country. Although China is still a communist country, China has to oblige its commitments of the WTO. Therefore, China has constantly reformed its economic structure and market system. With the reform measures, China has become a mega factory in the world. China has step by step participated in the world economy. China has also adopted the rules of international trade law. China's plan economy has been transformed into the market economy. Unfortunately, China is still a communist country.

To a certain extent, China is still a totalitarian state. On the contrary, Taiwan has ended with its totalitarian regime after the abolition of the Martial Law in 1987. There were also introduced a series of reform measures. Nowadays Taiwan has a free, democratic and open society. In fact, Taiwan has accepted universal values provided in Art. 2 of the Treaty of the European Union. Taiwan traditionally has adopted the German legal system, in particular constitution, civil law, business law, employment law, cooperation law, intellectual property law and so on. Taiwan has amended lots of outdated rules to fulfill its commitments after the access into the WTO. Taiwan has always an open society, therefore Taiwan offers an advantageous business environment for European enterprises.

Conclusion

The WTO is the most important platform and legal framework in the global governance. The triangle trade relation among China, the EU and Taiwan has recently well developed. The ECFA between China and Taiwan under the WTO framework is a new milestone for the development of the Cross-Straits relation. China has transformed its plan economy into the market economy after the access into the WTO, but China is still a communist regime. On the contrary, Taiwan has a democratic and open society. In fact, China and Taiwan have the same culture and language. The ECFA offers a very useful business environment for European enterprises. As a result, the European enterprises can establish headquarter for their business of the Chinese-speaking area in Taiwan and take advantage of the ECFA. The ECFA is very positive and advantageous for the triangle trade relation among China, the EU and Taiwan.

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http://dx.doi.org/10.18778/8088-012-2.02

2. Is China's capitalism sustainable?

Krystian Karnia*

Abstract

During the last three decades China's economic system has undergone a great transformation from communism to some form of state-led capitalism, in which 'the state' means actually 'the Communist Party'. Looking at the average rates of growth and reduction in poverty indices, the Party's evolutionary approach to reforms brought a successful catch-up process. However, the picture of the reforms is much more complex with the officials acting both as a developmental and inequality-enhancing force. The paper takes a closer look at the role of the state (and political actors) in economic development from socio-economical and macroeconomic perspective. It is argued that China's system is hardly Nash-like equilibrium and correction in the growth distribution pattern is required (in fact, there have already been first signs of rebalancing).

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Introduction

According to Polanyi ((1944) 2011), the market and the state constitute two inseparable pillars of modern capitalism. The former depends on incentives that are shaped by the state (and are encompassed in institutional framework), the latter relies on the market for the flows of revenues that finance its activity (Block and Evans, 2005, p. 505). Taking the role of the state as a major factor of differentiation, Schmidt (2002) distinguishes three types of capitalism: market capitalism in which the state provides economic actors with large autonomy and acts only as an arbiter; managed capitalism in which the state encourages associational governance and negotiations between different groups of economic actors, thus acts as a facilitator; state-enhanced capitalism in which the state strongly intervenes in private activity and takes the role of a leader. However, this classification focuses on already established structures, while China's institutional framework can still be described as 'work in progress'. Polanyi ((1944) 2011, p. 146) emphasised that even the systems considered as the models of liberal capitalism had established free market under 'continuous, centrally organized and controlled interventionism'. The idea of state actively shaping the market is pushed even further in case of transition economies, as in the initial setup the institution of private ownership and the class of private proprietors were virtually non-existing (King and Szelenyi, 2005, p. 207).

During the last three decades China's economic system went through the great transformation from communism to some form of state-led capitalism. If political monopoly of the Communist Party and the persistent importance of political ties (Shi, Markoczy and Stan, 2014) are taken into account, the term 'state' should actually be substituted with 'Party'. Having abandoned fundamentals of communist ideology, the legitimacy of the Party has been tied to its ability to deliver improvement in peoples' living standards. Economy-wide indices seem to support Party's claims – real GDP per capita growth averaged 8.8% in 1979–2013 period and the share of population living with less than $1.25 a day (PPP) declined from 84.3% in 1981 to 6.3% in 2011 (World Bank, 2014). However, the picture of China's gradual transformation is much more nuanced and the institutional outcome of the reforms is hardly on optimal one.

The next two sections describe briefly China's evolutionary approach to transformation that resulted in emergence of the Party-led capitalism. The system's main features are discussed in section four. Then, in the next two sections, a more detailed characteristic of the role of the state (and political actors) in China's economic development is presented. As the analysis tries to introduce the relationship between state and economy in a more universal way, some very unique features of China's institutional evolution (e.g. Household Registration System) are overlooked[1].

Combining the standard macroeconomic approach with insights from new institutional economics, the paper argues that while the government's actions were mostly growth-enhancing, the nature of this development was biased toward the Party-state and in the long-term unsustainable. According to the literature of comparative capitalism, there can be a 'good' form of *régulation* that allows for stable economic growth, low inequality and society-wide welfare, but also a 'bad' form that secures neither (Amable, 2003, p. 49–51). In order to continue its development, China's institutional framework has to move closer to the former (and there are signs that the partial shift has already started).

2.1. The marginal revolution

In the late-1970s, Chinese economy faced giant inefficiencies that constrained production and improvement in people's living standards. The legacy of institutional deterioration related to the Cultural Revolution resulted in China's underperformance not only against advanced market economies, but also when compared to other command economies. It is striking that the average per capita consumption of grain was lower at the outset of the reforms in 1978 than just prior to Great Leap Forward in 1957 (Lardy, 2014, p. 60).

In 1978, the Communist Party launched a set of small adjustments targeted at the long suppressed rural sector. The goal was to decrease the effective tax rate without relaxing state monopoly on agricultural production. Instead, the reforms unleashed a series of interactions between peasants and the Party (both on local and country level) that ended up with creation of family farming under the so called Household Responsibility System. The spontaneous movement toward private farming was so widespread that in late 1981 (when Household Responsibility System was officially recognized) there were only 55% of collectives left, and the ratio dropped further to 2% in the next two years (Lin, Cai and Li, 1994, p. 21). Thanks to the new set of incentives, annual growth of agricultural production during 1979–1984 period was more than three times higher than in the early and mid-1970s (Huang, Otsuka and Rozelle, 2008, p. 478). At the same time, employment in the primary sector decreased from 69.3% (of total employment) in 1978 to 49.5% in 1984 (Brandt, Hsieh and Zhu, 2008, p. 690).

1 For analysis focused on transition and China-specific characteristics, see e.g. Karnia (2012).

This structural change was supported by rapid development of another institutional novelty – Township and Village Enterprises (TVE). Actually, this form of rural industry – owned and operated by the local governments – existed in China since the early-1970s; however, it was significantly constrained by limited access to credit and resources. As estimated by Naughton (1995, p. 144), at the beginning of the reforms rural enterprises produced less than 9% of total industrial output. The sudden change in TVEs' fortune came with the relaxation of state's monopoly on purchase of agricultural materials. Rural enterprises started to manufacture basic goods for the primary sector, then entered into the long neglected light industry, became subcontractors to urban state-owned companies (SOE), and finally started to compete with them. At the heights of TVEs' development in 1996, there were more than 23 millions of rural enterprises employing totally 135 millions of workers (OECD, 2002, p. 88).

Because the TVEs were excluded from the resource allocation scheme, they had to acquire all the input from the market and were allowed to sell their output at negotiated prices. In effect, they were operating under hard budget constraints and faced factor-price ratio that reflected China's real factor endowment – abundance of labour and scarce of capital. During 1980s, total compensation of rural enterprise workers was much less than half that of state-owned enterprise workers (Naughton, 2007, p. 275). At the same time, when the economic situation deteriorated in 1989, about 3 million TVEs went bankrupt (or were taken over by the peers), while almost all of the loss-making SOEs were rescued (Qian and Xu, 1993, p. 37). Applying this to the macro level, the rise of rural industry introduced much needed price signals to the economy and reduced total misallocation of resources. In 1980–1996 period, collective enterprises (most of them TVEs) recorded average productivity growth of 4% annually – twice the ratio of SOEs (Jefferson et al., 2000).

Despite being registered as collectives and controlled by local governments, most of the TVEs were *de facto* private companies adopting this form of ownership in order to escape political discrimination (Huang, 2008). Small businesses employing less than seven nonfamily members have already been allowed to operate since 1978 in both rural and urban sector (Tsai, 2007, p. 50). However, the regulations were for sole proprietorship only (i.e. owners were responsible for their businesses with their personal wealth), and still leaved room for special government levies (Lardy, 2014, p. 90). Thus, as argued by Nee (1992), when the security of individual economic actors was concerned, TVEs were the second-best adaptation to the environment of underdeveloped formal institutions.

Reliable business norms and financing for this *quasi*-private sector were developed on the grounds of informal arrangements called *guanxi* (Peng and Quan, 2009). These included not only relationship between companies, but also alliances with local Party officials. Incentives for the latter came with fiscal decentralization introduced by the government in the early 1980's. Under the new fiscal-contract system, local governments had to submit a fixed proportion of their revenues to the upper levels, but everything that exceeded this amount could be retained to finance their own expenditures. This scheme created interdependence between companies' profits and local government's disposable income and might be credited for higher permissiveness when new informal arrangements were concerned (Montinola, Qian and Weingast, 1995).

In the mid-1990s, when the legal and political environment for private entrepreneurs have significantly improved, the privatisation of TVEs took off. According to the survey of 670 enterprises from two coastal provinces by Li and Roselle (2003), the shares were sold almost exclusively to companies management rather than to outsiders. In 2003, collective TVEs wholly owned by local governments represented less than 10% of total rural industry's employment (Naughton, 2007, p. 286).

2.2. Reforming state-owned enterprises

In contrast to the bottom-up transformation of rural sector, the reforms of the urban part of the economy followed much more centralized approach and proved to be less effective. That is hardly surprising – state-owned industry was the core of the command economy and the main area of both vested interests and pervasive control (Naughton, 2007, p. 287). Early initiatives tried to improve SOEs' performance by expanding enterprises' autonomy. This soon evolved into more controversial measures that gradually introduced basic market signals to SOEs' economic calculations. Companies were not only allowed to retain part of the profits, but also to produce goods outside mandatory quotas. Until 1983, extra output has been swapped between companies on informal market, then government allowed SOEs to trade it at negotiated prices. Under the dual-track price system, the planners had their pre-reform flows secured, while managers had incentives to increase production. Because mandatory quotas were fixed in nominal terms, 'plan' was slowly giving ground to the 'market'. By 1988, SOEs bought 60% of their inputs and sold similar share of output at the market prices (Lin, Cai and Li, 1994, p. 16).

The mandatory quotas had been completely dissolved by 1993. However, rigid labour market[2] combined with ever increasing competition from TVEs have gradually undermined SOEs' financial situation. By the mid-1990s their losses begun to spin out of control. Given the more decentralized nature of the economy, local governments were keen to engage radical measures (Naughton, 2007, p. 105–106). First, the authorities started to privatise small and medium SOEs. In most of the cases it took the form of managerial or employee buyouts; however, auctions with the participation of local entrepreneurs and joint-ventures also took place (Yusuf, Nabeshima and Perkins, 2006, p. 42). Second, by late 1997, a very aggressive restructuring of remaining enterprises was pushed through. Some SOEs were closed, other transformed into controlled by the state limited-liabilities or joint-stock companies. During the 1995–2002 period, more than 45 million urban workers (including 36 million from the state sector) have been laid off (Giles, Park and Zhang, 2005, p. 150). Most of the dislocated workers were absorbed by the rapidly expanding private sector; however, reemployment was neither smooth nor costless (Cai, Park and Zhao, 2008).

SOEs' reforms marked the end of the first stage of China's economic transformation and set the ground for some form of hybrid capitalism in which private ownership co-existed with a market-dependent state-owned sector. According to the report by OECD (2005a, p. 81–82), the share of private sector in GDP exceeded the one of public sector in 1998 for the first time (by 0.8 points); five years later the difference already amounted to 18.4 points. In 2004 private entrepreneurs finally received official legal protection ensuring equal status with state-owned companies, and in 2007 China's first Property Rights Law has been adopted.

The Communist Party may have lost much of the ideological commitment to state-owned companies, but it did not withdraw from the economy. Kennedy (2005) suggests that despite the shift to market-based competition, the role of political ties – defined as managers' personal connections with officials both on central and local level – has increased rather than declined. According to Fan, Morck and Yeung (2011, p. 1), China has developed a distinctive model of institutional framework that emulates market economy, but in its core remains deeply socialist. Former direct control over allocation of resources has been replaced by more discretionary measures including career rotation, Party affiliation and capital allocation. All of these features are analysed in the next section.

2 Despite introduction of work contracting in mid-1980s, in early-1990s SOEs still provided lifetime employment, housing, pensions and other social entitlements to majority of their workers.

2.3. Party-led capitalism

Looking at the official ownership figures, it seems that Chinese state has been gradually retreating from the economy. The share of public sector in the total number of industrial enterprises (with annual sales over 5mn RMB) fell from 39.2% to 4.5% over 1998–2012, and in total employment from 60.5% to 19.4% (World Bank, 2012, p. 110). However, the share in total industrial assets dropped modestly – from 68.8% to 42.4%. In effect, more than half of the seventy-three Chinese companies listed in the 2012 Fortune Global 500 are supervised by the state (Lin and Milhaupt, 2013, p. 699).

After the large-scale privatisation in the late 1990's, the government consolidated its assets and focused on several key sectors to promote national champions. Industries deemed as strategic – these which involved land or natural resources and interfered with country's safety – were monopolised by the state. Some other, deemed as 'pillar' – including automobiles, machinery, steel, chemicals, construction, electronics and IT – remained under strong bureaucratic influence that limited new entries from the private sector. Only downstream industries like factory-assembled exports, clothing and food became fully open to competition from private enterprises. At the same time, the state has become more sophisticated owner of its assets, as it transferred the authority of policy making and oversight to the central holding company known as the State-Owned Assets Supervision and Administration Commission (SASAC). After early experiments with different organisational frameworks, large vertically integrated business groups – in some aspects similar to Japanese *keiretsu* or Korean *chaebol* – have emerged. These groups (*qiye jituan*) typically include a dominant entity that is wholly owned by SASAC, a financial company, a research institute and at least one subsidiary that is listed on the stock exchange (Lin and Milhaupt, 2013, p. 711)[3]. Thanks to the hierarchical structure, state's policy could be enforced efficiently using interrelated channels of corporate governance and political relations. One of the most powerful tools of bureaucratic coordination is career rotation.

The managers of SOEs are typically appointed by the Party basing both on skills and loyalty (Fan, Morck and Yeung, 2011, p. 4). They are transferred back and forth either to government positions or to other SOEs (Lin, 2010, p. 74). Thus, the scheme provides managers with incentives to promote Party's rather than the company's interest. As documented by

3 State authorities exercised control over the listed companies by issuing only minority shares, and restricting purchases by foreign investors (so called A-shares).

McGregor (2010), the Party's ability to reward or punish executives and bureaucrats has increased since late 1990s which made the centralised human resources policy an effective mechanism of control.

While career rotation is deeply rooted in SOEs corporate governance, other coordination channel – Party affiliation including also some less formal political ties – stretches much beyond the domain dictated by the ownership. Since the late-1980's, many government officers quit their jobs to engage in private business, while those who stayed on the official position frequently hedged their bets by encouraging relatives. In a single year of 1992, when the government's reformatory stance has been re-confirmed by Deng Xiaoping, more than 120 thousand Party members switched to private sector (Wu and Xie, 2002, p. 8, supra note 3). In the late-1990s, another big wave of officials going entrepreneurial was brought by privatisation of small and medium SOEs. In effect, as presented by the study of 790 Chinese companies that went public between 1993 and 2001, almost 27% of the initially appointed CEOs had strong political connections (Fan, Wong and Zhang, 2007, p. 331).

Formal and informal ties have also been established between the political elite and grass root entrepreneurs. The later – motivated by hostile institutional environment and government's monopoly over land and natural resources – started to invite officials into firms' consulting bodies, and to join the ranks of the Communist Party. According to survey by Dickson (2003, p. 111), in the late-1990s, about 40% of large- and medium-scale entrepreneurs held the Party's membership, while this ratio for the whole population equalled only 5%. Facing the growth of private sector, the Party has also changed its approach toward the entrepreneurs. In the early-2000s, it started to court them with the new business-friendly ideology; however, one decade later it turned more heavy-handed by urging all private companies employing more than 50 people to establish party cells administrated by a highly powerful secretary (Shi, Markoczy and Stan, 2014, p. 63). In this way, the Party has created a 'shadow commanding' structure allowing to monitor private entity's micromanagement.

The last important mechanism of bureaucratic coordination is the capital allocation. More than three decades from the start of the reform, the state still controls all major banks in the country and only recently started to relax restrictions on international capital flows. Not surprisingly, during the whole period of economic reforms, the banks tended to support SOEs as well as to finance investments in local and national infrastructure leaving the private sector significantly underserviced (Dobson and Kashyap, 2006). According to Fan, Morck and Yeung (2011, p. 10), almost 90% of the private entrepreneurs rely on own corporate savings, with informal debt making up much of the remaining part.

2.4. The disadvantages of Party-state rule

As presented by Schmidt (2002), the general idea of the state's involvement in the economy refers to the existence of sectors that are essential for state's functioning. The perception of what is 'essential' changes from one variety of capitalism to another; but still, in many developed countries the state holds the dominant position in a number of industries including not only defence and infrastructure, but also utilities, energy, transport and banking (OECD, 2005b). As discussed earlier, under the comparative economics framework, active role of the state does not automatically imply worse economic outcome (Amable, 2001). However, formal and informal control of the Party-state raises serious concerns about the efficiency of China's system.

According to Lardy (2014, p. 34), SOEs 'corporatisation' brought some improvement in financial results as the number of enterprises in the red and their total losses have declined. Nevertheless, in terms of profitability, they still lagged behind non-state firms. In 2009, the average return on equity of Chinese state-owned companies was almost 10 points lower than that of the remaining ownership forms (World Bank, 2012, p. 111), but the profitability within this group varied considerably. The biggest SOEs engaged in resource-extraction industries (and enjoying near monopoly on the market) recorded very high returns on assets, whereas small SOEs acting in a more competitive environment struggled to display satisfactory rates of return (OECD, 2010, p. 1).

In addition to weaker performance of the public sector, state-led allocation of capital is consequently blamed for systematic misallocation of resources (Boyreau-Debray and Wei, 2005). This, in turn, significantly lowers aggregate total factor productivity (TFP). Using microdata on manufacturing plants, Hsieh and Klenow (2009) estimate that if capital and labour were reallocated to equalize marginal product across manufacturers, TFP growth in 1998–2005 period would have increased by 2% per year.

Additionally, the importance of political ties led to emergence of unproductive rent-seeking. Fan, Wong and Zhang (2007) find that during the first three years after initial public offering, companies managed by politically connected CEOs recorded lower stock returns (by almost 18%) compared with firms not having such CEOs. As documented by Wederman (2004), along with growing economic opportunities, the corruption has not only intensified during the 1990s, but also spread into the senior cadres. That added to already strong political opportunism. The offsprings of the Party elite, known as 'princelings', have acquired vast amount of wealth while managing biggest Chinese transnational corporations and financial institutions (Ding, 2000, p. 122; Barboza and La Franiere, 2012).

Public's growing discontent over corruption has led the leaders to pursue large-scale anti-graft campaign. Since its beginning in 2012, some high-profile Party members including the country's former security chief have been put into investigation. However, as much as directed at strengthening the Party's legitimacy by tackling one of the most debated issues, the crackdown was designed to consolidate Xi Jinping's political power. There is also more than a hint of hypocrisy in government's action, as the recent investigation by Bloomberg (2012) exposed assets of $500 million in control of Xi's extended family (though not the close relatives). After publishing story on current China's leader, Bloomberg's internet site has been blocked by censors.

Looking at the state-induced inefficiencies and widespread corruption[4], it seems that Party-led capitalism is very far from the 'good' form of *régulation* discussed broadly by Amable (2003). Nonetheless, the role of the political actors in China's institutional development is slightly more nuanced than the imperfect outcome might suggest. Nee and Opper (2012) stress the importance of Party's accommodative changes to formal rules that led to creation of vibrant private sector (so called market-preserving policies). As can be drawn from Olson's (1982) analysis of special interest groups, the Party had strong incentives to block the creation of new (formal and informal) institutions that challenged its privileged position. It can be argued that the persistence of political ties and political opportunism is the price to be paid when transformation unfolds without democratization[5].

The ambivalence toward the state-guided economy is shared by many other studies. Despite being critical to the Party's political monopoly, Coase and Wang (2012) suggest that most of the top-down reforms that paved the way for the rise of common national market have been underestimated. Similarly, Naughton (2007) praises the government's ability to implement decisive economic policies dealing with structural and economic problems. Next section completes the analysis of the role of the state in China's development by adding some macroeconomic perspective.

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4 In 2014, China ranked 100th out of 175 countries in Transparency International's Corruption Perception Index (CPI 2014, available at: http://www.transparency.org/cpi2014); however, the index is not a direct measure of corruption and may be subject to perceptual biases.

5 However, as the Russia's example suggests, even with democratization there is no guarantee of a positive outcome.

2.5. The role of the state in economic development – macroeconomic policy

Balcerowicz (1997, p. 201–202) argued that much of China's success can be attributed to its initial backwardness. As much as it is true, it also misses the point. Cross-country studies of Barro and Sala-i-Martin (2003) clearly show that convergence in levels of per capita income is everything but unconditional. All the mechanisms that allow poor economy to grow faster than the rich one – higher marginal returns to capital (Solow, 1956), structural change accompanied by factor reallocation (Lewis, 1954), and transfer of technology (Gerschenkron, 1962) – are only potential and work unless broad socio-economic institutions constrain them. Examining growth experiences over the past several decades, Johnson, Ostry and Subramanian (2006) distinguish some patterns that allowed countries with initially low level of GDP per capita and weak institutions to kick-start growth and then sustain it along with upgrading the quality of their institutions. They find that higher levels of educational attainment and lower levels of inequality helped; however, the key was to promote manufacturing export. Rodrik (2010, p. 89–90) goes into more details by providing specific policy prescription for successful export-led growth. First, sound fundamentals including stable macroeconomic environment, price signals and contract enforcement (sometimes achieved *de facto*, but not *de iure*). Second, industrial policies enhancing the capacity of tradables sector including tax incentives, undervalued currency, some trade protection, and even financial repression. This set of policy measures resembles Gerschenkron's (1962) notion of late development, according to which the state not only needs to construct the markets, but should also help to overcome low private capital and coordination failure.

Until the mid-1990s China has been trying to get its fundamentals right. The most direct consequence of marginal revolution and dual-price track system was the emergence of effective price mechanisms. The share of producer goods transacted at market prices increased from zero in 1978 to 46% in 1991 and 78% in 1995, while for the retail trade it amounted to 3%, 69% and 89% respectively (OECD, 2005a, p. 29). Deregulation has also embraced the exchange rate. Before the reforms started, the planners maintained fixed and overvalued exchange rate to subsidize the import of capital goods. In 1980s, the authorities gradually devalued the official rate and simultaneously introduced market quotations. In 1994, the official and market rates were unified, and two years later, the current account convertibility was announced (nevertheless, control over capital flows was still binding) (Lin and Schramm, 2003, p. 260–261). According to IMF estimates cited by Branstetter and Lardy (2008, p. 639), the Chinese currency lost about 70% of its value (in real terms) against the dollar over 1980–1995 period. This significantly improved the competitiveness of China-based manufacturing export and encouraged some further manipulations (Coudert and Couharde, 2007). Additionally, being *de facto* pegged to the dollar, the exchange rate become central not only to export-promoting strategy, but also to monetary policy. When the economy was 'growing out of the plan' from the mid-1980s to the mid-1990s, its output gap and inflation were highly volatile; however, since 1996 the economy has avoided significant slowdown (even during Asian and later global financial crisis), and inflation never exceeded 6.0% per year.

Along with building the fundamentals, the authorities started opening the country to foreign trade and investment; however, in highly selective fashion. Policies adopted by the government consequently aimed at promotion of export, while trying to maintain some protection for local market. First, in the early-1980s, two distinct trade regimes have been introduced – one that offered reduced tariffs for imports designed for companies engaged in export processing; the other that combined high tariffs with import quotas designed for remaining firms (Branstetter and Lardy, 2008, p. 634–637). The discrepancy between the two has been gradually lessened – in 2001, China joined World Trade Organization (WTO) having weighted average tariff amounting to 14%; five years later it was only 4% (World Bank, 2014). Second, several measures courting FDI in manufacturing export were approved. In 1979, the authorities passed the Law on Joint Ventures that provided basic framework for foreign companies investing in China. In the same year, four Special Economic Zones (SEZ) offering preferential taxes and simplified administrative rules were established. During the next decades more economic zones and more concessions followed; however, up to this day the system has been quite restrictive when it comes to investments in strategic sectors. The result of state's industrial policy was striking – in 1995, FDI firms accounted for 8.9% of manufacturing employment and 31.5% of China's export; by 2008, the shares increased to 33.0% and 55.2% respectively (Chen, 2011, p. 15).

Following the East Asian export-led growth strategies, China has managed to set all three catch-up mechanisms in motion. Higher investment resulting from FDI inflow and financial repression allowed for Solow-style convergence. Labour-intensive manufacturing export relied heavily on rural migrant workers (Chan, 2010, p. 359), and thus sped up the pace of structural transformation. At the same time, FDI made positive contribution to labour productivity both directly (as joint venture framework required transferring of technology to local partners) and indirectly (spillover effects – especially strong in the early phase of opening up).

By establishing sound fundamentals and promoting export, the state was acting like a developmental force. However, as reforms evolved, policy's center of gravity has been gradually shifting from 'opening-up' to 'financial repression'. Owing to controls on both interest rates and capital flows, dominance of state-owned banks, and strong state interventions, the government was able to mobilize savings and use these funds to develop strategic sectors. In some cases it may have succeeded in overcoming coordination failures, but generally, the result was an unsustainable pattern of growth. Zheng, Bigsten and Hu (2008) find that since the mid-1990s China's economic strategy relied too much on capital formation which has led to inefficient allocation of resources and a slowdown in TFP growth. Similarly, using a sample of more than 12 thousand firms, Dollar and Wei (2007) estimate that China could achieve the same growth by reducing its investment intensity by 5% and allowing for unbiased allocation of capital.

As financial repression acts as an implicit tax on labour (to subsidize capital), the costs of over-investment are borne by households – Lee, Syed and Liu (2012) estimate them at 4% of GDP per year in the last decade. This raises the question whether China's growth maximizes economy-wide social welfare or allows to profit politically-connected ones only. With patchy social safety net, suppressed consumption and growing environmental problems it started to look more like the latter. At the same time, heavy reliance on state-led investments led to SOE's overcapacity and surge in (official and hidden) public debt. According to estimates by Standard Chartered it rose from near 150% of GDP in 2008 to 250% in mid-2014 (Anderlini, 2014).

The last once-a-decade leadership transition that took place at the end of 2012 brought changes to the Party's economic strategy. New government is prone to accept a slowdown in economic growth as the cost of rebalancing the economy (Bloomberg, 2013). First, measures to limit the scope of financial repression have been gradually introduced – the ceiling on deposit rates was lifted, real effective exchange rate has been allowed to appreciate and the capital control partially scrapped. Second, the government is experimenting with new policy plans that focus more on quality rather than quantity of growth. The Economist (2015) reports that Shanghai municipality is the first to withdraw from GDP targeting, other provinces are expected to follow (however, not immediately). All these measures are welcomed, but it seems that diverting the benefits of economic growth from SOEs to households is going to take some time. Despite the reforms, China's financial system is still heavy biased toward the state and protected from foreign competition by subtle regulations. At the same time, there is no sign that the government is ready to give up promoting SOEs or to liberalize 'strategic' and 'pillar' sectors.

Conclusion

Thanks to the combination of market-oriented reforms and successful macroeconomic policy, China has recorded unprecedented economic growth since 1979. The market economy has emerged 'from below' forcing the state to take more accommodative rather than active approach. Nonetheless, the Party has been holding the reins all the time – it delayed introduction of hard budget constrains to SOEs and launched brutal crackdown on Tiananmen protests in 1989. The accounts for the export-led growth strategy are different. The institutional experiments were crafted by the state and adjusted to changing macroeconomic conditions. Thus, the state was acting like a developmental force and the goal – integration into the global value chains – was appealing to the international community.

However, after more than three decades of reforms, the Party-state still holds the dominant position in the China's economy. Former direct control over the resources has been replaced by more discretionary measures, entrepreneurs established strong political ties with the officials and the boundary between the market and the state has blurred. As presented by the paper, this institutional outcome is hardly an optimal one, especially when system's intrinsic deficiencies are reinforced by financial repression leading to investment-biased growth. China has established state-controlled economy, but certainly no welfare state.

The measures taken by the new leadership to rebalance the economy are welcomed, but as many pointed out, the reforms should also tackle Party's political monopoly. Since the authoritarian system does not allow for free flow of ideas, Coase and Wang (2012) see the Party as the biggest obstacle to China's long-term growth. Similarly, Acemoglu and Robinson (2012) suggest that the 'extractive' institutions that put the interests of the elite over the interests of the society will hamper China's further development. Even those who propose more pragmatic approach toward the Party, argue for smaller economic role for the state, further privatization of industrial SOEs and healthier relationship between the state and business firms (Yusuf, Nabeshima and Perkins, 2006, p. 238).

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http://dx.doi.org/10.18778/8088-012-2.03

3. Labour market developments in Visegrad countries: ten years of EU membership[1]

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Abstract

The Visegrad countries[2] (V4) joined the European Union in 2004 as rather weak economies, but growth potential was undeniable. Since then, they recorded a gradual improvement in labour market indicators. However, the economic crisis has affected the labour markets of V4 countries differently. The aim of the paper is to identify labour market developments in V4 countries and the impact of the economic development on them. The emphasis is being placed on the development of the selected specific unemployment rates. We know that the most important thing is to figure out how to get employment development back on track. Therefore, the

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1 The paper is the outcome of scientific project VEGA No. 1/0103/12 'Labour market in relation to economic growth in the context of socio-economic changes' (Trh práce vo väzbe na ekonomický rast v kontexte spoločensko-ekonomických zmien).

2 The Czech Republic, Hungary, Poland and Slovakia.

paper also deals with the issue: Where will new jobs come from? The last section reviews the green economy as one of the key sectors with great employment potential.

Introduction

In May 2014, the V4 countries were celebrating the tenth anniversary of EU Membership. Benefits of joining the EU were apparent at the very beginning and associated with four fundamental freedoms – free movement of goods, services, people and capital, including greater choice of products and inflow of foreign capital from EU states. The EU membership also extended opportunities to travel to the "old" Member States as well as to do a business, to work or study over there. However, EU membership meant increasing pressure to create a better business environment and at the same time new business opportunities for competitive firms have been created. The V4 countries also gained full access to structural funds, which was limited before joining EU. It definitely helped them to finance investments in regional development, to increase competitiveness and employment. The EU membership also brought the transfer of a number of important competencies in various areas, many times over-regulation, as well as the outflow of skilled labour force abroad and disappearance of certain businesses due to increased competitive pressure.

The second section of the paper deals with economic developments in V4 countries. The third section presents an overview of labour market developments in the Czech Republic, Slovak Republic, Hungary and Poland since EU accession in 2004. The major contribution of the forth section is to explore the employment opportunities for V4 countries in the field of green economy and employment. The importance of green economy and its potential of creating new jobs are obvious and it is constantly highlighted by the European Commission (2012b), OECD (2012) and the United Nations (UNEP 2008).

3.1. Economic developments in V4

The period after EU accession in 2004 could be divided into two periods, before and after crisis. The financial crisis has affected V4 economies in many ways, but it can be concluded that the common effects of the financial crisis were (Sobják, 2013):

- a sharp decrease in GDP,
- decrease in exports because the demand in the EU was falling,

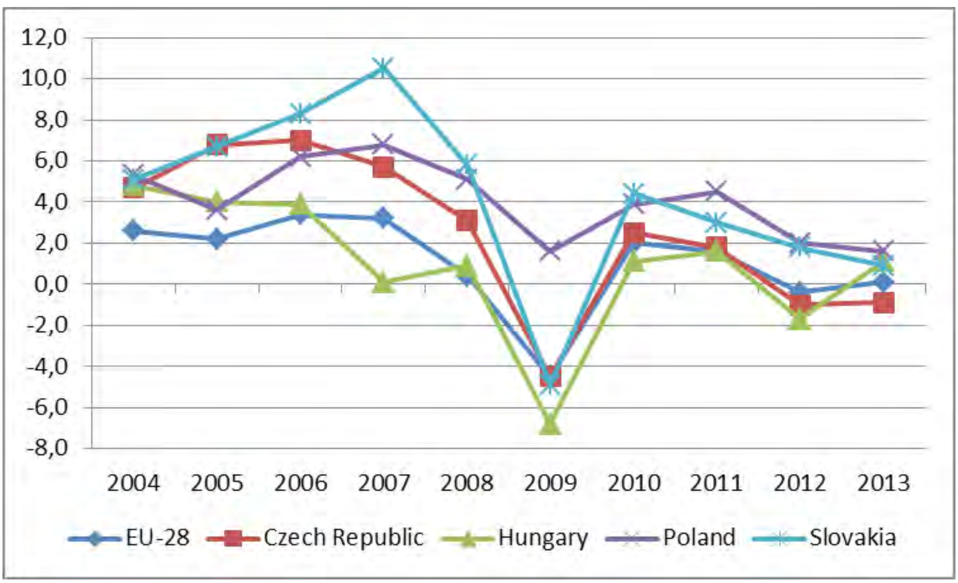
- an industrial production and the construction sector declined,
- the capital outflow from the V4 area.

The substantial fall in GDP led to significant increase in unemployment rates across V4 countries. The nature of V4 economies is that they are open, small (except Poland) and highly export-oriented, it means, their exposure to negative trends in global economy is quite high.

The economy of the Slovak Republic is one of the most dynamic in the European Union. It is a small and open economy that means exports make up a large part of GDP. However the greatest strength can also be the biggest weakness. In the period from 2004 to the onset of the crisis, GDP growth was among the highest in EU, also supported by strong productivity growth. The fall in GDP in the wake of the crisis was one of the highest (OECD 2013). The period after joining the European Union is characterized by acceleration in economic growth, and its dynamics has significant impact on the labour market in the direction of a decrease in unemployment and creating more permanent jobs. However, in Slovakia remained strong regional polarization of labour market, income inequalities within the state and the regions. In terms of Slovakia there was a sharp increase in GDP before the onset of the crisis. The GDP growth in 2007 peaked at more than 10%. Comparing the other V4 countries it can be conclude that the fall of GDP growth in Slovakia was enormous, from 10.5% in 2007 to -4.9% in 2009. Luckily, as shown in the graph 1, recovery was quite swift. The strong growth in the period before the crisis was driven by major export oriented FDI inflows, but mainly into the western regions of Slovakia (OECD 2014a). It means that benefits from high GDP growth are seen mostly in the western part of the state. It is necessary to add that exports of goods and services are ca 95% of GDP. Nevertheless, growth is dependent mainly on the situation in automotive and electronic industries.

The Czech economy is a stable, small and open economy, closely integrated with the European Union. The country is considered as export economy with strong machinery and automotive industry, closely connected with Germany as its main export partner. Before the financial crisis that occurred in 2008, the Czech Republic experienced the longest period of uninterrupted growth ever (European Commission, 2014a). The strategy was based on attracting FDI and positive labour market situation. When Germany slid into recession in November 2008, demand for Czech goods shrank dramatically and real GDP fell sharply in 2009 (Graph 3.1). There was a slow recovery in 2010 and 2011. However, in the next year the Czech economy fell back into the recession. Comparing the other V4 countries, the Czech Republic was the only V4 country with negative GDP growth in 2013. The Czech economy has remained weak for longer time than the majority of EU countries. The recovery started in the second half of 2013. The reasons could be seen in a lack of external demand and because of austerity measures taken by the government (OECD, 2014b).

The developments in the Hungarian economy are quite different. The serious slowdown of the economy could be seen since the beginning of the year 2006. Regarding GPD growth is obvious that the crisis has hit Hungary a bit earlier than the other V4 countries. In April 2006, the Hungarian government adopted a package of austerity measures in order to reduce the budget deficit. That was the reason of slowing down in next two years. Although the GDP growth fell below zero not until 2009, the years 2007 and 2008 could be called as stagnation, with GDP growth 0.1% and 0.9% respectively. Hungary was also forced to agree and take a loan from the IMF in October 2008. There was a sharp decrease in GDP growth in 2010 (Graph 3.1). After another GDP decline (1.7%), Hungary got out of recession in 2013, with GDP growth of 1.1%. However, weak investment, low employability of low-skilled workers and shortcomings in labour and product markets held back growth potential. All in all, further structural reforms are essential (OECD, 2014c).



Graph 3.1. GDP growth in V4 countries and EU-28 between 2004 and 2013 (in %)

Source: Eurostat, own processing.

Note: GDP at market prices, percentage change over previous period.

Comparing all V4 countries, Poland is the only one that has not met the negative GDP growth since joining the EU. The economic performance has been impressive since EU accession in 2004. The success of Poland in tackling the crisis is quite impressive. There are couple of reasons for positive development in GDP growth and for answer the question: why was Poland´s economy that resist to the global shocks? Firstly, at the beginning of the crisis in Europe, fiscal structure and banks were stable. Moreover, the Polish currency has not been pegged to the euro and it helped central bank of Poland. Depreciation of Polish currency facilitated to increase competitiveness in case of exports. Another important thing is that the Polish economy is not that open as the other V4 countries. And finally, the size of the Polish economy, robust domestic demand and consumption helped to overcome deteriorating economic conditions since the onset of the financial crisis (Sobják, 2013). Yet, a bit surprising was that the economy slowed down in 2012 and 2013. That means the important challenges remain.

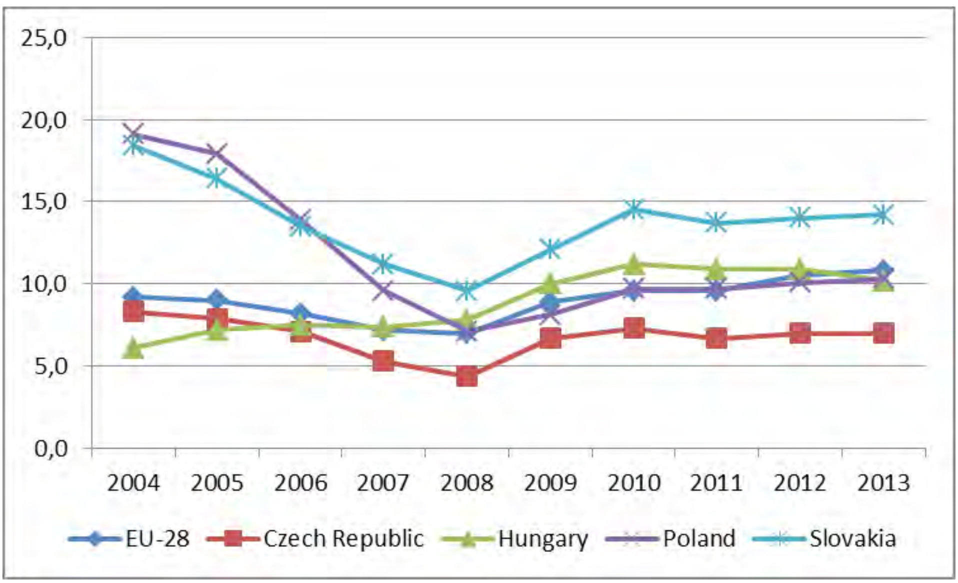
3.2. Labour market developments in V4

3.2.1. Labour market situation

After accession to the EU, the labour markets of V4 countries experienced significant changes. Any measures aimed at preventing significant labour migration were gradually removed. Free movement of persons as the main objective was clear. Developments in the labour markets after joining the EU can be divided into two periods (Graph 3.2), however, differed significantly in nature (Šikulová et al., 2014). The onset of the crisis in 2009 represents the dividing line and it left the significant negative phenomena in the V4 labour markets which are very difficult to overcome nowadays.

Slovak Republic

The labour market in Slovakia has been hard hit by the crisis. Total unemployment, youth unemployment and long-term unemployment are the major problems the Slovak Republic is facing. The most important problem the Slovak labour market needs to deal with is undoubtedly a long-term unemployment. While the number of unemployed has declined continuously since 2001, the number of long-term unemployed has increased its share of total unemployment. In 2013, more than 70% of unemployed were unemployed more than 12 months, the highest share not only in V4, but also across the EU. In 2007, there was a problem with the reduction in unemployment rate and the cause was mainly a large number of long-term unemployed in the labour market, either without work habits, or not willing to move to work. The graph 3.3 shows that the situation in case of long-term unemployment remains more or less stable since 2004 (except year 2009) and we cannot see any positive improvements. While in 2004 the long-term unemployment was at the level of 64.7% of total unemployment, in 2013 it was 70.2% and this is extremely high. Also, it is necessary to emphasize high unemployment among young people under 25. Every third economically active in this age group is unemployed, what is the worst among V4 countries. Frustration of young people of job prospects can be a destabilizing factor in the development of long-term unemployment. The developments in unemployment rate of young people can be seen in graph 3.4. Of course, there were some positive improvements between 2007 and 2008, but later the situation has deteriorated and high levels of unemployment which could be seen before crisis came back. The Slovak government knows that current situation needs solution so that a couple of new instruments will be implemented in order to improve the performance of the labour market. The measures are related mainly to employment services to make them more efficient and effective for disadvantages job-seekers. Also, other measures are aimed at young people under 29, long-term unemployed and Roma communities (NRP, 2014a).

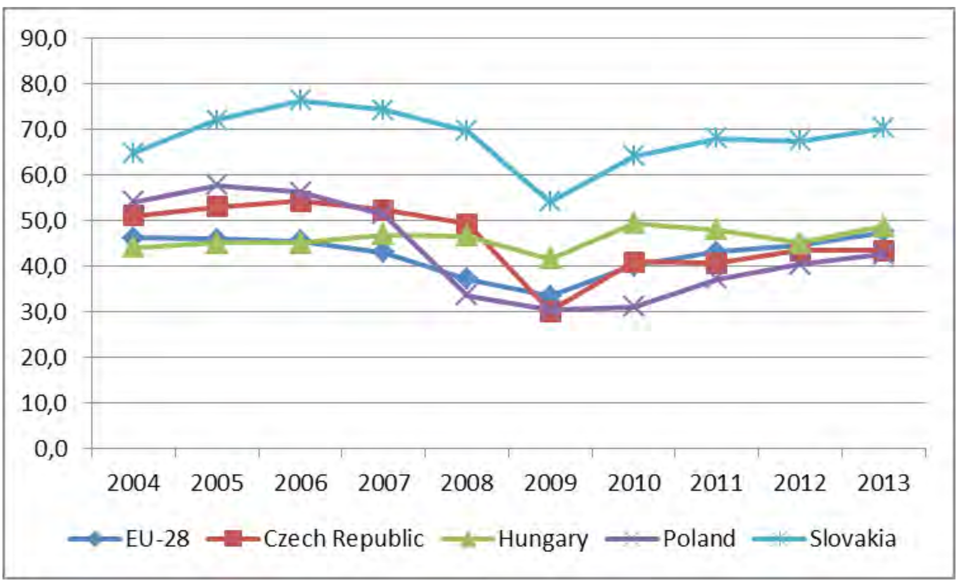


Graph 3.2. Unemployment rate in V4 countries and EU-28 between 2004 and 2013 (in %)
Source: Eurostat, own processing.

3.2.2. Czech Republic

Comparing the situation across V4 countries, the labour market indicators in the Czech Republic are quite good. The development of unemployment rate since joining the EU can be seen as a success. It started at the level of 8.3% in 2004, than it lowered to 4.4% in 2008 and finally, it reached 7.0% in 2013 (Graph 3.2). The level of 7.0% is the lowest unemployment rate among V4 countries and it is also 3.8 percentage points (pp) lower than EU average. However, the financial crisis revealed some structural problems; e.g. the labour demand has changed towards a more qualified labour force, without significant reaction of the government. Since 2008, the unemployment rate rose and affected mainly low-skilled and young people (OECD, 2014b). The youth unemployment reached 19.5% in 2012 (Graph 3.4), what is a big difference, if we compare it with total unemployment rate. The government has got a plan to deal with it, e.g.:

- better career guidance,
- improved information provision,
- facilitation of participation in active labour market policies,
- workplace training.



Graph 3.3. Long-term unemployment in V4 countries and EU-28 between 2004 and 2013 (in % of unemployment)
Source: Eurostat, own processing.

Another structural problem in the Czech labour market is the persistence of high long-term unemployment rate (Graph 3.3). There is 43.4% of the unemployed without a job for longer than 12 months. Active labour market policies could help in that situation to raise the employability of low-skilled and young people who left education system and have no skills needed in the labour market. However, the spending on active labour market policies in the Czech Republic is low and not that well targeted. A Youth Guarantee Programme was adopted with its aim to offer employment, further education, training or internship to everybody under 25. The offer needs to be within 4 months after becoming unemployed. The implementation of the programme is via existing 31 projects for youth (NRP, 2014b).

3.2.3. Hungary

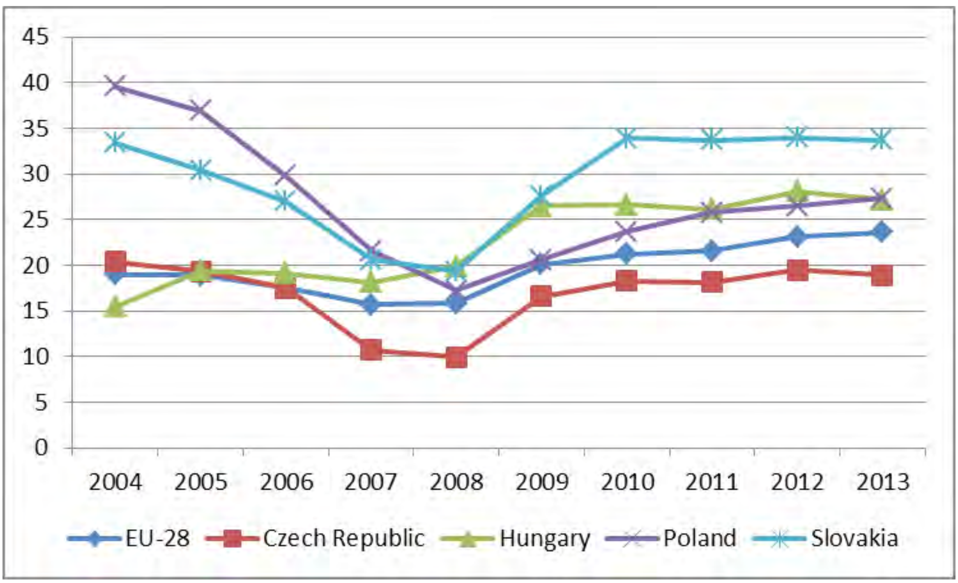
There are some visible improvements in labour market situation due to couple of reforms they had been made in the past years. However, Hungary still needs a lot to do in order to deal with challenges that country faces, namely structural problems and low economic growth.

Hungary adopted a couple of measures in order to mobilize labour force and boost employment in the past years, e.g. (European Commission, 2014b):

- the reform of the social service system to promote work,
- a reinforcement of active labour market instruments,
- the launching of new Public Work Programme,
- an adoption of new Labour Code,
- the transformation of labour income taxation,
- the reform of the tax system,
- an implementation of a new employer benefit system, which reduces employment costs directly,
- the reforms in the fields of vocational and adults training.

Despite the fact that the country has introduced a number of measures, the new ones need to be adopted. In 2004, unemployment rate was 6.1% (Graph 3.2). Over the decade, it increased and it is stabilised around 10% nowadays, which means ca 4 pp more than in year of joining the EU. If we compare V4 countries we can find out that for example in Poland in 2004 unemployment rate was 19.1% (exactly 13 pp more that in Hungary) and in 2013 unemployment rate in Poland was 10.3% (only 0.1% more that in Hungary), what is quite interesting for comparison. As we mentioned above, there are couple of issues to deal with. One of the important barriers is labour taxation, especially for people with low wages. The jobseekers in Hungary also need more time to find their job in comparison with the three months period of unemployment benefit. Of course they may be forced to join public work scheme, but they can be stuck inside that scheme for a longer time or just take the first job even if it does not fit their qualification.

The youth unemployment in Hungary rose significantly since joining the EU, from 15.5% to 28.1% in 2012 (Graph 3.4). Then, in 2013 decreased to 27.2% but still remains high. Some measures has already been undertaken in this area, e.g. retargeting active labour market policy to young people and support schemes for young entrepreneurs, or wage subsidies (European Commission, 2014b). The country considers youth unemployment as a top priority and challenge. Another very important priority is to tackle a problem of long-term unemployment (NRP, 2014c). Although there is not a significant rise over the years, the share of long-term unemployed among unemployed people increased from 44.0% in 2004 to 48.6% in 2013, the second highest level across V4 countries (Graph 3.3).



Graph 3.4. Unemployment rate of young people in V4 countries and EU-28 between 2004 and 2013 (less than 25 years, in %)
Source: Eurostat, own processing.

3.2.4. Poland

Labour market developments since Poland joined the EU are quite good at first sight. The level of unemployment rate decreased by 8.8 pp since 2004 and it was 10.3% only compared with 19.1% in 2004. So, what are the reasons? First of all it is mostly because of labour costs which are competitive, if we compare labour costs across the EU. It means that employees are not expensive for the companies, they are also productive, tax burden is not that high and labour law is flexible (European Commission, 2014c). In order to make the labour market situation in Poland better, the government committed to undertake reforms in the field of labour market in National Reform Programme 2014/2015 (NRP, 2014d). The government plans to introduce new labour market instruments mainly for vulnerable group in the labour market – young people under 30 and older people aged 50+. Another issue is what to do with the consequences of the financial crisis if we speak about long-term unemployment. The Polish government stated that emphasis is being placed on measures which can maintain employment even in the case of decrease in economic activity, e.g. they plan to co-finance the training costs of employees who face economic downturn or who's working time is reduced. Also, the measure which will support employment through providing financial supplements to employees who are in the risk of dismissal in case of temporarily deteriorated business conditions.

Especially the high incidence of unemployment among young people is a burden. In 2013 the unemployment rate of young people peaked at 27.3%, what is high level, taking into account 17.2% in 2008 (Graph 3.4). Comparing the situation in 2004, when it was 39.6%, it seems to be quite good nowadays. However, it is not. The rate is the second highest among V4 countries and the situation requires taking measures which would help the young people to find first job. Also, the problem is that there is a lack of access to quality apprenticeship and work-based learning. Some reforms have already been done in the field of vocational education and training system. The progress is obvious and it is going in the right direction (European Commission, 2014c). As mentioned above, government has got a plan what to do and how to fight long-term unemployment. If we take a look at graph 3.3, we can see that Poland has the lowest level of long-term unemployed of total unemployed. In 2013 it was 42.5%. It means that since joining the EU it has decreased by ca 11.5 pp and this we can consider for success comparing with other V4 countries.

3.3. Where will new jobs come from?

In order to respond to the continuing high unemployment and low employment rate in the EU, in April 2012 the Commission introduced a set of measures with a clear objective, namely to promote job creation, entitled Employment Package. The Employment Package is a set of documents outlining the options to link employment policy at the EU level with a number of other policies to promote smart, sustainable and inclusive growth. It identifies potential areas of job creation and the most effective ways to create them within the EU. The Commission proposed measures in the following areas (European Commission, 2012a):

a) Support job creation;
b) Restore the dynamics of labour markets;
c) Enhance the EU governance.

In the area of promoting job creation, the measures can be divided into three sub-areas (Table 3.1): (a) stepping up job creation in all sectors of the economy fostering labour demand, (b) exploiting the employment potential of key sectors, and (c) mobilisation EU funds for job creation (for more see Klimko and Rievajová, 2014). However, in the next section, attention will be paid and there will be highlighted measures to promote green economy as one of the key sectors with employment potential.

Section	Measures
Stepping up job creation in all sectors of the economy by supporting labour demand	• Targeting hiring subsidies to new hiring • Reducing the tax wedge on labour in a budgetary neutral way • Supporting self-employment, social enterprises and business start-ups • Transformation of informal and undeclared work into regular employment • Boosting 'take home' pay • Aligning wages and productivity
Exploiting the employment potential of key sectors	Job growth in sectors: • Green economy • Health and social care • ICT
Mobilisation of EU funds for job creation	Using funds: The European Social Fund (ESF) The European Regional Development Fund (ERDF) The European Progress Microfinance Facility The European Globalisation Adjustment Fund (EGF) The European Agricultural Fund for Rural Development (EAFRD)

Table 3.1. Measures to support job creation
Source: European Commission, 2012a, own processing.

3.3.1. Exploiting the employment potential of key sectors

The Europe 2020 strategy states that the EU is currently facing deep structural changes, in particular the transition to ecological, low-carbon and resource-efficient economy, demographic ageing and the rapid technological progress. That is why in the Annual Growth Survey 2012 were identified the following three main areas, each of them having a considerable future potential for job creation: (a) green economy, (b) health and social care, and (c) ICT (European Commission, 2011). The Commission noted that only the energy efficiency and renewable energy sectors could create five million jobs by 2020. However, the challenge remains to adapt skills to new technologies, especially for low-skilled workers and older workforce (European Commission, 2012a). Nowadays, employment in the health and social care within the EU is growing fast as a result of population ageing, as well as because of an expansion of services to better meet quality requirements and rising demand for personalised care and professional social services. The third area of job creation potential is the area of information and communication technologies. The demand for ICT professionals continues to grow and the demand for labour force exceeds supply.

3.3.2. Green economy

The Europe 2020 is based on the assumption that green, low-carbon and energy efficient economy is crucial to achieve smart and inclusive growth. Inefficient use of resources, unsustainable pressure on the environment and climate changes, as well as social exclusion and inequality pose challenges for long-term economic growth.

Green growth is a challenge and an opportunity for the labour market and skills that are key factors for enabling green growth. The transition will bring major changes in the overall economy and in a wide range of sectors, and thus create new jobs (OECD, 2012). In this context, it is important for better targeting and coordination of labour market measures and tools to establish the conditions necessary to promote green jobs, a support to overcome the mismatch between skills shortages and labour shortages, and anticipating changes in the needs of human capital.

The Employment package from 2012 identified the green economy as the major source of job creation in Europe. It is estimated that the implementation of measures in the field of energy efficiency could create or maintain up to 2 million jobs by 2020 and the renewable energy sources development could lead to 3 million new jobs by 2020 (European

Commission, 2012a). However, policies which lead to greening the economy may have an impact on employment in carbon-intensive sectors or require adaptation of skills and working methods. Therefore it is important to ensure that the skills needed in the emerging green industries could be anticipated and developed.

Annual Growth Survey 2014, as well as the previous one in 2013, emphasized the potential for job creation in the green economy and the need to develop the strategic frameworks in which labour market and skills policies play an active role in supporting job creation. However, integrated policy frameworks combining green growth and employment exist only in a few Member States, while the majority of them has a disjointed and fragmented approach (European Commission, 2013).

3.3.3. What is green economy?

UNEP (2008) defines the green economy as the economy, which leads to improvement of human well-being and social equity while reducing environmental risks and ecological damage. In the simplest terms, a green economy can be seen as a low-carbon, resource-efficient and promoting inclusive society. In terms of green economy the increase of income and employment should by driven by public and private investments that reduce carbon emissions and pollution, increase energy efficiency and resource efficiency, and prevent the loss of biodiversity and ecosystem disruption. Such investments are necessary to stimulate and encourage by targeted public expenditures, policy reforms and changes in regulatory areas.

The development of a competitive, low-carbon and energy-efficient economy will bring fundamental transformation in terms of business processes and the necessary skills that will contribute to the creation of so-called green jobs. In the longer term, many of jobs will be transformed to the green jobs. In this context, it is also the notion of green jobs associated with the various sectors of the economy. Thus, it is not only about certain sectors such as sector of renewable sources (European Commission, 2012b).

Green jobs include jobs that are dependent on the environment, or are created, substituted or redefined (in terms of skills, working methods, etc.) in the process of transition towards a greener economy. For example, more jobs will be created through the renovation of buildings, the development and introduction of new technologies such as renewables. Some employment in traditional cars production will be gradually replaced by production of hybrid cars.

3.3.4. European Union policy to support green jobs

The economic crisis has revealed some structural weaknesses that are present in the European economy. Global and long-term challenges in the areas of globalization, climate changes and natural resources, as well as technological changes and demographic changes (decreasing labour supply) were intensified. The European Commission launched the Europe 2020 on 3 March 2010 to promote joint activities that could turn the EU into a smart, sustainable and inclusive economy with high levels of employment, productivity and social cohesion.

There are a number of policies and strategies designed to move Europe towards a low-carbon economy and reduce its environmental impact. One of the most important of those, in terms of potential impacts on employment, is the European Energy and Climate Change Package. The goals of the package are generally known as the 20–20–20 targets. They include:

- to reduce the greenhouse gas emissions of at least 20% below 1990 levels,
- renewable sources will represent 20% of final energy consumption in the EU,
- to reduce energy consumption by 20% of the expected 2020 levels.

As a result of legislative reforms and emission targets will, on the one hand, the reduction and restructuring of industrial carbon-intensive sectors. On the other hand, employment growth can be expected in the field of renewable energy and activities to promote energy efficiency, particularly in construction and transport.

Key sources of investment to support sustainable growth and job creation are European Structural and Investment Funds. The main EU financial instruments to promote skills upgrading, job creation and the transition to a greener economy include:

- European Social Fund (ESF) co-finances labour market measures, measures to smooth the transition into work and improving knowledge and skills. The ESF may support the labour force transition towards greener jobs, help address the lack of skills and improve the vocational education and training.
- European Regional Development Fund (ERDF) supports investments in the areas of energy, renewable energy, waste and water management, green infrastructure, conservation and protection of biodiversity, eco-innovations, development and innovation of low-carbon technologies.
- European Agricultural Fund for Rural Development (EAFRD) promotes investment in agriculture, forestry, rural development, including investments in renewable energy and energy efficiency, etc.

Member States will have to invest at least 30% of total spending from the fund to mitigate climate changes, as well as to address issues relating to the environment.

In 2012, the European Commission highlighted the potential for job creation in the context of green growth and identified four actions for employment in order to promote the creation of green jobs (European Commission, 2012b):

- to integrate the green jobs in the national plans for the job creation,
- to strengthen the knowledge base of skills needed in the green economy,
- to encourage greater use of financial instruments for smart green investments,
- to build partnerships among participants in the labour market.

In order to stimulate innovations in technologies, ways of organizing and facilitating investments in physical and human capital, which support the efficient use of resources, there is a wide range of fiscal, financial, regulatory and legislative instruments at the European, national, local and sectorial levels. The purpose of these instruments, as well as individual policies, is the promotion and implementation of innovations and changes, which are more efficient in terms of resources and will have an impact on the labour market.

3.3.5. Examples of measures supporting green jobs in the European Union

3.3.5.1. Slovak Republic: The building insulation programme

The insulation programme, launched in mid-2009, was a part of the government stimulus package aimed at mitigating the negative impact of the economic crisis. The idea was to use the emission allowances revenues to make the energy saving better and reduce the cost of housing for households through insulation grants for residential houses built before 1989. The applicants, individuals and legal entities, could apply for interest-free loans of up to 100% of the costs with upper limit – maximum € 80 per square meter. The condition was that the supported projects have resulted in energy savings for heating by at least 20%. The evaluation report made by government confirmed the creation of around 8,000 jobs and evaluated the programme of insulation as one of the most cost-effective comparing measures adopted in the package. Since the applications exceeded the available funds significantly, the government decided in 2011 to extend the programme (10 million € in 2011, but 24 million in 2012 and 25.5 million in 2013).

3.3.5.2. Belgium: The energy scanners project

The energy scanners project includes training the long-term unemployed with low skills in the activities related to energy saving. Unemployed become energy scanners and they offer households free installation of energy saving devices. In addition, energy scanners provide professional advice on how to save energy. Services provided under this project were gradually extended into the services in the areas of recycling and insulation works like roof, walls and floors. Training courses are coordinated with public employment services and provided by more than 30 social economy organizations. In 2011, there were about 34,000 households in Belgium benefited from the services of expert advice how to save energy. Moreover, these advices enabled them to cut their energy bills and/or use the offer of insulation. Through this project, about 4,000 people have found new jobs.

Romania: The green house initiative

The ongoing initiative green house, which started in 2009, seeks to promote energy efficiency within both households and firms. Through this scheme it is possible to provide subsidies for the installation of heating and power plants using renewable energy sources. This measure supports the use of renewable energy, as well as employment in the construction sector. It is also an incentive for training in the area of green qualifications. This instrument encourages individual and community initiatives as well as the entrepreneurship. In 2011, about 11 000 households and 170 businesses used that initiative.

Conclusion

Ten years after joining the EU we can conclude that it was the right decision for V4 countries. Although the positive developments since 2004 were hit hard by the crisis, the situation is much better than at the beginning in 2004. Nowadays, the V4 countries are economically stronger and if work together they have also stronger voice in the EU. In terms of labour market, the biggest issues they need to solve are:

- high youth unemployment rates,
- long-term unemployment and to find out how to get long-term unemployed back to/to work.

As we showed in the fourth section, the opportunities how to increase employment and how to tackle youth unemployment or long-term unemployment already exist. We believe and it is moreover justified by official documents and reports made by the European Commission and OECD that green economy will help to maintain and create millions of jobs by 2020 and beyond. Regarding the Europe 2020 strategy, to green the economy is the commitment made at EU level with a significant job potential. The EU supports green jobs and offers funding through European Structural and Investment Funds. Therefore, we also paid attention to that and we highlighted some examples of measures supporting green jobs in the EU.

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http://dx.doi.org/10.18778/8088-012-2.04

4. Is the albanian economic growth influenced by importing countries growth?

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Abstract

International trade, as a major factor of openness, has a significant contribution to economic growth, especially nowadays when globalization is becoming a widespread phenomenon. Country's trade openness can be analyzed from one side by the impact of our revenue growth, which will influence the growth of domestic demand for imported goods and from the other side the revenue growth of other countries which will affect the growth of imported goods and thus in the growth of exports of analyzing country. Exports impact is very important to be treated combined with exchange rate, as another indicator of international competitiveness of countries goods.

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This paper will analyze the impact of economic growth of importing countries and effective exchange rate to the domestic economy growth, in our case to the Albanian economy. The increase demand for imported goods from Albanian trade exchange countries means an increase in our exports, thus an increase in aggregated demand and so in a higher economic growth. The exchange rate makes our goods more or less comparable in international market, as a result it will take a significant part on analyze. The goal of the paper is to investigate the impact of exports, other counties economic growth and exchange rate to economic growth of Albania. In the model are included a weighted index of other countries economic growth based on the imports that they make from Albania and the effective exchange rates as a variable of competiveness. The results are based on annual data collected from 2000 to 2013. The empirical results indicate that exist a positive correlation of importing countries from Albania and effective exchange rate in Albania's economic growth.

Introduction

Economic growth is the main focus of economic study by most researchers and economists, where they have tried to find and analyze the main factors and determinants of growth. There are many studies concerning the role of consumption, investments, government expenditures, inflation, public deficit, remittances and other macroeconomic variables that are crucial in spurring the economic growth of a country. There has been paid a special attention in last years to the impact of international trade on the growth level. An extensive theoretical and empirical literature exists on the impact of exports on economic growth but the relationship between imports and growth is more complicated and there is a lack on the literature theory. The findings and results in the current economic literature show that the level of international trade in an economy may be one of the main sources of its growth. In the literature, the main findings are on the positive impact of exports in economic growth because being part of GDP it will increase it.

Exports of goods and services represent one of the most important sources of foreign exchange income that ease the pressure on the balance of payments and create employment opportunities. Exports help countries to raise their productivity, investment and enhance efficiency, but countries such as Albania from the other part faces with a lack of production factors so they raise their imports level. The demand for imports is determined by both economic and noneconomic factors, such as exchange rates, economic activity, domestic and external economic conditions, production and political conditions. According to Rivera Batiz there is a direct relationship between imports and economic growth, because a rise in economic activity or high real income will increase consumption and induce an increase in imports. In order to finance imports, an economy must rely on exports, foreign credit, foreign direct investment and foreign aid. They are usually classified according to economic destination and the classification of a product. They contribute to the main components of GDP (investment, consumption, government expenditure, exports), they should grow when consumers disposal income increases.

An export led growth strategy aims to provide producers with incentives to export their goods through various economic and governmental policies. It also aims to increase the capability of producing goods and services that are able to compete in the world market, to use advanced technology, and to provide foreign exchange needed to import capital goods. Exports can increase intra-industry trade, help the country to integrate in the world economy and reduce the impact of external shocks on the domestic economy.

4.1. Review of related literature

4.1.1. Theoretical review

The literature on international trade which suggests that exports have a positive impact on economic growth is known as the Export-led-growth (Giles and Williams, 2000). Different reasons have been proposed for explaining the evidence found in previous studies dealing with this issue on export-led growth. The simplest explanation is that, as international the contribution to growth made by domestic consumption is limited to the size of regional (or national) markets, sales to foreign markets represents an additional consumption demand which increases the amount of real output produced in the economy (Giles and Williams, 2000). Another more elaborated explanation is that exporting is associated with more productive firms (Bernard and Jensen, 1999; Bernard and Wagner, 1997), and thus export-led growth at aggregate level may be the result of both the accumulation of within-firm productivity gains from export participation, or the reallocation of resources from comparatively less productive non-exporters to more productive exporters (Bernard and Jensen, 2004; Roberts and Tybout, 1991).

According to Uche (2009), the relevance of exports in boosting economic growth and prosperity is captured in the theoretical justification for international trade. In the mercantilist economic thought, for instance, foreign trade is seen as an indispensable engine of economic growth and prosperity (Roll, 1953; Bhatia, 1978). Indeed, foreign trade under mercantilism is considered to be profitable only when there is positive balance of trade thus implying that exports are the most crucial aspect of international trade. But as pointed out by Ozughalu and Ajayi (2004), if every country ensures that it gets a surplus in international trade, there will be high degree of protectionism and many barriers to the flow of foreign trade; and these are incompatible with the essence of globalization. A highly robust theoretical underpinning for international trade lies in the classical economic theory of comparative cost advantage.

The theory of comparative cost advantage states that global output will reach its optimum level if every country specializes in the production of the commodity (or commodities) in which it has comparative cost advantage over others; this is seen as the basis for profitable trade (Ozughalu and Ajayi, 2004). In contemporary economics, the dominant model of comparative cost advantage is known as Heckscher-Ohlin model. As pointed out by Sodersten and Reed (1994), this is a theory of long-term general equilibrium in which two factors of production – labor and capital – are both mobile between sectors. The Heckscher-Ohlin theory postulates that international trade – of which exports are expected to constitute the major component – will significantly reduce the gap between the rich and poor countries.

The theory contends that inter-country differences in factor endowments are the basis for foreign trade. Comparative cost advantage comes as a result of different factor intensities in the production of various commodities (Sodersten and Reed, 1994). The Heckscher-Ohlin theory also implies that free trade specialization in production based on relative factor endowments will tend to bring about factor price equalization and thus will increase the returns to labor in poor countries to the levels in rich countries; this suggests that international trade in general and exports in particular have the ability to mitigate inequality in income and wealth distribution between and within nations as well as the ability to bring about a convergence in absolute poverty incidence between the rich and poor countries (Ozughalu and Ajayi, 2004). The relationship between exports and economic growth has always been a hot issue and has often generated heated debate among economists and policy makers. As observed by Lin and Li (2007), there are basically two approaches used in addressing the issue. The first approach has to do with studying the contribution of exports to the economic growth of an economy through analysis of the supply side of the economy. This approach emanates from the neoclassical economic growth theory/model. The approach states that the major source of economic growth lies in two major areas namely: increases in factor input(s) and improvements in efficiency. Following the above statement, analysis from the approach often regards exports as a factor that can affect technological progress or to be among factors that are related to economic efficiency. In practical terms, the contribution of exports is thought to be included in the residuals of growth accounting. It is noteworthy that the new growth theory/model endogenises the mechanism through which exports impact on economic growth. In line with this theory/model, Grossman and Helpman (1990) proposed a two-nation growth model with endogenous technological progress. As shown in their model, exports help to promote technology and knowledge and thus accelerate economic growth. It is instructive to state here that how to introduce exports into the production function is the major problem involved in the econometric analysis that follows the neo-classical approach. Some analysts directly include exports in the production function as the third variable while others use more sophisticated methods.

The second approach is to study the contributions of exports to a country's economic growth through analysis of the demand side of the country's economy. The demand side approach is also called demand oriented analysis or post-Keynesian analysis. According to the traditional Keynesian theory, an increase in exports is one of the factors that can cause increases in demand and thus will surely bring about increases in outputs, all other things being equal (Lin and Li, 2007). It is important to note that though this approach is highly sophisticated and robust, it has not been widely used. This is partly because of the remnant of Say's law in people's mind (McCombie and Thirlwall, 1994). Indeed most people believe that the major constraints of modern economic growth lie on the supply side instead of on the demand side. In other words, they believe that only increases in factor inputs and improvements in economic efficiency can stimulate economic growth (Lin and Li, 2007). However, proponents of the demand-oriented analysis disagree with the above view and argue persuasively that it is growth in exports that is the major stimulant of aggregate economic activity and economic growth. Thirlwall (1987), McCombie (1985), McCombie and Thirlwall (1994, 1997 and 1999) and others later developed the argument of the proponents of the demand-oriented analysis into a powerful theoretical framework that analyses the relationship between exports and economic growth. Put briefly, the theoretical framework has the following characteristics:

- contrary to popular belief, the Keynesian theory/model can be used to analyze long-term phenomena such as economic growth,

- exports are an autonomous component of demand,
- the role that exports play in an open economy model is as important as investment in a closed economy model,
- the role of the balance of payments as a constraint on economic growth is important.

There are several studies that have analyzed the impact of exchange rate on economic growth and the economic literatures on this issue have evolved in the last few decades. An increase in exchange rate volatility would result in lower international trade is that there are risks and transaction costs associated with variability in the exchange rate, and these reduce the incentives to trade. While early studies found adverse effects of exchange rate volatility on trade (Ethier, 1973; Clark, 1973; Baron, 1976; Cushman, 1983; Peree and Steinherr, 1989) subsequent studies report very small impacts (Franke, 1991; Sercu and Vanhulle, 1992). In addition, any relation between volatility and international trade could be driven by reverse causality, in which trade flows help stabilize real exchange rate fluctuations, thus reducing exchange rate volatility (Broda and Romalis, 2010).

4.1.2. Empirical review

It is important to note that a large number of studies on the importance of exports in economic performance and the relationship between exports and aggregate economic activity/economic growth have been conducted over the years, particularly in recent years. It is gratifying to observe that in recent times, there has been great and increasing interest in the study of exports and economic growth within the context of developing countries; a great number of research works have captured this interest. The research works may be said to be of two main categories. The first category concentrates on individual countries and assesses the implications of export promotion versus import substitution strategies for economic growth (Bhagwati, 1978; Krueger, 1978). As observed by Fosu (1990), such analyses may provide useful country specific information on the success or failure of various development mechanisms, at least as they relate to the period of analyses. However, the long gestation periods associated with economic projects, in conjunction with the usual lack of adequately detailed data for individual countries, may prevent the proper evaluation of the importance of exports in any general fashion. The second category of studies examines the extent to which export performance differences may explain inter-country economic growth differentials. Studies in this category include Balassa (1978 and 1985), Ram (1985), Feder (1982) and Michaely (1977).

Most of these studies employed a production function framework that included exports as an additional argument of the production function. As shown by Fosu (1990) in Uche (2009), the standard justification for such a treatment is based on the fact that the development of exports allows the home country to concentrate investment in those sectors where it enjoys a comparative advantage and the resulting specialization is likely to augment overall productivity. In the same way worldwide competitive pressures are likely to reduce inefficiencies in the export area and result in the adoption of more efficient techniques in the overall traded goods sector. A larger export sector would make available more of the resources necessary to import in a more timely fashion both physical and human capital, including advanced technologies in production and management, and for training higher quality labor. The numerous studies on exports and economic growth as found in the literature were conducted along various methodological lines. The early studies examined the simple correlation coefficient between export growth and economic growth (Michaely, 1977; Balassa, 1978).

These studies in general concluded that there is strong evidence in favor of the export-led growth hypothesis based on the fact that export growth and economic growth were found to be highly correlated. The principal weakness of this group of studies is that they used a high degree of correlation between the two variables as evidence supporting the export-led growth hypothesis. But high degree of correlation between the two variables is not a sufficient condition to validate the export-led growth hypothesis. It is well known in econometrics and statistics that correlation does not necessarily imply causality. Following the early group of studies on exports and economic growth, we have the next group, which may be called the second generation of studies on the issue. This group examined whether or not exports are driving output by estimating output growth regression equations based on the neoclassical growth accounting technique of production function analysis, including exports or export growth as an explanatory variable (Feder, 1982; Balassa, 1985; Ram, 1987).

This second generation of studies used a highly significant positive value of the coefficient of export growth variable in the growth accounting equation and a significant improvement in the coefficient of determination with the inclusion of the export growth variable in the regression equation as evidence for the export-led growth hypothesis. This group of studies has been severely criticized based mainly on a methodological issue (Ekanayake, 1999). The studies in general made a priori assumption that export growth causes output growth and they did not consider the direction of causal relationship between the two variables.

There is a third generation of studies, which is relatively recent. This group of studies laid emphasis on causality between export growth and economic growth. This approach has been taken in a large number of recent studies designed to assess whether or not individual countries exhibit evidence for export-led growth hypothesis using Granger (1969) or Sims (1972) causality test (Ahmad and Kwan, 1991; Serletis, 1992; Jin and Yu, 1995; Holman and Graves, 1995). The major weakness of this generation of studies (that are based on causality tests) is that the traditional Granger and Sims causality tests used in the studies are only valid if, among other things, the original time series are not co-integrated; the tests are invalid and misleading when the original time series are integrated of order one and are co-integrated (Granger, 1980, 1986 and 1988; Engel and Granger, 1987; Ahmad and Harnhirun, 1996).

Therefore, there is need for one to check for stationary and co-integration properties of original exports and output time series before using Granger or Sims causality test. Despite the weaknesses associated with the techniques adopted by the foregoing generations of studies they are still very relevant for they can provide useful insights on the relationship between exports and economic growth. Indeed the techniques serve as simple and handy analytical methods of testing the validity of the export-led growth hypothesis and other related hypotheses. It is interesting to point out here that there have been relatively new studies on exports and economic growth that have used modern econometric techniques of co-integration and error-correction models (Oxley, 1993; Ghatak, Milner and Utkulu, 1997; Islam, 1998).

As observed by Ekanayake (1999), this new generation of studies does not suffer from the shortcomings found in the methodologies adopted in the previous studies. In fact, the new group of studies has produced highly robust and reliable results; this is largely because they used modern econometric techniques that are not only highly sophisticated but also highly efficient. There is a dearth of studies on exports and economic growth based on modern econometric techniques. The few studies on exports and economic growth in Albania that used modern econometric methods that is within our reach include Ekpo and Egwaikhide (1994), Odusola and Akinlo (1995), Idowu (2005) and Uche (2009). These studies suffer from some methodological defects. Ekpo and Egwaikhide (1994) analyzed the relationship between exports and economic growth within the framework of a general production function. The study employed modern econometric techniques of co-integration and error correction model in its analysis.

4.2. Country export and import profile

Albania is a potential imported country. Exports in the recent years have been characterized by a slight increase but still negligible. Compared to its small territorial surface, Albania is in fact rich in natural resources. The south – western part of the country is rich in oil and natural gas, while in the north – east part are found considerable reserves of minerals among which the following: chromium, copper, iron, nickel. Albania is also rich in torrential rivers which are also the best potential for hydropower stations. In the period 1945–1991, the communist government's policy of rapid industrialization intended to make the country as much independent as possible, which led to the creation of many industrial branches relatively modern. The industry now generates only a small part of the national income. Since early 1990's, Albania had a trade deficit, where the exports of its goods have represented no more than 25% of its imports. A big part of exports result on behalf of the corporations that work as subcontractors for European corporations which have used the low cost of labor in Albania.

Albanian exports to Europe are still low from quotas given as grant under preferential trade agreement. Albania's main trading partners in Europe are Italy, Greece and Germany. Lack of competition of Albanian products, low level of production, poor infrastructure, inadequate procedures for crossing the border, lack of promotional activities and a weak institutional capacity have been the factors that have caused the increase of trade deficit. Year after year this deficit has begun to decrease although at a slower pace, due to the growth of exports and the greater efforts of Albanian companies to compete in the domestic market, especially against European import products. The production of goods for export has gone through a considerable increase, being a positive sign that was accompanied by an increase in investment as well as a revival and strengthening of the Albanian economy.

The facts emphasize once more that liberalization policies and the several economic reforms undertaken can change the pace from negative to positive, which indicate the progress of our country's economy but also its influence from external factors. Since 1994, foreign trade development in Albania, in general, is characterized primarily by increased trade flows, which indicates an opening and intensification of economic and trade exchanges with the Albanian market economies and global markets. Increasing the opening levels of small countries, such as Albania, was considered a way to eliminate obstacles encountered in market restrictions. Although Albania's opening levels have consistently followed a positive trend, they still remain low compared with other countries in the region. The growth of trade flows has been occasionally irregular, thus reflecting the main developments in the Albanian economy and the impact of various factors such as the international and regional levels. Although exports have improved their contribution to trade flows, they again stay away from the value of imports.

The impact of exports in trade volume is still very small, although in some periods, it is noted that export growth is bigger than the increase in imports. Albania exports are focused on local agricultural products, electricity, oil and its by-products. Apart from heavy industry (oil exploitation and electricity) and manufacture industry for goods send abroad for processing (known as façon industry), Albania's industry is somewhat stagnant. The causes of the collapse of the industry and the slowdown in the use of natural resources are the lack of proper organization, outdated machinery and equipments. Also, due to wrong investments in the economy (supported by Western experts) by the government after the fall of communism, Albania's industry is not able to meet the economic demands of the local population and as a result it imports.

However, some Albanian products are uncompetitive in the domestic market as well as in the external one, and the first aspect of a trade promotion policy should be to increase the level of competitiveness of Albanian companies. Currently, if Albania would only work towards the growth of exports, it would not be able to produce enough to satisfy the domestic market. Therefore, based on its competitive advantages the biggest need is to increase the Albanian agricultural production with quality and quantity, and the sectors of mining and processing. The Albanian companies need technical assistance to enhance the competitiveness of their products in the domestic market as well as in the external one. Their main weaknesses are the small size, machinery and old equipment, lack of own capital and foreign capital, lack of managerial and marketing knowledge, lack of information on the conditions of international markets for procurement and sales, as well as the lack of contacts with international markets.

In this situation, measures taken by the government and businesses to promote exports have functioned as a catalyst to enhance competitiveness, by helping to introduce modern production methods of management and marketing, increasing quality of products and introducing new methods of marketing and distribution. Albania is trying to compete with a number of European countries in domestic markets, as well as in those of export, by offering similar or better products, a general economic framework that enhances trade and investment as well as resources or advantages in competitiveness. In addition, fast and necessary measures are being taken in order to improve the competitiveness of Albanian companies, because in a globalized economy the time factor is critical in order to have economic success.

In the case of exporting Albanian goods, import markets in the EU are characterized by a quite high competitiveness in terms of quality, price, packaging and services. Other factors that have great influence on the level of competitiveness are market rules, administrative constraints, lack of financial and business services and quality of infrastructure. As a result, Albania needs an effective and comprehensive system to promote together with export, the competitiveness of its industry. As the market matures, competition increases, the consumer wants more and more quality, the markets open, products' life cycles change and companies, especially large and medium, cannot remain indifferent to these developments. Modern management practices, commitment to quality, improvement of relations with employees, are becoming more and more evident and indispensable for the successful progress of a business. This proves that the number of companies that implement ISO standard has increased: currently it is approaching the number 200 from 7 that were several years ago.

Practices such as Corporate Governance or Corporate Social Responsibility are not unknown, but they are increasingly being embraced by pioneer businesses. The use of advanced technology systems in the management is continuously becoming more applicable. A number of companies are seeking to expand current markets and there is evidence of successful cases of investments in neighboring countries, especially in Kosovo and Macedonia, while expansion plans of Albanian entrepreneurs are becoming more ambitious, targeting also other countries. The efforts to export in the European Union markets fall in the same line. On the other hand, of course, it is understandable that one cannot speak of such standards in small businesses, which still continue to sell without the bill and where the level of fiscal evasion remains very high. There is no doubt that the level of informal economy is very high and this constitutes a major problem. What is evident however is the level of maturity that is reaching a large proportion of domestic companies that in the future is expected to be even higher. However, the state administration does not seem to respond similarly with the same pace to this new phase of business development in Albania. Indeed the former has shown a willingness to formalize the economy and create a sustainable business environment, but the most visible action in this direction has been especially the methodology used by setting references in almost all areas: wages, profit rates, up to the prices that businesses can buy and sell.

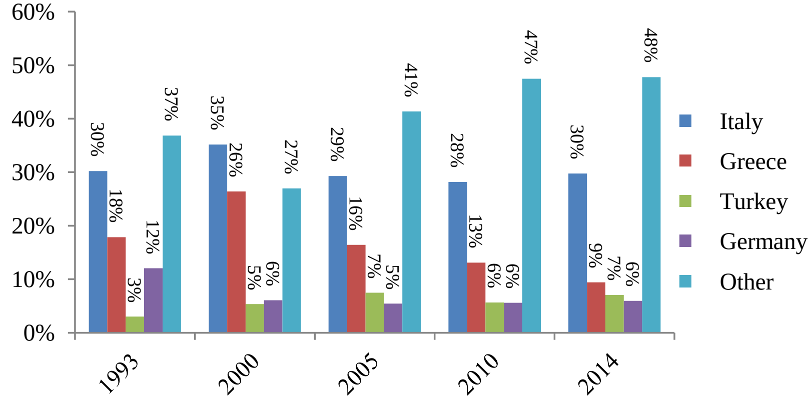
4.2.1. The main foreign trade partners of Albania

The commercial partner countries of Albania are mostly neighbor countries. For imported goods Italy and Greece are the biggest importer with 30% and 9% respectively. In table one are shown data from 1993 to 2014 for main partner countries of Albania for imports and exports. From the table can be seen that Italy is the main partner country for imports and exports too. This mostly related with façon industry focused in Albania because of different wages level or labor cost.

	1993	1995	2000	2005	2010	2011	2012	2013	2014
Main Importing Countries									
Italy	17,630	24,438	55,244	76,770	134,569	166,045	168,370	170,445	164,408
Greece	10,420	16,335	41,498	43,070	62,617	57,796	50,117	45,699	52,058
Turkey	1,760	2,786	8,401	19,624	27,046	30,200	30,376	32,890	39,011
Germany	7,030	3,379	9,567	14,312	26,768	31,163	31,936	30,002	32,963
Total	**58,336**	**66,147**	**157,109**	**262,191**	**477,768**	**544,004**	**528,490**	**517,378**	**552,263**
Main Exporting Countries									
Italy	5,125	9,641	26,423	47,675	82,114	104,998	108,847	114,153	133,046
Kosovo				2,710	10,008	14,657	17,369	16,292	18,774
Spain	64	20	22	60	5,589	7,010	19,693	24,088	16,684
Malta	4	29	-	-	1,226	4,684	3,835	16,540	15,906
Turkey	170	1,161	245	1,133	9,573	14,484	13,464	9,223	10,094
Total	**12,499**	**18,710**	**37,037**	**65,818**	**161,548**	**196,897**	**213,030**	**246,391**	**255,759**

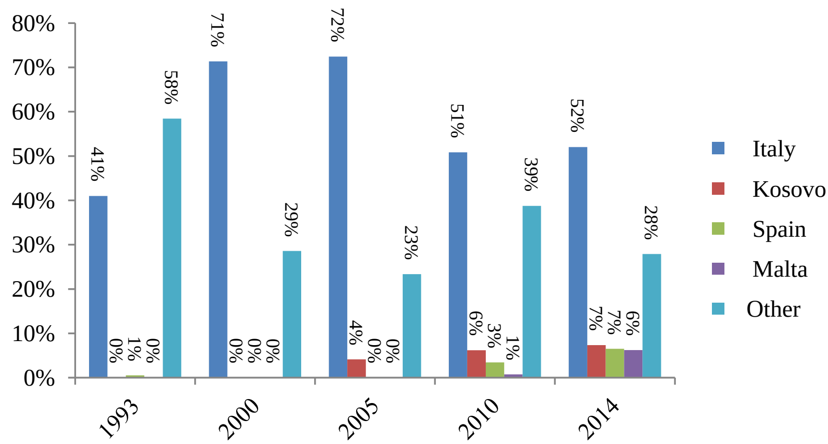
Table 4.1. Main partner countries
Source: INSTAT (Institute of Statistics of Albania).

More concretely the percentages by main partners are shown in graph one and two where easily can be seen that there are only a small group of countries that have more than 50% of total imports and exports.



Graph 4.1. Key Partners in imports for Albania
Source: INSTAT (Institute of Statistics of Albania).

Related with exports the picture is different because except Italy which still is a very important countries at international trade the other countries are present only in the latest years.



Graph 4.2. Key Partners in exports for Albania
Source: INSTAT (Institute of Statistics of Albania).

It is important to be mention that most of international trade is done with European countries, more concretely in 2014 exports in EU countries were 94% of total Albania's exports and imports from EU countries were 82%. In table two are shown imports and exports by continents.

	1993	1995	2000	2005	2010	2011	2012	2013	2014
Imports by continents									
Europe	54,496	63,939	148,233	226,546	401,551	456,938	440,974	424,680	453,227
Africa	74	200	421	1,816	2,906	3,078	3,272	14,335	9,247
America	1,442	1,232	3,155	7,673	15,415	20,015	23,791	24,065	28,566
Asia	652	464	4,472	25,181	56,607	62,725	58,638	51,383	59,985
Australia -Oceania	–	3	125	138	230	594	304	261	252
Others	1,671	309	702	839	1,059	655	1,512	2,654	986
Total	**58,336**	**66,147**	**157,109**	**262,191**	**477,768**	**544,004**	**528,490**	**517,378**	**552,263**
Exports by continents									
Europe	11,413	17,618	36,648	64,517	146,115	187,685	201,880	229,474	240,303
Africa	–	14	9	70	1,747	983	1,668	1,841	3,107
America	522	656	333	755	2,755	2,312	1,238	1,375	1,701
Asia	549	418	30	458	10,489	5,834	7,675	13,692	10,192
Australia -Oceania	8	–	3	–	0	6	12	–	11
Others	7	3	14	18	442	77	557	10	445
Total	**12,499**	**18,710**	**37,037**	**65,818**	**161,548**	**196,897**	**213,030**	**246,391**	**255,759**

Table 4.2. International trade by continents
Source: INSTAT (Institute of Statistics of Albania).

Trade flows in the region remain at a higher level compared to European economies. Cultural similarities, geographic proximity, which affect costs and competitiveness of products in the relevant markets, but also similarities in the demand side factors, are some of the causes that may have influenced the high level of commercial flows.

In terms of an opening of the Albanian economy, according to Albania's Progress Report for 2014, it is shown that this process has continued to progress during last year's. The volume of Albanian imports and exports of goods and services for 2013 were 60.7% of GDP for imports and 40.2% of GDP for exports. In this process, the EU is the main trading partner of Albania with about three quarters of exports and imports taken together. In general, the EU is the main trading partner of Albania in the field of investment, while trade with CEFTA countries is growing. However, the base of Albanian production is focused only on certain sectors and export markets with low added value, leaving the economy vulnerable and exposed to specific shocks.

4.3. Empirical model

The macroeconomic model that is treated in the paper is based on the impact of income growth of foreign countries (Y_f) to the economic growth of the home country (Y), in our case to Albania. In this model are taken all economic growth rates of countries where Albania exports. The impact of exported countries growth has been implemented in a weighted way to have a better impact of each respective country in the Albanian economy. This index has been named trade index and has been estimated as:

$$I = w_i * g_i \qquad \text{(eg.4.1)}$$

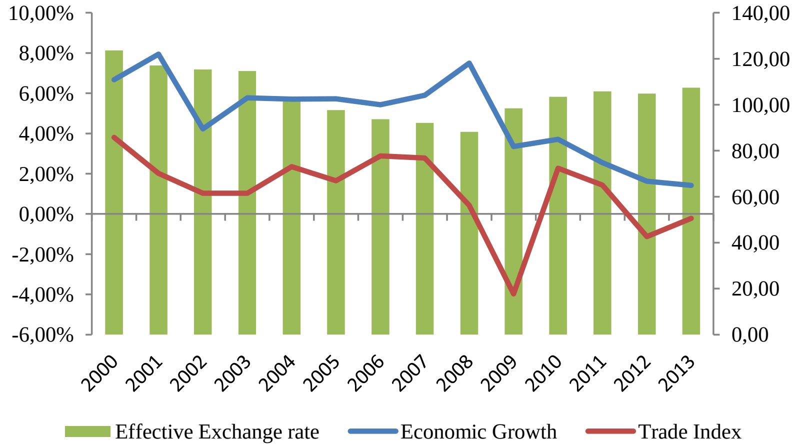
where:
w_i – is the weight of exports of country i to the total exports of Albania,
g_i – is the economic growth of country i.

In the international trade an important part is even the impact of exchange rate as an indicator of competitiveness. This variable becomes more important in the cases of big changes like the world financial crises of 2008, when the exchange rate between lek and euro becomes from 122.8 l/€ in 132.1 l/€ in 2009. As has been shown in the previous paragraph EU is the main trade partner, and mostly from euro zone. In the model the impact of exchange rate is measured by estimating effective exchange rate, so all currencies are involved in the model with their respective weights. The effective exchange rate is estimated as:

$$E_{ex} = w_i * Ex_i \qquad \text{(eg.4.2)}$$

where:
w_i – is the weight of imports of country i to the total imports of Albania,
Ex_i – is the exchange rate lek/foreign currency of country i.

In the graph below are shown three series that are taken in the model, the Albanian economic growth, estimated trade index and effective exchange rate. From the graph it can be seen that economic growth in years 2008 and 2009 are in contrary with two other variables.



Graph 4.3. Main indicators of the model
Source: Author work.

These two variables are included in the model to see their influence in Albanian economy growth. Except those two variables in the model is included even a dummy variable for years 2008 and 2009, because of the different situation of Albanian economy in these years. To see this relation between variables is used an ordinary lest square (OLS) technique. Theoretical equation of the model is shown in equation 4.3.

$$Alb_{gr_t} = b_0 + b_1 I_t + b_2 E_{ex_t} + b_3 Dum \qquad \text{(eg.4.3)}$$

The series are treated from 2000–2013 because the social riots of 1997 in Albania doesn't allowed to make analyze between growth and international trade. Also another reasons starting from year 2000 is related with Euro currency which has been lunched for the first time in 1999. Albania imports most of its goods from euro zone, approximately 80% of total imports. So to have a better analyze of the relation that exist between imported countries growth and Albanian growth the focus has been to the period 2000–2013. Year 2008 has been treated as a dummy variable because the impact of world financial crises hasn't been field in Albania in that period, furthermore in this year the Albanian economy has been in one of the highest economic growth, with 7.5%. In 2008 in Albania start a lot of public constructions influencing in a contradictory way with world economic picture. In 2009 the Albanian economy started to fill the impact of crises but the economy performance was much better than other countries. This situation was the result of public investments started in 2008 and continuing even in this year.

Based on this analyzes in the table three are shown the results of the model. The economic growth, as dependent variable has 65% explanation by independent variables.

Variable	Coefficients	Standard. Error	t-Statistic	Probability
Trade index	1.064821	0.236843	4.495894	0.0009
Effective exchange rate	0.027870	0.005080	5.486279	0.0002
Dummy	4.719718	1.249685	3.776727	0.0031
R-squared	0.650255		Mean dependent var	4.823100
Adjusted R-squared	0.586665		S.D. dependent var	2.058092
S.E. of regression	1.323171		Akaike info criterion	3.585349
Sum squared residuals	19.25861		Schwarz criterion	3.722290
Log likelihood	-22.09745		Hannan-Quinn criter.	3.572673
Durbin-Watson stat	1.745337			

Table 4.3. Model Results
Source: own elaboration.

From the table our regress can be written as:

$$Alb_{gr_t} = 1.65I_t + 0.03E_{ex_t} + 4.7Dum \qquad \text{(eg.4.4)}$$

From the results it can be seen that exist a positive relationship between dependent and independent variables. The increase of trade index means that if importing countries have a positive economic growth they will influence positively in Albanian economic growth. As was shown in the previous parts of the paper, if they have a positive growth they will need more goods to import, or otherwise more export for Albania.

If effective exchange rate is grown it means that Albanian goods are more competitive than foreign goods so the demand for Albanian products will be grown, which means more production exported and as a results more economic growth.

Positive impact of dummy variable in the model means that there are other factors influencing Albanian economic growth, like public investments, which for sure have a positive impact.

Conclusions

This study examined the impact of economic growth of importing countries and their exchange rate to the Albanian economy growth, considering the coefficients the variables used, exports are positively related to the real GDP while other variables such exchange rate, exert a negative influence on the real GDP.

The positive coefficient of the net export ratio implies higher productivity. The positive coefficient ratio of the exports also helped to stimulate the economy thereby increasing capital inflow into the economy. In the light of this research, the conclusion that foreign trade exerts positive effects upon Albania's economic growth could be drawn. Therefore to achieve sustainable economic growth, Albania should pay more attention to proper and appropriate trade strategies and polices.

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http://dx.doi.org/10.18778/8088-012-2.05

5. Comparison of economic cycles morphology based on Polish gross domestic product analysis in years 2000–2013

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Abstract

For centuries economic fluctuations have been one of the most interesting phenomena to economists of different schools. Despite of different theoretical approaches it is human desire to understand the pattern behind cyclical nature of the economy. In this paper economic cycles in Poland in years 2000–2013 are investigated to verify how cycles morphology changed after the crisis of 2008 and whether they match theoretical characteristics of classic or modern cycle.

Results obtained based on analysis of Polish Gross Domestic Product show that the growth rate (although positive) has been lower since the crisis, cycles last for approximately 3.5–4 years, have sharp upper turning

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points, and turning zones instead of clearly visible troughs. Their length and turning points suggest that in terms of morphology they match characteristics of modern cycle.

The importance of this research is high, as it clearly shows that cyclical nature of Polish economy has changed. Findings may be very useful for further research (e.g. similar analysis of other economic aggregates), as well as to those all who are interested in forecasting future economic growth.

Introduction

After the economic turbulence of 2007–2008 it is important to understand whether the economy still follows pattern observed before the crisis or not. This is an essentialpiece of information regarding forecasting future behavior of the economy. If the economy followedknown characteristics of classic or modern cycle, and no disturbances occurred after 2008, it would imply that the same forecasting tools and assumptions could be used in the future. Should any changes occur after 2008, methodology used to forecasting should be revised and adjusted to the new reality.

As it will be shown in the paper, economic cycles evolve. Based on their changes, they can be divided into two groups: classic and modern cycles. The aim of this paper is to analyze economic cycles in Poland which occurred since 2000 and verify whether they fit into morphological characteristics of classic or modern cycle.

In the paper the most important theories will be presented. This is to help the reader understand why there are fluctuations in the economy. Theories also indicate how the economic cycles can be analyzed. Following the theory, the concept of morphology is introduced. Only when very specific terminology is defined, the empirical analysis can be conducted. The analysis itself is a starting point for further research. For this, it is relatively simple, yet provides insight into how economic cycles behaved before and after 2008, and how this phenomenon can be analyzed.

5.1. Theoretical background

The reason for presenting theories in the paper is to underline the fact that:

1. The phenomenon is complex and important as a field of study.
2. The matter has been extensively researched by economists representing various approach, yet it has not been explained sufficiently.
3. Theories on economic cycles explain how and what economic indicators can be analyzed.

The official scientific announcement regarding existence of the economic cycles was made around 1860 by a French economist Clement Juglar (Marczak and Piech, 2008, p. 2–3). However, at that time, classical view on the economics was dominant. Classical economists (with J.B. Say as one of the most famous ones) claimed that economic fluctuations are totally coincidental and therefore investigating theircyclical nature is unnecessary (Say from Marczak and Piech, 2008).

Meanwhile, the number of alternative theories evolved. Some of them attempt to explain economic fluctuations with mathematics, some with psychology, or even astronomy (Malthus, St. Jevons, Prescott, from Marczak and Piech, 2008, p. 3–4). In this paper main economic theories will be presented.

They can be divided into two groups: endogenous and exogenous.

The endogenous concepts are associated with the Keynesian school, although Keynes himself focused on finding methodology to mitigate negative effects of economic crises rather than on cycles (Jędruchniewicz, 2012, p. 40). The theories developed, however, claim that the reasons for economic fluctuations are totally internal, meaning that they are caused by factors occurring within the economic system.

According to the Keynesian school, factors influencing economic fluctuations are divided into two groups: dependent and independent variables. The model of these variables is presented in the figure 5.1.

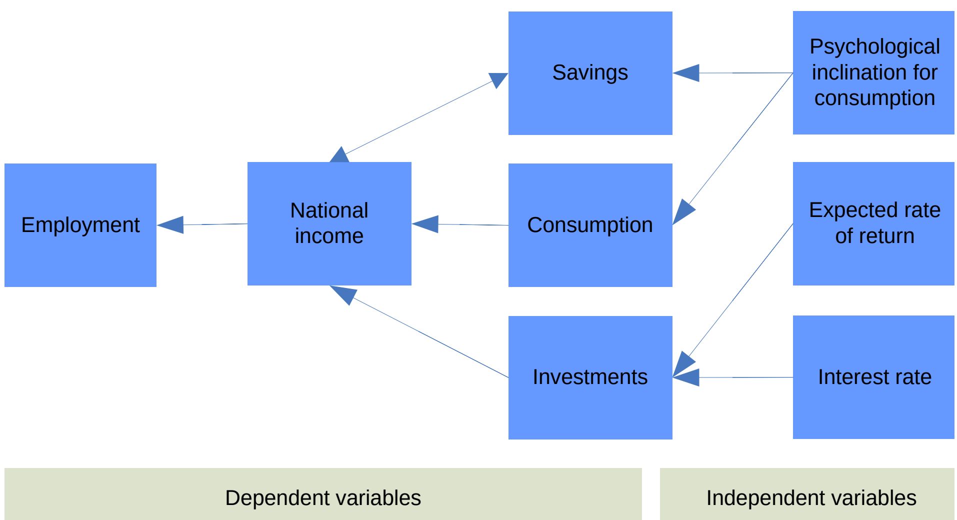

Figure 5.1. 'Variables of the Keynes' model
Source: (Górski and Sierpiński, 1979, p. 324).

The model states that the key element is the national income which is influenced directly by savings, consumption and investments, which on the other hand are influenced by psychological inclination for consumption, expected rate of return from investments and the interest rate. The dependency of the national income on investments is the core of the economic growth. Their level depends on the interest rate and 'animal spirit' of entrepreneurs, and is almost never equal to the level of savings, which makes the economy fluctuate. Further research introducing multiplier-accelerator model proved that types of fluctuations may differ (Hicks from Jakimowicz, 2005), however every next peak of the Gross Domestic Product tends to be attained at the higher level than previously (Smithies, 1966).

A model cycle developed by Keynes states that investments in the market start when the confidence level is high enough, i.e. that the rate of return on investments will increase (Jakimowicz, 2005, p. 42–45). For some time companies neglect rising costs of resources and rising interest rates, which results in the increase of the production volume, income and employment level. At some point rising costs of resources, or even lack of some commodities results in no faith concerning future growth. When the disappointment appears, income and the expected rate of return drop. Share prices decreasefollowed by consumption. That phase lasts until there is lack of some goods in the market and, in time, the expectation concerning rise of the rate of return appears again, which stimulates investments and starts new cycle.

The exogenous concepts, as opposed to the Keynesian school, claim that reasons for economic fluctuations are external, meaning that they are caused by factors which come from the outside of the economic system (Muth from Barczyk, 1993). Most of these theories grew on imperfections of the Keynesian school, e.g. the impossibility of including future expectations into the models (Kalecki, 1979, p. 272), as well as failure in explaining simultaneous occurrence of high inflation and high unemployment (Barczyk, 1993, p. 45). This can be explained with the help of monetary theories which relate economic fluctuations with financial markets. The crucial point here is the impact of monetary and fiscal policy on the economy, as supply of money causes disproportions between supply and demand in the market (Barczyk, 2006, p. 65–68). In the growth phase of the economic cycle market participants (e.g. companies), when the interest rates set by the central bank are lower than the natural ones (if the central bank never existed), are willing to take up loans even if they do not need it. This causes overproduction of goods, which need to be sold to pay back the loans. That implies lower prices, drop in revenues and risk of failure in the loan payback.

Some famous representatives of the exogenous concepts (e.g. Friedman, 1963) claim that fluctuations are generally positive phenomenon (Marczak and Piech, 2008, p. 5–11), as they simply result from optimal choices made by market participants. Moreover, even economic slowdown is needed to remove heavily indebted participants. For this, the state should focus on mitigating the negative effects of the economic slowdown only by minimizing the impact of the economic policy while the economy is still expanding, as aggressive expansion is followed by dramatic recession. An attempt to react to a post investment bubble breakdown in one sector of the economy, causes new investment bubble in another one (Białek, 2008).

Apart from the monetary concepts, among exogenous factors, there can be many other factors investigated. For instance the impact of climate changes, wars, technology shocks, political factors (Piech, 2003, p. 59–82). For the purpose of this paper, it is vital to realize that the economic cycles are a complex problem and there is still no one unique theory covering all aspects of the phenomenon.

5.2. Definition and types of economic cycles

Before the analysis of economic cycles can be conducted, it is crucial to define certain terminology. It will enable the reader understand very precise outcome of this, as well of some other research of the matter.

The main criterion based on which economic fluctuations may be classified is their time span (Rekowski, 1997, p. 18–19). This classification consists of:

a) Development trend which is the direction of changes in the long-run. It can be positive (growth), negative (decline) or neutral (stability).
b) Periodic fluctuations which are typically measured in days, weeks, months, or other short-term time units. They are caused by such factors as human habits, number of working days in a given period of time, climate and seasonal factors.
c) Random fluctuations which are caused by unknown factors, but they are independent of the economy.
d) Economic fluctuations which are oscillations of the economy around its trend line of short or medium duration. They are caused by economic factors.

Economic cycles are a specific type of economic fluctuations. However, not all economic fluctuations can be defined as cyclical, as cycles are only defined to be consecutive positive and negative change of a process. At this point it is vital to indicate three main definitions of cycles, all of which result from the methodology used to analyze raw (in this case economic) data series:

a) Growth cycle (Mintz, 1972, p. 41)

Once the trend line of data series is established, phases of the cycle can be divided into two periods: of a relatively high growth rate and of a relatively low growth rate.

b) Deviation cycle (Mintz, 1972, p. 41)

If the trend line is presented on the horizontal *X* axis and the vertical (*Y*) axis represents deviation of the data series from its trend line, a deviation cycle is obtained.

c) Step cycle (Friedman and Schwartz, 1963, p. 32–78)

If a growth rate of a series of data (e.g. Gross Domestic Product quarter/previous quarter) is calculated and composed into new series of data, the step cycle is obtained. It is also possible to construct the step cycle by calculating growth rate between a given quarter and the corresponding quarter of the previous year.

The advantage of the step cycle is that it does not depend on the estimation of the trend line, which is necessary in case of growth and deviation cycles. For the purpose of this paper the economic cycle is defined as the step cycle of the Gross Domestic Product data series.

The literature provides characteristics of two types of economic cycles (Barczyk, 1993, p. 28).

1) Classic cycles which were observed before World War II;

2) Modern cycles which were observed after the World War II.

Their characteristic is presented in the table 5.1.

Morphology	Classic cycle	Modern Cycle
Number of phases defined	4 phases	2 phases
Turning points	Sharp points	Turning zones
Length: **– growth phase** **– decline phase** **– cycle**	 4–6 years 4–6 years 8–12 years	 2–3 years 1,5–2 years 3,5–5 years
Frequency	Low	High
Amplitude: **– phases** **– cycle**	 – similar amplitudes – amplitude close to zero	 – higher amplitude of growth phase than of the decline phase – growing amplitudę
Intensity	High	Low
Symmetry/asymmetry	Asymmetry	Asymmetry

Morphology	Classic cycle	Modern Cycle
Structure: **Lead/delay time**	Long lead/delay times between turning points of different economic indicators	Short lead/delay times between turning points of different economic indicators
Cause and effect	Simple relations, small number of variables	Complex relations, numerous variables

Table 5.1. Comparison of classic and modern economic cycles
Source: Own, based on (Barczyk and Kowalczyk, 1993, p. 29).

As it can be observed in the table 5.1, the main difference is that modern cycles are much shorter, with turning zones instead of sharp turning points, and two phases instead of clearly visible four. Their amplitude is positive and growing, not close to zero as in the case of the classic cycle. It is also much more difficult to identify direct reasons for its morphology, as there are many complex relations of numerous variables.

There can be indicated tree major reasons for this change:

1. Structural changes – privatisation in former centrally planned economies combined with growth of companies and monopolisation results in increasing efficiency, thus increasing amplitude of cycles.
2. Anticyclical policy of governments – cycles become shorter, turning zones smother and amplitudes higher as policy makers tend to sustain constant economic growth and fight against economic crises.
3. Internationalisation of economic activities – flow of information, capital, people, goods and services is as easy as never before, which results in complex relations of variables that have impact on the economy on the national level.

5.2. Methodology

Identification of a cycle in a series of data requires introduction of a proper methodology. In this paper methodology of Bry-Boschan is used (Massmann and Mitchell, 2003, p. 102–103), which states the following:

a) The peak of the cycle is attained in the quarter t, if the value of the cycle in the preceding and the following quarter is lower than in the quarter t,
b) The trough of the cycle is attained in the quarter t, if the value of the cycle in the preceding and the following quarter is higher than in the quarter t,
c) Each phase of the cycle must be at least 2 quarters long,

d) The length of the cycle cannot be shorter than 5 quarters,

e) When a given cycle ends, another one starts.

In order to conduct analysis of a cycle additional terminology needs to be introduced. It will enable further discussion on morphology[1] of the cycle.

Turning points – are the most important points of the cycle. They indicate where each phase starts and ends. Their location also indicates where the cycle starts and ends, as the beginning and the end of the cycle is limited by two consecutive points of the same type. The upper turning point of the cycle is called "peak" or "downturn", while the lower one is called "trough" or "upturn". If precise identification of a turning point is not possible due to similar values that cycle attains around it, the term "turning zone" is applied.

Phases – based on the definition of turning points, it can be stated that a phase is the time span between two opposite turning points. Basic classification distinguishes the growth phase (starting from the trough and lasting until the peak) and the decline phase (starting from the peak and lasting till the trough). However, these two phases can be divided into sub-phases: expansion, prosperity, depression and contraction (Barczyk, 2006, p. 140).

Length – time duration of a phase is called its length. The same applies to the length of the cycle, which is the duration of all phases of the cycle.

Frequency – is the inversion of the cycle length. It states how many cycles fit into a specific time interval.

Amplitude – can be defined with respect to the phase, as well as the cycle. Amplitude of the phase is the absolute value of the difference between values attained by the cycle at the beginning and the end of the phase. The amplitude of the cycle is the value equal to the difference between amplitudes of the phases. There are three types of cycle amplitude that can be distinguished. These are: constant, damping and explosive amplitude.

Intensity – is equal to the standard deviation of the data series. It measures strength of growth (decline) of either phase or the whole cycle.

Symmetry/asymmetry – a cycle is said to be symmetrical with respect to amplitudes of its phases if they are equal (thus the amplitude of the cycle equals to zero). A cycle is symmetrical with respect to length of its phases, if they are equal.

For the purposes of this paper data published by Eurostat is used. The time span of data covers period from 1st quarter of 2001 to 2nd quarter of 2014. Data series analyzed in the paper are the quarterly values of the Gross Domestic Product of Poland in million units of national currency

1 The term 'morphology' has been transferred to economics from other fields of study like biology or language studies. It comes from the Greek language (*morphe* = shape; *logos* = science). Source: *Słownik wyrazów obcych*, PWN, Warszawa, 1977, p. 492.

(Polish Zloty, PLN) at current prices. Data was also adjusted seasonally and adjusted by the number of working days. The database was last updated on 8.12.2014 and extracted on 9.04.2015.

Based on the above, step cycle was constructed according to the formula:

$$CYCLE\_VALUE(t) = \frac{GDP(t)}{GDP(t-4)} - 1 \tag{5.1}$$

Equation 1 Formula used to calculate values of the GDP step cycle (Mintz, 1972).

5.3. Research results

Based on the Gross Domestic Product data series, quarter/quarter of the previous year, a cycle can be constructed. Its graphical representation is shown in figure 5.2. As it can be observed, in the time span from first quarter of 2001 to second quarter of 2014 three economic cycles occurred.

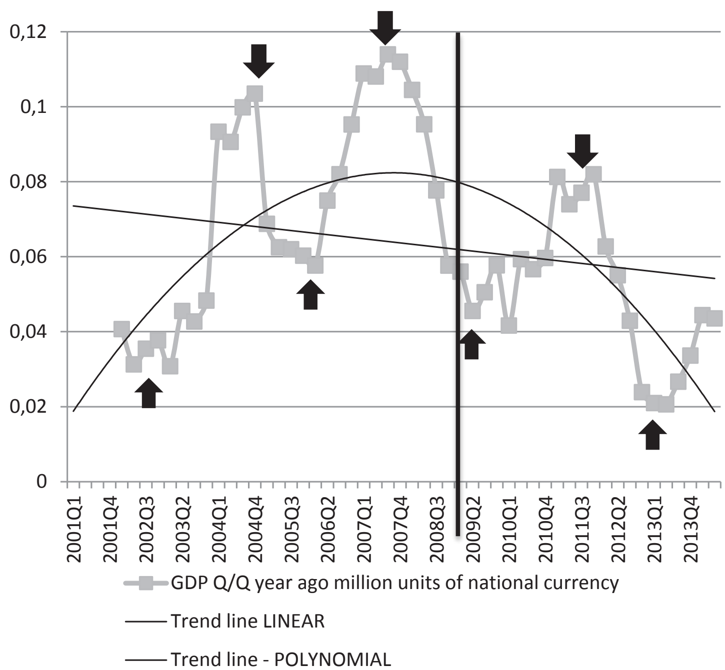

Figure 5.2. Graphical representation of GDP Quarter/Quarter prev. year, million PLN, current prices

Source: own, based on Eurostat data.

Cycle 1 started in 2002Q2 and lasted 15 quarters up to 2006Q1. That was the cycle which started recovery after global economic slowdown being result of the dotcom crash. Cycle 2 started in 2006Q1 and lasted 13 quarters until 2009Q2. During that cycle global crisis (famous Lehman Brothers bankruptcy[2]) took place. The cycle which followed that was Cycle 3. It started in 2009Q2 and lasted until 2013Q2. It can be stated that Cycle 3 was the first post-crisis cycle.

It is important to observe that in the investigated time span Poland has not been in a recession, as its GDP change never fell below the ZERO line. It can be noticed however, that the trend line of the cycle investigated is negative, which suggest that the rate of growth of the Polish economy is decreasing.

The last observation is in line with the research conducted by K. Beck and M. Grodzki (2014), who analyzed convergence and synchronization of economic cycles in the European Union. Slowing rate of growth of Polish economy results from the fact that it is catching up other, more developed countries within the EU[3].

The question is whether the cycles of the GDP of Poland follow classic or modern cycle morphological pattern and if/how did it change after the crisis of 2008?

Characteristics of modern and classic cycles was presented in table 5.1 which can be compared with results obtained from the actual cycles analysis presented in table 5.2.

	Cycle 1	**Cycle 2**	**Cycle 3**
Begin	2002Q2	2006Q1	2009Q2
End	2006Q1	2009Q2	2013Q2
Turning points			
Lower	2002Q2	2006Q1	2009Q2
Upper	2004Q4	2007Q3	2011Q4
Length			
Growth phase	10	6	10
Decline phase	5	7	6
Cycle	**15**	**13**	**16**

2 See: "The New York Times" article *Lehman Files for Bankruptcy; Merrill Is Sold*, http://www.nytimes.com/2008/09/15/business/15lehman.html?pagewanted=all&_r=0.

3 See: Beck K., Grodzki M. (2014), *Konwergencja realna i synchronizacja cykli koniunkturalnych w Unii Europejskie*j, Wydawnictwo Naukowe Scholar, Warszawa, p. 9–10.

	Cycle 1	Cycle 2	Cycle 3
Amplitude			
Growth phase	7.2	5.6	3.6
Decline phase	4.5	6.8	6.1
Cycle	**2.7**	**–1.2**	**–2.5**
Symmetry	assymetry	symmetry wrt. Length	assymetry
Intensity			
Growth phase	0.005	0.018	0.013
Decline phase	0.019	0.023	0.021
Cycle	**0.025**	**0.021**	**0.018**

Table 5.2. Morphology of the economic cycles in Poland based on GDP Quarter/Quarterprev. Year data
Source: own.

Results show that cycles 1 and 3 have 4 phases visible, while cycle 2 only 2 phases. What is more, all of them have sharp upper turning points. However, their lower turning points seem more like turning zones (cycle attains similar values for several quarters). From these observations we cannot precisely tell whether cycles follow modern or classic cycle characteristics. Also the morphology of their amplitudes does not match either classic nor modern pattern, as (1) they are different than zero and (2) last two cycles amplitudes are negative.

However, closer analysis of cycles length shows that each of them lasts approximately 4 years. This implies that they fulfill length condition of modern cycle. Results obtained in the morphology analysis of these cycles correspond to results obtained by other researchers (Skrzypczyńska, 2012, p. 11). The summary of the analysis is presented in table 5.3.

	Cycle 1	Cycle 2	Cycle 3
Numer of phases	4	2	4
CYCLE TYPE	**modern**	**classic**	**modern**
Turning points			
Upper	Sharp	Sharp	sharp
Lower	turning zone	turning zone	turning zone
CYCLE TYPE	**cannot tell**	**cannot tell**	**cannot tell**

	Cycle 1	Cycle 2	Cycle 3
Length	3–4 years	3–4 years	4 years
CYCLE TYPE	**modern**	**modern**	**modern**
Amplitude	Growing	Declining	Declining
CYCLE TYPE	**cannot tell**	**cannot tell**	**cannot tell**

Table 5.3. Comparison of cycles morphology with theoretical description of classic and modern cycles
Source: own.

It is important to observe the difference between cycles before and after the crisis. Clearly, the biggest difference is their amplitude. Cycle 2 and cycle 3 both have negative amplitudes. The length of all cycles and their symmetry are also similar. Cycle 3 is less intensive, though. From this, it can be stated that the cycles do not differ much, except of their amplitudes.

5.4. Discussion

In this paper we analyzed three economic cycles:
Cycle 1 – before the crisis,
Cycle 2 – 'including' crisis,
Cycle 3 – post-crisis.
It can be stated that either of them matches the description of classic and modern cycles, except of their length (appr. 4 years), which indicates that in terms of length the cycles match the characteristics of the modern cycle.

The fact that upper turning points of cycles area clearly visible, while lower turning points have characteristics of turning zones implies, that when an economic cycles reaches its peak, the following decline phase appears rapidly. On the other hand, economic trough smoothly becomes the beginning of the following growing phase. It is of a high importance to all who try to forecast future economic growth, as it turns out that at its peak, economic cycles rapidly change its behavior.

Their morphology also seems similar, except for their amplitudes which have been negative since the crisis. It implies that Polish economy is still in the slow-down phase. That is caused by time difference in the GDP components, which recover from the slow-down with different rate (Gradzewicz, Growiec, Hagemejer and Popowski, 2010, p. 30). However that information alone should not be used as an assumption for prognostic tool, as it may be expected that due to economic, political, social, or other factors, the declining trend line of the economic growth might stabilize or even change its gradient to positive one.

It is recommended to conduct similar analysis when data for following years are available. In time it will possible to observe if the economy and its fluctuations have changed after the crisis. It is also advised to investigate how other economic aggregates behaved before and after 2008. That information would be of a great value to forecasting and understanding processes which take place within the economy.

Conclusion

In this paper the analysis of economic cycles in Poland in years 2000–2013 was conducted in order to verify whether the economy still follows pattern observed before the crisis of years 2007–2008 or not. Additionally, the similarities of their morphology with respect to characteristics of classic and modern cycles were examined.

The results clearly show, that in the examined period Poland was not in a recession, growth of Polish economy has become less dynamic after the crisis. As the last cycles lasted approximately 3–4 years with turning zones as their troughs, it can be stated that they party fulfill the characteristics of modern economic cycle.

It is recommended to conduct similar analysis when more data is available. Moreover, it is advised to analyze other economic aggregates it terms of their behavior before and after the crisis.

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http://dx.doi.org/10.18778/8088-012-2.06

The regional policy

6. Sustainable city – flexible or durable? Socio-economics aspects of urban patterns

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Abstract

This paper's goal is to introduce an interdisciplinary assessment of urban patterns as a factor of socio-economic development, presenting selected examples of how different urban patterns (compactness, complexity, decentralisation and porosity) influence family economics, risk management for city dwellers and entrepreneurs, labour market and social inclusion or inequality. Urban patterns and socio-economic aspects of urban life are closely linked in a complex and manifold way. The main topic of the paper will be the assessment in what way durability or flexibility of a built environment influences urban sustainable development.

It is not possible to identify one spatial pattern that in the best way meets the need to adapt to new challenges and threats. However, case studies can point to certain features of cities, especially their diversity, as being the most important for their proper functioning.

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Introduction

The beginning of the XXI century has been shaped by a number of important phenomena. The first of them is globalisation with the ever-growing flow of the information, people and capital, but also the transfer of pollution, disease, and increasing conflicts between the regions. The second is the high level of urbanisation. In 2050 the share of the urban population is expected to reach 70% globally, while in European Union (EU) it is already higher (EEA, 2011). Cities also host concentration of economic activity. The share of big cities in the national GDPs excesses significantly the share of their residents in the population of the country. City clusters may represent even stronger influence on economy. The best example in EU is "pentagon area" demarcated by the urban agglomerations of London, Hamburg, Munich, Milan and Paris, which generates 46% of the whole GDP of EU (EEA, 2010a).

Another important phenomenon is the increasing instability of the environment and climate. The standard of living in developed countries has never been so high and yet we are facing an increasing number of hazards in almost all areas of human life: climate change, depletion of fossil resources, the emergence of new health problems, economic crises and political conflicts, including terrorism and armed conflict, some of them within the borders of Europe or in its immediate near.

Most of the challenges and problems of the modern world are concentrated in urban areas. Cities are the main consumers of energy and centres of creating new technologies for energy savings, the most endangered places epidemiologically-wise and yet those where the medical assistance is provided and new methods of disease prevention and treatment developed. Cities are centres of social and economic activity, places where ideas and innovations are emerging; last but not least – places where millions of people live in close proximity to each other. The idea that connects most of the answers to the contemporary challenges is that of sustainable or durable development.

Sustainable development refers to three interconnected resources: the socio-economic capital (human being and their communities), the natural environment (natural systems we whare and depend upon) and the built environment (Rodin, 2014). Durability of the city and its ability to adapt must include the relationship between these elements. The paper will present an analysis of the relations between the spatial patterns of the urban built environment and its resilience to socio-economic and envirenmental risks. The risk may represent not only a disaster or crisis, but every radical change which may destabilize the functioning of the city.

Resilience is the opposite to urban vulnerabilty and the interaction of these two properties reduce or enhance accumulative disaster impacts (Lankao and Qin, 2011). Spacial patterns are the most durable elements of the cities. At the same time, a city is a dynamic organism that must respond to changing demands of city dwellers, to new opportunities and risks; adapt to technical progress and climate change. Existing urban patterns may be the cities' assets or barriers to farther development, they can enhance or decrease their resilience. Exploring the possibility of urban adaptation is now one of the most pressing tasks of urban studies. While the level of coverage of costs and benefits of adaptation related to the environment (especially the coastal zones and agriculture) is already high, and these related to health, infrastructure, flood control and energy – medium, studies on water management, transport, tourism, and macroeconomic effects are yet in the initial stage (EEA, 2013). However, the current research and state of art provide some insight of what types of urban patterns may be the most resilient.

6.1. Typology of urban patterns and their elements

Urban space is a complex system of tangible and intangible elements. It consists of buildings, infrastructure, built-up areas and undeveloped/green areas, as well as the connections and interactions between them. Built environment patterns comprise transport systems; size and scale of districts, quarters and building plots; localisation of different functions (residential, industrial, commercial, administrative, recreational, cultural, educational and other); and the urban density. The intangible aspects of urban patterns inlude the character of the city (industrial, academic, touristic), its landscape (a system of panoramas and views) and the soundscape (sounds, their types and intensity) (Schafer, 1993; Dubois, Guastavino and Raimbault, 2006). A collection of these diverse elements defines the city as a whole.

Socio-economic development of the cities both depends on the urban patterns and shapes them. In the history of the urban development, we can follow the influence of urban ideas, but mostly this of political, social and economic ones. In the past these ideas affected the size and location of public buildings, residential structure and building quality differentiation. Today, urban patterns are consciously used as a tool to shape sustainable socio-economic development (Gospodini, 2006). 71.7% of the EU-28's population live in a densely-populated or an intermediate urbanised area; around 200 million persons are living in densely-populated areas and almost 160 million in intermediate urbanised areas (Eurostat, 2012). Urban resilience and sustainability must be based on good use and proper reshaping of the existing patterns and new built environment should be created with care to be an asset and not a burden for the future.

The most common elements of urban typology comprises:

1) size of the city. Despite centuries-long efforts to determine the optimal size of city (e.g. Leonardo da Vinci ideal city, satelite city of E. Howard or B. Malisz theory of city thresholds) there is no dominant theory in this regard (Batty, 2008). City scale also depends on regional conditions;
2) boundaries that may be administrative, functional or morphological (EEA, 2009);
3) population density (number of inhabitants per unit area, usually 1 km^2). Generally higher density is correlated with bigger size of the city.

Analysis presented in the paper is based on the urban typology proposed by Huang, Lu and Sellers (2007). They proposed following characteristics of the urban patterns, based on the metric analysis of patches in the satellite images of metropolitan areas:

1) complexity (determined by the irregularity of patch shapes; the more different and the smaller the patches – the higher the complexity);
2) centrality (average distance of the dispersed parts to the city centre, which was defined as the centroid of the largest patch);
3) compactness (defined as the fragmentation of the overall urban landscape);
4) porosity (defined as the ratio of open space compared to the total urban area).

In this paper the following typology will be used:

1) complex city;
2) decentralized city;
3) compact city;
4) city of high porosity.

In complex city there is a variety of economic activities, comprising different form and size of enterprises. Most of the global and regional metropolis can be described as complex city – from Paris and London to Warsaw and Berlin. Also smaller cities may be complex if they provide various opportunities and activities, e.g. Salzburg, Nice or Lublin. The opposite is the industrial or mining city with one enterprise as a core of local business and highly dominant job-provider. In such city, commercial and public services are also addressed to the needs of the homogeneous group of people, and as a result – less numerous and less varied (Rodin, 2014). In complex cities, variety of economic and social activities are mirrored by diverse urban and architectural forms. There is also a bigger variety of housing, associated with the diversity of social groups in terms of the financial situation and lifestyle. In a very complex city there is no large monofunctional districts or quarters (office, industrial or residential), and the activities of different city dwellers are not separated spatially.

In decentralized city there is more then one area where the concentration of different services, both commercial and public, can be observed. The more decentralized a city, the bigger number of the sub-centres. An important feature is also the dispersion of such sub-centres and their availability (measured by the distance between residence areas, workplaces and other functions).

Many towns and cities in recent years has changed the structure from monocentric to polycentric (Dieleman and Faludi, 1998; Hall, 1999; Helbich, 2010; Batty, 2008). It is the result of intruducing new functions to the housing districts, the emergence of new economic clusters, dispersal of jobs instead of their previous concentration in large industrial plants and office districts (Malmber and Maskell, 2002). The nature of this decentralisation may be very different, from the urban-style centres (squares with shops, cafes, local cultural centres, some local administration, parks and common gardens in Warsaw (Centra Lokalne, 2015)), through new jobs cetres in Edge Cities (as Schiphol in Amsterdam or Massy-Saclay near Paris (Bontje and Burdack, 2005)) to large malls on the outskirts of many European and American cities (Gospodini, 2004). All of them, however, mean that local residents have access to a variety of functions without having to travel to the city center. It is essential that these centres also provide them with jobs, thereby further enhancing the reduction of travel, cost of living and strengthening local identity (Malone-Lee, Sim and Chin, 2001).

Compact city is one of the most often discussed and generally recommended feature of the sustainable city (Burton, Jenk and Williams, 2003; Burgess, 2000). It reduces the costs of infrastructure, enables city dwellers to move around on foot, reduces the energy consumption and waste production, decreases the negative impact on natural environment and provides the social and economic benefits of proximity (Litman, 1997; Gehl, 2014; Owen, 2009; Sadowy, 2014b; Malone-Lee, Sim and Chin, 2001). Still, there are some doubts and reservations regarding the downside of the compactness, especially related to highrising building (Mega, 2000).

On the other hand, one of the most prominent problems of modern cities is urban sprawl (Brueckner, 2000; EEA, 2006). Suburbs represent very low diversity, both in terms of urban patterns, architecture and socio-economic ascpects. They usually comprise single family houses, inhabited by the middle class, often homogeneous in terms of nationality, race, and/or religion; devoid of functions other than housing, with the exception of shopping malls, located beyond the pedestrian walk. Suburbs are also characterized by low and very low intensity of development, which results in more rapid increase consumption of the space then the increase of the number of inhabitants of urban areas (EEA, 2010).

Porosity of the city can be primary or secondary. If we treat the areas of the city that are not sealed as urban “pores”, they can be natural, green areas (as parks, lawns, water, simply not yet built-up areas, lakes and rivers, etc.) or the brownfields, devastated by natural or human-related causes (hurricanes, bombing, devastation of former industrial areas). The first could be represented by Stockholm, the latter by New Orleans. The origin of the former can also be two-fold: they can be introduced according to urban planning or be a result of chaotic urbanisation. Therefore, the role they play in the city functions can differ significantly.

The relations between the urban types are not straightforward. Generally, high complexity should be related to high decentralisation, and very compact city could be expected to have smaller porosity. However, well-planned, compact city with higher buildings may have a higher lever of porosity then suburbs with almost completely sealed areas. Complex city may tend to be compact, but as well it can be sprawled across a large area. Therefore, the possible combination of the features (including also size of cities) are numerous.

6.2. Drivers of change and socio-economic risks

Cities are shaped in a centuries long process and are influenced by many factors. Some of these factors have a distinct character of threats, such as natural disasters or war. Others may be even positive – as the emerging new industries or migrations of creative class. However, they aways destabilize the current way in which the city operates. City dwellers and investors shape the lifestyles and patterns of the city, but they must also adapt to them. Different stakeholders’ relations with a city vary, both in terms of impact strength and durability of the relations, as presented in table 6.1.

		LONGEVITY OF THE RELATION WITH THE CITY		
		LOW	MEDIUM	HIGH
IMPACT ON THE CITY	LOW	A participant of a business meeting at the airport conference centre	An employee temporarily assigned to a particular city or student from another city or country	A resident of the suburbs, occasionally visiting the city
	MEDIUM	A tourist	Public administration official working temporarily in the city	A common city dweller
	HIGH	A specialist invited to propose a program of revitalization or development strategy	International developer	A resident, property and entrepreneurship owner (family business)

Table 6.1. Examples of city stakeholders, depending on the strength and durability of their relations with a given urban space
Source: Sadowy, 2014a.

It is just an outline of the numerous and complex relations between the city and its stakeholders and is by no means a complete catalogue. However, we may state that the more diverse the group of stakeholders, the more their interest in sustainable and durable development vary. Developers may tend to ignore the negative long-term effects of construction. Tourists will visit specific locations and their impact on the non-touristic parts of the city will be limited. Both groups represent increasing number of stakeholders, whose links to the city are short-termed and aimed primarily at achieving short-term benefits.

Tourism may have very negative influence, not only in form of the damage to the environment and the local communities of less developed countries (Dielemans, 2011), but also to European cities (Russo, 2002). An example would be Venice, which is gradually being deserted by the residents as a result of rising prices and growing burden of everyday life. Globally, number of tourists is constantly growing, with 2 million leisure travelers in 1950 to approx. 800 million tourists in 2008. The forecast for 2020 stipulates a 1600 million leisure travelers (EEA, 2011). For cities, this means a lot of investing and functional pressure.

Globalization and increasing mobility encourage the migration flows. City dwellers move between the cities in search of work and more attractive living conditions, as well as for personal reasons. In the years 1995–2004, in Europe, the number of internal migration amounted to over 10 million (EEA, 2011). Cities compete for highly qualified residents and creative class (Florida, 2004). The greater the difference between the quality of life in cities and their attractiveness, the greater the pressure for migrations (Turok and Mykhnenko, 2007). Migrants introduce new demands and expectations. They have differents habits and lifestyle, including cooking habits, size of living space and demands on it, different demands on public spaces and services (EEA, 2009). Therefore they may look for more complex cities, but even in formerly homogenous ones they may create important change (Rodin, 2014).

Another type of pressure comes from the changes of the lifestyles. The crisis in the US in 2008 was in part caused by the belief that every American family could afford a family house. Also in Europe the size of the average house or flat is constantly growing (EEA, 2009). Hence comes the pressure for cheaper land for new development in the outskirts of cities, formerly used as farmland. Such suburbanisation may be favored by inadequate planning policy. This is the case in Poland, where the local spatial development plans provided for residential areas would be enough for 65 million people, while today Poland has 38 million citizens (Kowalewski, Mordasewicz, Osiatyński, Regulski, Stępień and Śleszyński, 2014). Expanding cities cover the areas that has not been built-up before because of the high risk. An example would be building on floodplains in Poland or bushfires in the suburbs of Australian cities (Chen and McAneney, 2004).

Other important risks are the social polarization and exclusion of certain groups, as well as lack of spatial justice. Often they are associated with economic change, as the deindustrialization of Europe and the closing of large industrial plants in Central and Eastern Europe after 1989. The conversion or destrying of former industrial buildings may not only make thousands of people jobless, but also blur social memory and have very negative social impact. An example may be the case of the Gdansk Shipyard (Stocznia Gdańska), where the wall mural presenting stories of former workers was demolished for the investment of real estate development. It was perceived as as a strikeout of entire profession for a new social order dominated by the middle class (Chomicka, 2010; Sadowy, 2014a). There is also the very different case of Birmingham, where despite of the fact that the revitalization did not fulfil the city dwellers hope in terms of the economic recovery, the transformation of the image of the city minimized the social discontent (Hubbard, 1995).

Health is one of the most important factors of quality of life. Medicine has now reached a very high level, and the cities are hubs of medical knowledge, as well as that of medical care. However, there are also new health risks, resulting from urban lifestyles. Numerous trips; urban population growth and high number of everyday contacts; overuse of antibiotics or waiver of vaccinations all pose new and serious epidemiological threats. In addition, there are negative effects of air pollution, the source of which is mainly cars, constant exposure to excessive noise (EEA, 2014c) or excessive lighting with artificial light, obesity resulting form the lack of exercise and daily walks. The spatial structure of cities has an impact on many of these kinds of behaviour, and the World Health Organisation (WHO) considers that urban planning is an important determinant of health (EEA, 2009). This interdisciplinary approach is also expressed in the content of local policy documents. Health equity issue appeared in approx. 60% of such documents concernig planning in 2012 and approx. 65% in 2013. In the case of housing these figures are approx. 58% and approx. 62% for the years 2012 and 2013 (WHO, 2014). Healthy urban planning depends greatly on the existing urban patterns.

One of the major challenges in contemporary urban policy is also adaptation to climate change (EEA, 2013 and 2014b; European Comission, 2009). It is a complex and manifold problem. In the paper two type of threats will be taken under consideration: disasters caused by hurricanes and heavy rains and the temperature rise, with special emphasis on heat waves.

6.3. The resilience of different type of urban patterns

Sustainable urban development must provide personal, economic, social and health safety. In the first Survey on Quality of Life in Europe in 2003 8 factors have been identified: economic situation; housing and the local environment; employment, eduaction and skills; household structures and family relations; work-life balance; health and health care; subjective well-being; perceived quality of society (Eurofound, 2003). It is very important to perceive also the variations between demographic and social groups. Social polarisation may be the result of spatial injustice: spatial concentration of people with low/high incomes in separate areas of the city, as well as the location of the less well-off households in the areas most exposed to nuisance and health hazards. An example would be a greater exposure to noise of people living in conditions of relative poverty. According to WHO research, the most vulnerable social group in the EU in this regard are single parents living in relative poverty (WHO, 2012).

Proposed analysis presents the impact of the urban patterns on city resilience. It is shown according to the typology of 4 urban patterns: complexity, decentralization, compactness and level of porosity. The analyzed risks/challenges are: migration flows (significant inflow or outflow of city dwellers) and socio-economic polarization of city dwellers; the economic crisis, in particular related to the high levels of unemployment; increase in crime and the threat of a terrorism; health risks, especially related to heat waves and epidemic occurences; the last problem is related also to climate change causing not only tmperature increase but also hurricans and torrential rains.

Positive effects of urban pattern enhance the resilience and ability to adapt, facilitate quick and appropriate response or even reduce the likelihood of the risk. Negative effects are barriers to adjustment, make it difficult to react or increase the likelihood of risk.

6.4. Complex city

Facing the migration and social polarisation problem complex cities tend to ease the including the new residents into existing social structure. In a diverse spatial pattern it is easier to find a suitable place to live and work. Heterogeneous neighbourhoods have fewer social tensions, which makes easier for immigrants to be included in the local society. In the case of migration from the city, it is difficult to identify a very clear advantage or weakness of this kind of urban pattern. However, in homogenous, monofunctional residential areas emigration of a specific social group may leave whole parts of town deserted and degraded, and in a result, more difficult to be revitalized (e.g. large housing estates in former East Germany (Ott, 2001).

Urban complexity can take many forms. In case of a genuine diversity of urban pattern, where people of different social status are living in close proximity, social polarisation is unlikely. The city where poverty and wealth districts are clearly separated from each other loses its important social function, which is the opportunity to meet people different from ourselves (Sennet, 2007). According to the model proposed by Huang, Lu and Sellers, the more diverse the city (the smaller patches of different functions/groups of users), the greater resilience to the phenomenon of social polarisation.

Each economic diversification makes the city resilience grow. There are various opportunities to find employment or start one's own enterprise. In the complex structure of the city it is also easier to find spaces suitable for particular type of enterprise, as there are simply more choices. It is also possible, in case of the reduction of the household income, to remain in the same neighbourhood, but after moving to a smaller residence.

Complexity also favors maintaining some unique characteristic features of the city. In the global and regional competition between the cities it can provide a significant advantage, since the identity of the place is important factor attracting the creative class and tourists. It also promotes a sense of roots and self-esteem in other groups of city dwellers (Gospodini, 2004; Hubbard, 1995). On the other hand, there is a drive for economic and cultural clusters, due to the benefits of proximity, and possibility to use the same infrastructure (Gospodini, 2004). Such actions, even as they seem to reduce the complexity of the city, can also enhance resilience to economic fluctuations.

Crime factors are similar to the mechanisms of social polarisation. In complex city different levels of social control and responsibility for immediate neighbourhood may occur. In the cities with "better" and "worse" districts, wealthier residents may have a tendency to cede all responsibility for law and order to appropriate services (in extreme cases – exclusively for the private security), and even police can avoid intervention in "ghettos" of poverty and high crime rates. Real complexity provides better understanding and cooperation between different groups of city dwellers, thus providing the higher level of social trust and cohesion, the best defence against crime and violence.

The diversity of the urban pattern in this case is beneficial especially if it provides the diversification of the infrastructure. Diverse modes of transport can complement each other, if a failure occurs in one of them (eg. flooded subway tunnels, damaged tram lines or blocked streets). The location of power plants in one place makes their eventual failure affect all consumers in a city. The dispersion of plants producing electricity and/or heat guarantees that at least part of the city should not be deprived of them. The same applies to the diversification of other important resources including services for crisis management.

Diverse urban patterns provide more diverse response to heat waves. They make it easier to find cooler places, in open public space or in commercial or public building, e.g. air-conditioned shops, public administration buliding or cultural institutions. The possibility of spending even short time in a lower temperature can make a big difference to health, especially for groups of high risk (elderly city dwellers, children and some disease sufferers). Mostly, however, the city resilience to temperature increase depend on the specific type of architecture, use of natural ventilation, shadowed public spaces, accessibility of green spaces and/or water (Changnon, Kunkel and Reinke, 1996).

The epidemiological effects of interactions between different city dwellers (e.g. children and elderly citizens), different patterns of moving around the city (cars versus public transport) and sustainable urban planning require more extensive research in which they will be taken into account. Undoubtedly, the uniformity of the spatial structure and building facilitates both analysis of possible scenarios of the epidemic, as well as the development of standards of conduct. Spatially diverse city does not have to be at greater risk, but it is surely an environment in which there is a need to develop more varied methods of gathering information and implementing varied standards of conduct. Mostly, health of city dwellers depend on numerous factors, but social cohesion and support, more typical for the complex city, are also important to maintain individual resilience (McLaren, 1992).

6.5. The decentralized city

Similar to complex city, urban patterns with strong local sub-centres makes better environment for new city dwellers, who can root in local community, find different services and possibly even jobs close to their new homes. Sub-centres are also important places of connecting people from the same neighbourhood, building social relations and local identity. All that factors should enhance social cohesion, but in general, it is possible to find many sub-centres in significantly polarized city, as well as in a city with high level of social cohesion. In really diverse neighbourhood sub-local centres enhance positive trends, but in a "gettoized" city different city dwellers may also concentrate around their sub-centres, further secluding from other social groups.

Existence of many sub-centres coincides with more diverse economic activities – there simply must be more services, health, educational and cultural centres, local shops and small-scale employers to form sub-centres. Consequently, more sub-centres equals more complex city, benefiting from its economical resilience to crisis. As sub- centres also should result in stronger social relations, it would be easier for the unemployed to find help and support, very important for people in difficult situation, practically- and psychologically-wise. Proximity of the services provided by local sub-centres also reduces the commuting costs for city dwellers. In ideal cases it is possible to access all needed destination or even find a new job within walking distance. Long trips to location of workplaces can even exclude whole social groups from the labour market, e.g. women living in the suburbs, when the only car left in family is claimed by their husbands or partners (Hirt, 2008) or people too tired after the long commute to work effectively (Zenou, 2002).

Single, clearly defined city centres, gathering a large number of city dwellers and tourists make the important target for many types of crime – from pickpockets hunting for careless tourists and shoppers, to the terrorists who choose crowded places as goals of their attacks. It should be not an argument against having attractive main centres in the cities, with historical monuments and many cultural and entertainment facilities. It is only important to remember that some dispersion of city functions may make a city not only more comfortable but also safer.

Heat waves result or not in heat islands depending on the density and porosity of urban patterns and the presence of sub-centers do not seem to have any serious influence. They may become an asset, if they provide the concentration of local services helping to soften the impact of the heat. It may be public space with some green area or water, public spaces within the air-conditioned buildings, easily accessible for the neighbourhood.

The presence of sub-centres makes the long and numerous trips across the city unnecessary, thus decreasing the contacts with other city dwellers in the public transport or in crowded city center. This can reduce the risk of accidents and epidemiological risks. It is also important that sub-centres should comprise health centres or at least some medical services. They should be included in a crisis management network, not only for epidemiological reasons but also for any biohazard risk.

Similarly to the high temperature risk, presence of the sub-centres does not reduce the risk itself form the torrential rains and/or hurricanes but may be helpful in managing the crisis, especially if they provide dispersion of the infrastructure and public services.

6.6. The compact city

Compact cities have lesser tendency for homogenous districts as it is more difficult to introduce social boundaries in highly populated areas. Compactness is in fact very often correlated with mixture of land uses and proximity of varied uses (Neuman, 2005). Segregation and polarisation along ethnic and/or socio-economic lines are typical for suburbs and areas of urban sprawl (EEA, 2009). However, the exact influence of compactness on social equity is not yet fully researched and some findings suggest that some effects may even be negative. However, cities with large proportion of high-density housing and large quantity of locally provided services and facilities are those that are best in promoting social equity (Burton, 2000).

Compactness and density of the city have direct influence on municipal costs of the public infrastructure, also in long term, which affects future generations. Low-density housing, typical especially for the suburbs, is more cost intensive than high-density housing (EEA, 2010a). Development of the green fields outside the city requires also new social infrastructure, while some infrastructure existing within city boundaries or in central districts remains ineffectively used. Compact cities may also tend to provide more stable markets. Urban sprawl, land abandonment and competition with agriculture for farming land around the city may create unpredictable pressures and expectations on the market. They may result in prices which do not reflect the real value of the land, as well as jeopardise the sustainable land-use in long term (EEA, 2010a).

Compact cities often are characterised by smaller flats and more effective use of common services. They also have better developed public transportation system which is effective only if provided in reasonably high density. Therefore, city dwellers spend less on everyday necessities. Difference between the costs of private and public transport can be significant. In EU households spend about 12% of their income on private transport and less then 2% on the public one (EEA, 2005).

Compactness encourages walking, cycling and the use of public transport thus reducing the costs and risks related to PM and energy use – both important determinants of direct and indirect costs (EEA, 2009). Quality of the space for pedestrians and cyclists may strongly influence how frequent commuters chose this type of moving around the city. Disparity between EU countries are still very marked – from 8.9 km of cycling paths and lanes per 1 km^2 in Helsinki, 4 km/km^2 in Copenhagen, Hannover and Stockholm, to less then 0.5 km/km^2 in Madrid, Prague, Rome and Oslo (EEA, 2009).

Compact urban areas use much less resources then the low-density areas. It can be seen even on national level, where countries with very low density (Australia, Canada, Finland and USA) use 30–40 tons of the raw resources per capita, while more urbanized countries of higher density (Germany, Austria, UK, Japan or UE-27 as a whole) use below 20 tons per capita (Sadowy, 2014b).

It is statistically feasible that larger number of people may comprise larger number of offenders, and urban areas of high density are potential targets for different types of crime. High level of crime, along with congestion and pollution have been one of the most prominent drivers to move from the densely populated central areas to suburbs (Howley, 2009). However, low density provides less of social common control of the space and single houses are more prone to breaking and entering then multifamily housing.

Highly populated areas are more risk-prone for this type of terrorism where the goal of the attack is to reach as many victims as possible, as shown by the dramatic examples of 9/11 or attacks in European metro lines. Also, even if the attack is precisely targeted, in compact cities the collateral damages are more probable.

Compact cities increase the risks associated with heat waves because of the high percentage of the sealed soil and the longer time it takes for the bigger cubatures of buildings to cool during the night. Most of the premature deaths due to the heat during a heat wave in 2003 took place in urban areas (EEA, 2013). The cause of heat islands is the lack of green spaces, ponds, but also the use of air conditioning. Whereas it takes more effort to provide the natural methods to cool the buildings (proper insulation, natural ventilation, window shutters), the installation of air conditioning cool air inside, but give off extra heat outside. Such a phenomenon can further enhance the spatial injustice – when air-conditioned office and residential buildings of high standard make the risk even greater for other city dwellers.

Number of people is also an important factor. The higher density , the more people feel the effects of the flood, or hurricane rains that affect the area. For example, in 2002 in Dresden, when Elba poured in a similar area as it was in the XIX century losses were much higher. On the other hand, the intensity reduces the unit costs of building infrastructure, so it is easier to implemment appropriate investments in order to drain rainwater.

6.7. Cities of high porosity

Influence of the city porosity on migrants behaviour and on social equity depends mostly on the character of the "pores", as mentioned before. Well-planned cities with several green areas are much more flexible in case of significant change of their population. It is easier to introduce new buildings into existing urban structure, as well as the losses of some of the inhabitants are not so clearly concentrated in specific areas. Even chaotic planning, leaving some of the plots not built-up, gives the city potential to host new city dwellers. Green areas used as a common gardens may enhance social cohesion.

On the other hand, secondary porosity, caused by the war damages, hurricanes or foreclosing of some buildings can create very unfriendly and even dangerous urban pattern. Weaker social groups may be more exposed to risk and social injustice may increase.

Very high porosity means that city is sprawled and ineffective in terms of land-use. Some porosity is yet needed for the city to function properly and have both green areas and reserves for further development. There is also an interesting trend of local urban farming and gardening that may benefit from this urban pattern (Barthel, Parker and Ernstson, 2013). It generally corresponds to the trends to live, consume and work more locally in the face of the global crisis.

Similar to the problem of social spatial injustice, secondary porosity may be the source of several dangers and create habitats and operational grounds for criminal groups. Also chaotic planning, resulting in uncontrolled empty plots may reduce the public safety in the city.

Natural porosity of the city, that is the presence of numerous green areas in the urban pattern is one of the most important factors in creating the resilience to heat waves. It is especially beneficent if the areas create corridors and networks that help to naturally introduce cooler air from outside of the city (Kronenberg, 2012). Also the proximity to safe green areas has very positive influence of lifestyle and health.

City porosity reduces the risk associated with large amounts of water from heavy rains or flooding. Introduction of a "porosity" to the structure of the city can be simple and unexpensive addition to building storm sewers. In San Francisco, very rapid, short-lived downpours sometimes cause overflows of sewer. Therefore, in addition to the construction of new infrastructure, it was decided to introduce a water permeable pavements, squares and parking lots to increase natural retention (Rodin, 2014).

Conclusion

Sustainable city is a resilient city. However, the above analysis shows that there is no perfect model of the city, which arguably would provide a competitive advantage in the economy and high quality of life.

The diversity of the cities seems to be particularly important feature in terms of their sustainability. This confirms the hypothesis of J. Jacobs that cities diverse in terms of architecture, space and functions are more friendly, more dynamic places to live (Jacobs, 1992) as well as more recent theories (Leichenko, 2011). Diverse communities, with a range of demands, expectations and activities and are also more resistant to economic crises (Rodin, 2014).

Another important feature is the porosity of the city. Excessive porosity equals excessive growth of urban sprawl and suburbs, while within the city are vast undeveloped areas. However, the presence of undeveloped patches enhances the flexibility and adaptability of the city in many fields. If necessary, allows further development and introduction of new facilities and infrastructure. In the case of climate change, makes the city more flexible in responding to extreme temperatures (less risk of heat islands), and heavy rain or flooding (greater possibilities of natural retention). City diverse and reasonably porous is also more conducive to the welfare of the inhabitants and biodiversity. It applies only to the primary porosity, while secondary porosity may become an asset only in case of well-planned revitalisation.

The level of compactness and decentralisation of cities is more ambiguous. Indisputably the compact city helsp to reduce the costs and increase the efficiency of the infrastructure, stabilizes the real estate market, strengthens social bonds, generates economic clusters. Compact city favors walking and cycling, important for the costs of living and health of residents. However, compact urban pattern is less flexible in adaptation to new trends. If the city is so compact that it is not sufficiently porous, its residents have limited access to green spaces and recreation. It is also more difficult to minimize the effects of heat waves and torrential rains. High concentration of population may increase the risk of crime and terrorism. However, all evidence indicates are that the radical alternative – urban sprawl and suburbanisation – is a source of even greater harm and risks.

The current decentralisation of cities shows that this trend corresponds to a very strong demand. It is certainly associated with the deindustrialisation and the need for the local identity. So it is already part of the process of adapting to the new expectations of urban residents. Generally, the city with many sub-centres is more resilient and flexible but it requires more coordinated management.

Overall, urban patterns of the cities seem to play a much more important role than their size. According to Eurostat forecasts, the share of urban population in the total population of the EU will remain stable in the horizon of 2030 and even 2050. The period of "new cities for new society" is long gone. In contrast, the volatility and uncertainty of the environment is likely to remain high or even increase. Therefore, it is important to know in what extent the existing cities are able to respond and adapt to new demands and risks. Diverse city, primarily porous, decentralized, fairly compact, with a good information system and coordinated management seems to be best suited to today's challenges. This city can be a healthy form advocated by the European Environment Agency Healthscape 2030 (EEA, 2013), as well as a favorable environment for socio-economic development. From the point of view of urban sustainable development the best guarantee of durability is flexibility.

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http://dx.doi.org/10.18778/8088-012-2.07

7. The debt management conditions of local government units in Poland

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Introduction

Operating in Poland since 1999 the three-tier administrative division of the country (communes, districts and provinces) has helped to increase the financial independence of these units. The main objective of introducing Poland with a system of country division into individual local government units was essentially the pursuit of efficient, and therefore, the effective functioning of the state in all spheres of public activity. This primarily involved the establishment of a range of criteria, rights and obligations which different parties have accepted. Due to the significant amount of a wide range of tasks that result from the functioning of local government, it is difficult now to imagine the existence of the state without taking into account such a segmentation of these entities. Local

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government units, which are included in the local government sector due to the large range of tasks assigned to them, play an extremely important role when it comes to the management of public funds. This is related to the broader decentralization of public tasks and also to some extent of autonomy in shaping their own fiscal policies. Since the introduction of local government reform a large number of operators in the sector are facing a growing debt problem which is also reflected in the increase of the public debt level. In the main extent this is the result of the aforementioned decentralization of tasks, in other words, the transfer of a substantial part of the state's obligations related to the functioning of the country to the level of local government (Marchewka and Bartkowiak, 2012). Due to the limited amount of funds it significantly contributes to reducing opportunities for the entity of local government, and as a consequence it forces local government authorities to use debt instruments such as credits, loans and issuance of debt securities. However, the debt results from the lack of stable budgetary policy in the sense of its possibilities. Sometimes, from the moment of creation of the budget for the next year we can see some kind of lack of vision and planning to continue the development of the unit in the future, which could contribute to stabilizing its finances. You could say that for the governing bodies of local government units 'it's all about the here and now'. A key element contributing to the debt growth of the local government sector over the last few years was also the possibility to use funds from the European Union and other non-refundable external funds. Unfortunately, this is conditioned by the necessity of bringing their own contribution, which in turn imposes the use of debt instruments. Because of the fact that the debt, which is generated by local government, affects the growth of the state debt level and involves a risk of exceeding the legally adopted restrictions in this area, it is also connected to the so-called safety thresholds. The problem of local government debt is mainly linked with all activities relating to the analysis of the debt. This man itself through the introduction of appropriate indicators that determine the situations enabling the occurrence of debt, as well as the designation of mechanisms for debt monitoring. In Poland so far lacked strict financial rules, which would help to gradually reduce the borrowing of local government entities. Constantly increasing n the indebtedness of local governments sector entities contributed significantly to the increase in debt at the national level. This was particularly relevant when it cames to managing public finance sector debt. Introduced regulations in Poland are expected to contribute to a gradual reduction of the debt of local government units. The following article attempts to bring the issues of control and reduction of local government debt in connection to new restrictions implemented at the Polish local government level.

7.1. The indebtedness of local government units

According to Article 72 of the Act from 29/08/2009 on public finance, public debt includes the obligations of the public finance sector. Due to the fact that local government units and their unions have been classified as the entities making up the sector, debts arising from their activities will be included in the overall level of public debt. Debts created by local governments undergo the numerous legal limitations designed to prevent over indebtedness and the problems connected with the timely settlement of obligations. Notwithstanding, there is no doubt that because of local government debt included into public debt, the legal conditions to reduce the level of local government debt have to limit the gradual increase in the debt of the country (Dobrzyński, 2014).

The implementation of a number of public tasks conducted by local government units and improving the standards in, inter alia, technical and social infrastructure requires extended costs. The source of income for self-government units is not sufficient to fully meet the needs of local communities and, correspondingly, to make up the civilization delay that is associated with the decisions of local government bodies about the acquisition of additional resources, often of payable character. The existing literature emphasizes that there are two main reasons for incurring liabilities by local government units. The first one relates to the lack of adequacy between the tasks performed by the entity and the financial resources which are at its disposal. The second one is related to the mismanagement of its own budget. As a consequence, there is shortage of funds for task implementation, which leads further to using all kinds of debt instruments. Loans and advances are the most commonly used financial instruments classified as public debt. Also, it increases the interest of local government units with the possibility of issuing securities and bonds, which so far were mostly identified as the domain of large cities, to finance the borrowing needs of smaller local government units (Ruśkowski, 2008).

Local government units may take loans and issue securities for specific purposes in accordance with the provisions of the Article 89 Paragraph 1 of the Acton Public Finances (APF). External funds proceeded this way can be spent only on (Ciak, 2012):

- the coverage of budget deficits that occur during a transition year,
- the financing of planned budget deficits,
- the repayment of earlier obligations due to the issue of securities and loans and borrowings,
- the pre-financing of financial activities with funds from the European Union budget.

Credits, loans and securities incurred or issued in order to finance the budget deficits transition are characterized by the repayment compulsion or redemption in the same year in which they are incurred or issued. These instruments enable the balancing of the budget during its execution, in situations of periodic budgetary imbalance, i.e. transition deficit. They are not associated with a permanent shortage of financial means for spending included in the budget plan, but only with the lack of synchronization between the sources coming into and flowing from that account. Due to there venues and expenses in this area, they are not planned in the budget of local government units. The expenditure plan covers only expenses related to debt repayment. Bank credits, loans, and securities issued for the purpose of financing the deficit are subject to be revealed in the relevant budget reports (Kosikowski, 2010).

Financing of the planned deficit is an the other situation envisaged by the legislature, in which local governments have the right to enlist the commitment that increases public debt. According to the APF, local government budget deficit can be financed by revenues derived from (Lipiec and Warzecha, 2010):

- the sale of securities issued by local government units,
- loans,
- privatization ofthe assets of local government units,
- local government budget surpluses from previous years,
- free cash, as cash surplus on the current account of the budget of local government unitsresultfrom the settlement of issued securities, loans and credits from previous years.

The condition for incurring debt obligation for financing the expected deficit is to plan expenses that exceed revenues and to include in the budget a resolution limit to incur debt instruments with such use. If the limit is set separately, it can't exceed the amount of the planned deficit.

Yet another situation that allows the realization of revenue is the repayment of debt instruments, previously contracted liabilities arising from the issue of securities, and loans. The level of income received by local government is usually not enough to finance spending, including other potential finance expenditures related to the previously contracted debt. The condition for incurring obligations for the purpose of debt repayment obligations with respect to the issue of securities and loans and credits is to determine the amount of the expenditure budget plan and to include in the budget the resolution limits on incurring debt instruments with such use. If the limit is set separately, it can't exceed the amount of planned expenditures. The constitutional organ can authorize the executive authority of local government units to incur liabilities allocated for the repayment of earlier loans and borrowings and the redemption of securities (Walczak, 2014).

The next situation indicated by the legislature, which allows theincrease of debt, relates to liabilities arising from loans and securities designated for leading finance activities funded from the budget of the European Union. Revenues obtained in this way are closely connected to the agreements between the local government and the institutions managing the operational programs on the granting of financial assistance from European Union funds, in connection with the execution of a specific project. The condition for incurring such obligations is to include an amount of revenues in the budget plan as well as the limit to incur debt instruments in the budget resolution. If the limit is set separately, it can't exceed the amount of planned expenditure financed from European funds for the entire period of the project. The constitutional organ can authorize the executive authority of local government units in the budget resolution to take out credits, loans, and issue securities held for leading finance activities funded from the budget of the European Union (Walczak, 2014).

According to the regulation of Article 90 of the Acton Public Finance, local government units to finance expenditure on investments and investment purchases may borrow in state-appropriated funds, as long as the law establishing the fund that is. Costs related to long-term liabilities contracted by the local government must be paid at least once a year. Discounts on securities issued by local government units cannot exceed 5% of the nominal value. In the case of issuing securities or contracting loans with a maturity longer than one year, it is also acceptable to capitalize the interest. Moreover, Article 93 Section 1 of the Public Finance Act does not allow it to entities from the public sector, with the exception of the Treasury, took out loans or credits and issued securities and guaranteed loans, whose nominal value payable at maturity denominated in zloty, they have not been determined at the conclusion of the transaction. In addition to the statutory restrictions relating to the purpose of local governments liabilities from loans, borrowings and issuance of securities, the legislature has included the principle according to which the sum of the borrowings and liabilities of the issued securities referred to in Article 89 Paragraph 1 and Article 90 of the Act on Public Finances may not exceed the amount specified in the budget resolution of a local government unit.

7.2. The level of local government debt in the context of growth of public debt in Poland

Polish local government sector consists of (as of 1/01/2015):

- local governments of 2479 municipalities, including 66 cities with county status, 314 counties, and 16 voivodeships,
- local government budgetary units and local government budgetary establishments,
- associations of municipalities and associations of counties,
- local legal entities (including local government cultural institutions, independent public health care centers, provincial traffic centers, provincial agricultural advisory centers, and provincial funds for environmental protection and water management).

As shown in the table below, the local government sector debt in the years of 2012 – 14 consituted about 8% of the debt of public finance sector after consolidation[1]. The main factor contributing to the country's debt was the government sector with almost 92% share.

Public Finance Sector Debt	2012		2013		2014	
	XII	Structure	XII	Structure	VI	Structure
	mln zł	%	mln zł	%	mln zł	%
After a total of consolidation	**840 476.8**	**100**	**882 293**	**100**	**793 565.5**	**100**
The central government subsector debt	770 819.5	91.7	813 515.3	92.2	726 538.7	91.6
The local government subsector debt	**67 398.2**	**8**	**68 397.6**	**7.8**	**66 859.8**	**8.4**
The social insurance subsector debt	2 259.1	0.3	380.1	0	167	0

Table 7.1. Public debt in Poland in 2012–2014 (after consolidation)
Source: own study based on data from: Debt Management Strategy of the public finance sector in the years 2015–2018.

1 By consolidating public finances (as determined in accordance with the domestic methodology) or sector general government (presented in accordance with EU methodology) we understood as a statement of income and expenditure after eliminating the transfers within the sector among its elements. It eliminates the double counting of some quantities and ensures the correct calculation of the deficit (or surplus budget) of the whole sector and its sub-sectorsfrom the point of view of the employed methodology. According to the European System of Integrated Economic Accounts (ESA),

Local government debt at the end of 2013 was equal to 68.3 billion PLN in comparison to 67.3 billion at the end of 2012. After the first half of 2014 it dropped to the level of 66.8 billion PLN. In 2009 the annual growth rate of debt recorded a significant increase (of 45.7% after consolidation). In subsequent years, the growth rate was gradually reduced and in 2013 years it was equal to 1.9% (Figure 7.1).

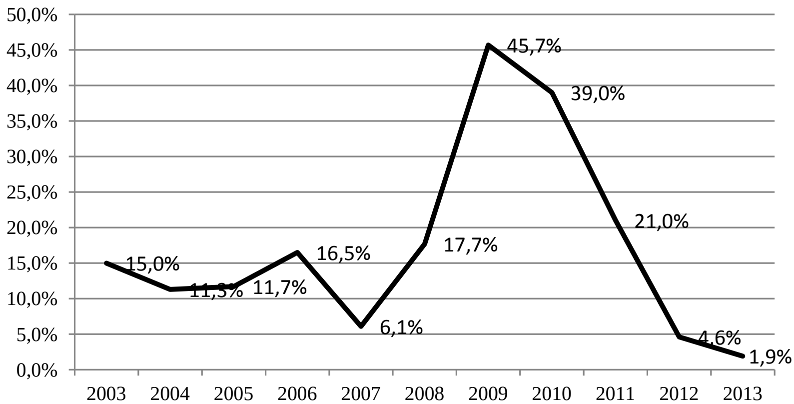

Figure 7.1. The annual growth of local governments' debts and their associations in Poland in the years 2003–2014 (after consolidation)
Source: own study based on data from: Debt Management Strategy of the public finance sector in the years 2015–2018.

Poniatowicz (2010) presents the following reasons for that:

- decline in local government own revenues caused by the economic crisis, which negatively affected the overall financial position of local government,
- launching of local investments co-financed with European Union assistance funds for which debt instruments increase the absorption capacity of EU funds,
- mobilizing the local governments to borrow according to the principles applicable to the end of 2013, in the fear of losing formal creditworthiness due to new rules that define local government debt limits by the size of the operating surplus earned for the last 3 years.

consolidation refers to the elimination of transactions occurring between entities belonging to the group, from both expenditures as well as from revenues, and to the elimination of reciprocal financial assets and liabilities (http://www.sejm.gov.com).

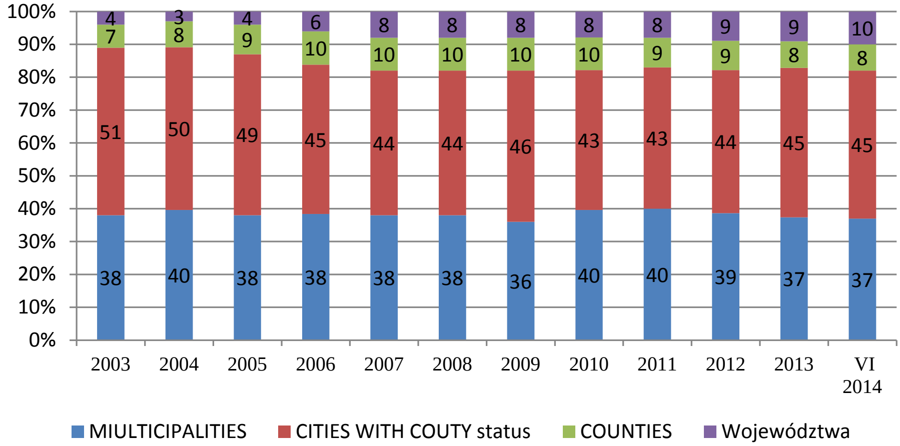

Figure 7.2. The debt structure of local government units in Poland in the years of 2003–2014 (according to levels)
Source: own study based on data from: Debt Management Strategy of the public finance sector in the years 2015–2018.

Of thetotal liabilities of local government units the largest share of liabilities belonged to the cities with county status (45.3% in 2013 and 44.9% in the first half of 2014). The share of liabilities of municipalities in the years 2003–2014 remained at a relatively stable level of approx. 36–40% (at the end of 2013 the share was 37% and remained at the same level at the end of June 2014), and the shares of counties and province after several years of growth stabilized at approx. 8–10% (at the end of the second quarter of 2014 years it was equal to 9.7% and 8.5%).

7.3. Legal conditions for the commitments of local government units

In 2006–2013 the elements that fundamentally affected the level of local government debt were statutory limits of incurring debt, that were expressed in two indicators in Article 169 and 170 of the APF from 2005. According to these regulations, the total amount of local government debt during the financial year could not exceed 60% of the planned revenue of the unit during the financial year, and at the end of the financial year it could not exceed 60% of the total executed revenues. Also, the total amount of loans and credits repayments with accrued interest, the redemption of issued securities with interest and discount, and the potential payments under guarantees issued by local government units and sureties that occur in a year, could not exceed 15% of the yearly planned income of local government unit. The new and currently binding definition of the indicator is described in Article 243 Paragraph 1 UFP from 2009. According to this provision, "the organ of a local government cannot accept a budget which implementation will cause that in the budget year and each year following the budget year, the ratio of the total amount falling within a given budget year repayments of borrowings together with accrued interest in a given year, redemptions of securities with accrued interest and discount, potential payments resulting from sureties and guarantees granted to the planned total revenues will exceed the arithmetic mean, calculated for the last 3 years of the relation of its current income plus the income from the sale of assets, minus current expenditures to total revenues" (Walczak, 2014).

The above relation is presented with the formula:

$$\left(\frac{R+O}{D}\right)_n \leq \frac{1}{3} x \left(\frac{Db_{n-1}+Sm_{n-1}-Wb_{n-1}}{D_{n-1}} + \frac{Db_{n-2}+Sm_{n-2}-Wb_{n-2}}{D_{n-2}} + \right.$$
$$\left. + \frac{Db_{n-3}+Sm_{n-3}-Wb_{n-3}}{D_{n-3}}\right) \quad (7.1)$$

In which the individual symbols stand for: *R* – total amount of repayment installments loans and redemptions of securities planned for the financial year, *O* – interest on credits and loans, interest and discount on securities issued for the purposes specified and payments resulting from sureties and guarantees granted planned for the financial year, *D* – total budget income in a particular financial year, *Db* – current revenue, *Sm* – the revenue from the sale of assets, *Wb* – current expenditure, *N* – financial year for which the relation is established, *n*-1 – the year preceding the financial year for which the relation is established, *n*-2 – the year preceding the financial year for two years, *n*-3 – the year preceding the financial year for three years.

By adopting the structure-limiting repayment of liabilities expressed in Article 243 of the APF, the legislator resigned from a fixed rate formula that was used by all local governments and functioned for many years. The new formula, which determines the limit of planned repayments of liabilities specified in the regulation, in the financial year is based on the category of operating surplus that substantially characterizes the financial situation of local governments. For greater reliability of the result, it has been determined that data from the three years preceding the financial year, for which the maximum rate of repayments are fixed, will be accepted in order to calculate the ability of local governments to repay its liabilities. It limits the level of repayments of the titles listed by the legislature in a given year, but does not limit the size of local government debt. This debt, with a proper schedule of loans and credits repayments and the redemption of issued securities, can achieve significantly high values that excess already known from the previous limit of 60% APF made at the end of the year for the local government budget revenues (Salachna, 2011).

Individual local government debt ratios started taking effect from 2014. With the new construction of barriers it is important to prevent over-indebtedness and loss of local government units, according to long-term financial liquidity regulations contained in Article 242 of the APF. Under this rule, the current expenditure planned within local government budget cannot be higher than planned current revenues of the budget surplus from previous years and free funds. Also, executed current expenditures cannot be higher than executed current revenues of surplus from previous years and free funds at the end of the financial year. The part of Article 242 of the APF, which concerns revenue and current expenditure, expresses the principle of balancing the budget. This rule is only limited by the possibility of planning and implementation of the current budget deficit, as long as it covers revenues from available funds or surplus from previous years. Repayable revenues such as those arising from the borrowing, loans or issued bonds by local governments cannot be the source of financing for the part of current deficit. Article 242 of the APF introduces rational rule, from the point of view of the economy, which prohibits long-term debt incurring for current expenses that found the basic tasks carried out by local government, and at the same time it orders the financing of these expenditures from current income. The purpose of those regulations was also to prepare local governments to meet the requirements of new debt ratio. In the case of the inability of the Long-term Financial Plan (LFP) resolution or deciding about the local government budget. According to that provision, if it is not possible to pass the local government budget or LFP with the principles set out in the regulations from Articles 242–244 of the APF, and if there is a threat to further implementation of public tasks, the Regional Chamber of Audit (RCA) orders local governments to develop and adopt a proper recovery program (Walczak, 2014).

The recovery program is a formalized document and its regulations define its minimum range. According to APF designed recovery program should include at least the following:

- analysis of local government finances, with determining the cause of the risk of public tasks completion,

- plan of recovery projects, including a timetable for their implementation, in order to remove the threats, as referred in Article 240 Section 1 of the APF and to preserve a relation specified in Articles 242–244,
- anticipated financial effects of individual recovery projects with the ways to calculate them.

The constitutional organ of the local government will be able to adopt the budget and LFP, which do not maintain a relation specified in Articles 242–244 of the APF only during the implementation of a recovery program when the document obtains a favorable opinion of the RCA.

During the recovery procedure, a unit of local government:

- cannot make new investments financed with credit, loan or issue of securities,
- cannot grant financial assistance to other local government units,
- cannot give sureties, guarantees and loans,
- cannot spend on its promotion,
- cannot create hamlet fund,
- reduces implementation of tasks other than obligatory, financed from its own funds.

Those limits are applicable from the month following the month in which the program was adopted until the completion of recovery proceedings. Local government failure to prepare a recovery program or to obtain a positive opinion of the RCA results in the fixing of the budget by RCA. RCAs are state-nominated supervisors of financial management and control for local governments, municipalities associations, local government agencies, and other entities benefiting from grants from the budgets of local governments. Given the statutory powers of the RCAs and their ability to use all sorts of tools to assess the financial situation of local authorities, those organs play a special role in the system of local government debt level control. While carrying out supervisory tasks the RCA examines the resolutions and directives adopted by local government in the following matters (Sawicka, 2011):

- budget resolution procedures and its changes,
- commitments that affect the level of public debt of local governments and its ability to provide loans,
- principles and scope of grants from the local government budget,
- local taxes and fees controlled by the tax regulations,
- discharge,
- long-term financial forecast and its changes.

The list of issues that need RCA's opinion is formulated in Article 13 of the Act from 7.10.1992. According to that regulation, the tasks of the chamber include:

- to issue the opinions about the ability to repay the loan or redemption of securities at the request of the executive body of local government units,
- to issue the opinions on the draft resolutions submitted to the local government budget,
- to issue the opinions on progress reports on budget implementation during the first half of the year submitted by the boards of counties and voivodeships, and heads of municipalities (mayors),
- to issue the opinions on reports on budget implementation, submitted by the boards of counties and voivodeships as well as by heads of municipalities (mayors), along with information about the state of local government property and commentary,
- to issue the opinions on audit committees applications that represent local government bodies during discharge; and opinions on the resolution on not providing the mayor with dischargeby municipal council,
- to investigate the issues that relate to the treasurer notifications of countersignature cases on the written supervisor request, that is consistent with separate laws,
- to consider other issues defined in separate rules,
- to provide explanations for the requests of the entities described in Article 1.

In case of monitoring and evaluating the financial condition, there is a particular importance in the obligation imposed on the executive body of local governments to take action in order to obtain the opinion of the RCA regarding the ability to repay borrowings or redemption of securities, especially when the local government seeks to obtain repayable revenue for the following purposes (Dobrzyński, 2014):

- financing of planned budget deficits,
- repayment of earlier obligations with respect to the issued securities, loans and credits,
- pre-financing the financial activities with funds from the European Union budget,
- expenditure on investments and investment purchases included in the list of projects described in the appendix to the resolution on LFP.

As can be seen from the above directory, the study covers resolutions and orders made by the local government in terms of budget, LFP, as well as their liabilities shaping the amount of local government debt, as well as borrowing, lending, and issuing securities.

Conclusion

The local government sector, which includes government entities, is an important element of the state functioning due to a number of actions implemented in the framework of top-down defined tasks. Unfortunately, excessive borrowing in the scope of local government financial policy has recently become a quite common tendency. Debt management is a key area when it comes to the smooth functioning of the country. The new law on public finance debt repayment that introduces the rate outlines solution designed to discipline and reduce the indebtedness of local governments. This is especially important from the point of view of dynamically changing government debt level. The new indicator used by local government units for repayment of liabilities and based on the adopted law on public finance, in the long term should contribute to slow the pace of indebtedness of local governments. Numerous of legal conditions enclosed in the Public Finance Act regarding the conduct of local government fiscal policies are designed to outline the limits of the financial management which, if exceeded, could lead to financial difficulties. There is also a big importance of the RCA, which controlling activity meaningfully regulates the proper execution of local government financial policy. All of these legal tasks should indirectly affect the gradual debt reduction and improvement of the financial situation of local governments in Poland.

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http://dx.doi.org/10.18778/8088-012-2.08

8. Perception on poverty and inequality concerning social housing

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Abstract

This paper gives an account on the main feature of social housing within Romania and analyzes how the local authorities react to an emergency housing situation. After being evicted from a social building that has been the subject of retrocession, 25 Roma families spent five months in improvised shacks on the street as a form of protest. Local authorities only react at the pressure of civic society and tried to deal with this situation with over bureaucracy. Within this article I debate on the possibility of having in Romania an endemic discriminatory attitude towards the people who are at risk of being homeless.

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Introduction

On the 15th of September 2014, in Bucharest, 20 families were evicted from their homes located in the centrally located *Vulturilor 50* street, on the very first day of school in Romania. Appreciatively 100 people were forced out of the buildings by local police forces and riot police, with no permission or time to take all their belongings. Along with the evicted people, representatives of the NGOs tried to advocate for their rights concerning eviction. Within hours, people were out on the street. The months that followed the eviction were marked by a combination humiliation and shanty living: as of six months later, they still live in improvised shelters, on the sidewalks of the buildings where they once lived. This happened despite formal and informal efforts to reach and sensitize the municipal housing providers, which are responsible for solving their problem. These efforts materialized in protests organized both in front of public institutions and in the streets, with written pleas to the Prime Minister and the Mayors and diplomatic inquiries by several foreign embassies.

In this article, I describe the linkage between housing re-privatization (restitution) and lack of social housing policies and displacement in Bucharest, Romania. I argue, following Hackworth and Abigail (2006) that the municipal housing providers and their revanchist attitude play a key role on how the neoliberalization of housing policy unfolds. I found evidence that reinforces GerDuijzings' (2010, p. 109) the point that "some of the features of neo-liberalism have taken their purest form in Eastern Europe".

There seems to be a general consensus that social housing has experienced significant transformations over the last three decades, mainly through privatization the home ownership (Priemus and Dieleman, 2002, p. 191; Ronald, 2012; Hills, 2007, p. 5). Despite the high level of rentals and social housing remaining high in some European countries (Denmark, United Kingdom, Austria and of course Holland), the promotion of home ownership made leading scholars affirm that "everywhere, the (social) rented sector is on defense" (Priemus and Dieleman, 2002, p. 191; see also Priemus, 1995).

The disregard for social housing has reached aparticularly acute level in post-socialist countries which have mass privatized, resulting in outstanding levels of home ownership. The existing housing stock was massively privatized in the early 1990s, either through purchase by the sitting tenants, or re-privatized through the restitution of housing confiscated by the socialist state (Pickvance, 1994, 2002). Moreover, after the early 1990s, the housing stock contains no more than 4% of the total housing units constructed as social housing. Out of the entire housing stock, 98.2% are privately owned in Romania (Bejan et al., 2014, p. 8), compared to 60 to 80 per cent for the other post-socialist countries.

In order to document these issues I used a mixed method approach. The data on housing, standards of living and poverty are based on secondary analysis of statistical data. For understanding the local political dynamics and the street level dynamics of eviction, I used mainly interviews, observation of meetings with local administration officials and participatory observation. After people were evicted in September 2015, until January 2015 I spent significant periods of time with the people evicted. Aside from spending time on the streets and sidewalk where they stayed after housing eviction, I also participated in groups, meetings and protests aimed at advocating their cause. The meetings with different local administrative representatives proved to be an invaluable source of information about how social workers, municipal housing providers and their political supervisors actively and aggressively avoid, push and supervise the social dumping and the removal of poor and vulnerable tenants from central areas.

I have also been involved in an editorial project and helped the people evicted write a blog on their daily problems on the street and I have also spent time with them during their protest on the street. Aside from participant observation, interviews, participation in administrative meetings, I have also studied local budgets and administrative documents in order to identify the financial allocations of local authorities for social housing between 2003 and 2014. Despite the legal obligation to provide data on their budgets, obtaining and interpreting budget figures, the poor transparency of municipal authorities have prevented me from giving a full account on these matters. The paper continues with an overview of housing policy in Romania focused on the absence of a safety net for housing. In this section I also describe how the devolution of social housing policy from the central government to the local administration, meant, that local administration (including Bucharest) had the right to ignore the critical needs for housing of the poor households. In the second section, I describe the dynamics of that episode of eviction as a window on the joint effects of faulty housing policies and the revanchist (Smith, 1986) attitude of the local administration on the poor.

8.1. The Elephant in the Room: Housing costs and social dumping in Bucharest

The right to a proper living is an international acknowledged need. In Romania, one has one of the biggest rates of poverty in Europe. As a rule, public authorities have a *laissez faire* attitude towards vulnerable groups in terms of housing (Dan and Dan, 2003, p. 5). Hegedus and Struyk (Hegedus and Struyk, 2005, p. 17) note that the management of the housing stock has been left to the whims of the unregulated market and that legislation has an *ad hoc* character. This was taken to extreme in Romania. According to official statistics, the price of housing became simply beyond the reach of poorer families: as Dan and Dan (2003, p. 5) describe, if a two-room flat was worth about 40 average wages in 1989, 14 years down the road, in 2003, its price became about 120 average wages.

Eurostat statistics indicate that tenants in Romania experience some of the highest housing overburden costs in the entire European Union (Rybkowska and Schneider, 2011, p. 7; see also Table 8.1). In the unregulated market, it is the highest in Europe. No less than 56.5% of all tenants experience the burden of paying rent and utilities (Rybkowska and Schneider, 2011, p. 7). Despite that, Bucharest local authorities tend to solve case by case the locative problems. Currently, social housing, rent regulation and tenant protection are simply outside the public agenda. Instead, infrastructure investments, car related infrastructure and mega-projects loom on the imagination of political campaigns and municipal public investment departments.

Country	**Gross monthly income (€)**	**Unemployment rate (%)**	**Threat of poverty (%)**	**Extreme poverty rate (%) ***
Czech Republic	990	26.7	15.3	0.0
Hungary	760	10.9	29.9	0.4
Poland	830	9.7	27.8	0.2
Slovak Republic	850	13.6	20.6	0.1
Slovenia	1530	8.2	19.3	0.0
Albania	290	14.0	–	4.3
Bosnia and Herzegovina	410	27.6	28.1	0.2
Bulgaria	330	11.3	41.6	0.4
Croatia	1050	13.5	31.3	0.1
Macedonia	330	31.0		5.9
Serbia	510	23.0	23.4	0.7
ROMANIA	470	7.4	40.3	1.7

Table 8.1. Living conditions in selected European Union countries.
Source: Eurostat (http://ec.europa.eu/eurostat/web/population-and-housing-census/statistics-illustrated).

Housing poverty is worsened not only by social dumping, but also by its invisibility in the administrative practices and on the public agenda. Statistical invisibility and conflicts between different levels of governance are other problems. A sound analysis on the scope of needs for social housing is a rather difficult task. In most of the cases, the phenomenon of poverty is invisible, as some of the vulnerable groups are either without documents or without lease. Tsenkova nicely expresses that "the mix is complicated to evaluate since there is no systematic assessment of different governments (central or local) in the housing sector in terms of their efficiency (costs), targeting and effectiveness (outreach)" (Tsenkova, 2009, p. 91).

Conflicts of governance have also prevented the placement of social housing on the political agenda. The housing issue was transferred from the central authorities to the local authorities. Even though there are legislative paths and resources offered by central authorities to get the local administration involved into housing programs for the poor, the central and local governments have only allocated funds to programs for the middle-income people. The national housing programs do not include emergency social housing. Instead, they focus on financially solvent middle class tenants, either for renting or mortgage (Pittini and Laino, 2011, p. 25). Regulations by which public authorities can impose a minimum threshold of social housing in all the new real estate projects are unknown in Bucharest or Romania. Such cases have been implemented a long time ago in countries such as United States, England and France (Pittini and Laino, 2011, p. 29), as a means to avoid social exclusion and segregation of the poor.

Another problem that significantly shrunk the function and scope of social housing has been the problem of housing restitution of the nationalized houses (Chelcea, 2006, 2012; Stan, 2013; Dawidson, 2004). This is a former socialist specific problem. There has been applied several solutions for different countries. Some governments chose to give the right to the tenants to buy "their" buildings. Other gave them to NGOs, in order to keep them as social housing. Yet others kept them in the public domain and used them as social houses. Some also restituted them back to the former owner (Pittini and Laino, 2011, p. 24, 28). Romanian legislation allowed some tenants to purchase their apartments, but also restitute the property rights to the former owner in other cases. After 2006 the state financialized its restitution policies, with former owners receiving financial compensations, a process that has generated extreme cases of corruption. No matter what solution they chose, housing restitution affected severely the social rented sector, diminishing its capacity and size.

With no public efforts in the construction new social housing or the acquisition of existing units in order to offer them as rentals, it comes as no surprise that municipal authorities claim that they cannot offer a solution for the people evicted (Tsenkova, 2009, p. 150, 152). The enforcement of the housing restitution legislation generated major housing problems. People were evicted from the homes they have been living in for decades, with no proper alternatives. Even though the local authorities in Bucharest had received from the Court final decisions on the retrocession years before the eviction, public authorities deal with each of the cases in terms of an emergency. This leaves the people depending on a waiting lists that consists of hundreds of requirements (Pittini and Laino, 2011, p. 24).

The Global Financial Crisis has worsened the situation. The European Commission has stated that housing exclusion is one of the biggest challenges after the financial crisis that erupted in 2009. Social exclusion, according to the institution's official strategies (Europe 2020[1]), must be dealt by creating affordable accommodation. EUROSTAT has now added new indicators that monitor housing conditions and the costs associated with it. Overcrowding and the quality of the house (such as access to running water, flushing toilets or the quality of the roof) are particularly monitored. As of 2011, there is an average of 6% of Europeans who suffer from severe housing deprivation. Romania has the highest percentage – 28.6%[2].

8.2. Main features of social housing in Bucharest

The main problem of social housing sector failure in Bucharest is the very lack of houses available to the local administration. There are hundreds of pending applications each year. I have met cases of people who have been placed on waiting lists for more than 10 years. Each year, there are tens of new applications and only a few available houses. Table 8.1 indicates the number of valid applications filled in. One may notice, the time series for each district are quite stable, which is indicative of the fact that the applications do not move ahead, but are passed on year after year.

1 COM(2010) 758 final- Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. "The European Platform against Poverty and Social Exclusion: A European framework for social and territorial cohesion", December 2011.

2 Available online: http://ec.europa.eu/eurostat/web/population-and-housing-census/statistics-illustrated.

Table 8.2 indicates that the total numbers of housing units administered by each district[3].

Year/ District	District 1	District 2	District 3	District 4	District 5	District 6
2009	n/a	1351	1073	n/a	n/a	361
2010	364	1304	745	521	n/a	n/a
2011	269	1107	618	326	670	568
2012	338	1091	796	394	n/a	587
2013	343	1058	925	389	610	592
2014	n/a	1054	817	642	n/a	592

Table 8.2. The number of applications on waiting lists
Data source: I obtained the information based on a solicitation of public information sent to local authorities (FOIA).

District	Sector 1	Sector 2	Sector 3	Sector 4	Sector 5	Sector 6
No. houses	n/a	176	33**	287	n/a	136

Table 8.3. The number of housing units managed by the districts 2008–2014
Data source: FOIA requests.
** District 3 only gave me information on the houses received between 2005–2014.

Both the national and local housing programs – even as limited in scope as they are – focus on households with medium income. National housing programs aimed at reducing the social risks associated with living costs are focused on people with medium incomes, leaving the people who live in extreme poverty in the care of local authorities[4]. As Hegedus and Struyk have shown, the need for middle-income households to be supported by the state in facing the housing problems often competes and impedes the development of the social housing system for the poor (Hegedus and Struyk, 2005, p. 22). After having studied the budgets of district and central administration in Bucharest, I have found only two proposed social housing projects (in District 1 and District 3), but none of them

3 I have no data on the houses that the main City Hall has in administration, as for the institution did not answer to my solicitation.
4 The national programs' objectives are to build homes for the young population (max. 35) and that are especially to be sold, not rented.

have materialized yet. This is a typical case of policy driven by thelocal resources and not by the local need (Lux, 2003, p. 39–67). Even though the law stipulates for the possibility for the central authorities to co-finance the construction of buildings dedicated to social housing, according to my research, there has been no such construction in Bucharest.

Who is responsible for social housing is also a contested terrain. The responsibility concerning social housing is diffuse in Bucharest, given the fact that there are six different districts and a central municipal administration. These administrative units have overlapping and unclear distribution of responsibility between them. Social housing is nominally owned by the central municipal administration. Each year, districts receive a few housing units to distribute to housing in needs. This creates a rather unclear legal context for petitioners: whom should they address and who should answer them. Households complain that they are sent from one institution to another and that they do not know which of the institutions should solve their problem. None of the regulations stipulate which institution should deal with these problems. The same illegibility reigns over whom inside the institutions should take over the petitions. Apparently, the people should first address to the District where they are registered and only if the lower level administration has no housing available, they should petition the central municipal administration.

Bureaucracy and the documents culture is another obstacle. One of the evicted persons nicely expressed the problems one encounters in such quests: "they ask us to fill in tons of documents. These papers are handed out to us piece by piece; the moment we have one paper, another one expires. And why do they ask for education papers? If I have no school, what, don't I deserve a shelter?". The "social file" as the call the social work inscriptions of the applicants consists of papers issued by different authorities, with different paces of response. Furthermore, District administration has different deadlines for these files to be completed. If they do not succeed in finishing in time with these documents, they must wait for the next year period, as the "social file" can only be completed yearly and must be renewed each year. For the people with no access to Internet and for illiterate ones, access to information is a very delicate problem. They depend on the information that is given by the social workers. To make the things worse, as I will show later on, the support from social workers is not appreciated among the people who should be their main beneficiaries, and for legitimate reasons.

Despite the official information on the situation, the NGOs claim that the situation is worse than shown. There are cases of people that do not have the necessary information nor the support to complete their files in time. What is more, there are extreme cases of people not having IDs and, therefore, they cannot complete the documents for a social home. During the interviews with part of the local administration, they claimed, "there are no cases of people with no IDs. If they do not have documents, they are not citizens' of this District, therefore they are not our problem". This gives an account on the overall attitude of the local authorities towards people in need of a shelter.

The lack of legal support for people who are being evacuated resulted in cases of illegal evacuation is another significant problem. Accordingly to several NGO activists, there have been cases of people evicted without proper eviction papers. In such cases, the people do not have money to pay for legal support and they are forced to leave their homes. As I previously stated, one of the biggest corruption matters in Romania – and more so in Bucharest, given the high value of land – has been illegal housing restitution. Lacking legal support and proper information concerning their rights, such financially disadvantaged people become victims of the lawyer paid by the former owners.

Evictions of the people living in ex-nationalized houses come as no surprise for the local authorities. According to the law, the local authorities are notified when a Court gives its final ruling on a restitution case. Between the moment of notification and the eviction of tenants should pass, according to the law, no more than five years. Within this period, "somebody" should identify a solution for the people who are to be evicted. Despite this, local authorities become vaguely attentive to the future displaced just before the eviction. According to the interviewees, this happens because there is always a more critical case lined up ahead. Therefore, authorities deal with the eviction in terms of "crisis", with no strategy or public policy that should address this problem tenably.

8.3. The history and the practice of *Vulturilor* eviction

The case of *Vulturilor 50* is an iconic case of eviction from nationalized housing in Bucharest. On Vulturilor Street, at no. 50, lived 25 families, 100 people. Most of the families lived there with legal forms. Most of the families are Roma and most household members earn the minimum wage – that is if they haveemployment. In 2012, the initial tenants also received in "their" house some recent additions from another wave of evictions caused by an infrastructure public project[5].

5 The project aimed at widening a street in a historical part of the city lead to the demolishing of 89 buildings. All the people were forced out of their buildings on 22th December 2010, despite the fact that they did non have another place to live.

These households have been living there since the communist period. The person with the oldest contract dates back to 1979. The people used to work for state companies, therefore, they received housing either through employment or through municipal housing offices. In 2001 the property rights over "their" building were restituted to the owner. Between 2001 and 2006 the people lived there with the consent of the owner, as the private owner was forced to sign a contract with them. As soon as the households learned that "their" house was restituted in 2001, they began filling out applications for social housing.

In 2007 the owner sold the entire building to a real estate investor. Since that moment, the households have lived illegally , as the new owner refused to sign newcontracts. Despite this, they were allowed to stay there through an informal settlement with the owner. With no other solution in hand and even if they had no legal documents they have accepted these terms. Rents differed from family to family. Such informal agreements are common practice among poor households living in restituted housing, since the owners try to make some money out of their buildings until they have the necessary funds for an investment. In 2009, the legal bodies decided that the families could be evicted. After the households learned that, they also added this piece of information to their yearly application.

In September 2014, they all received a notification that in less than a week the owner will evict them from the building. Prior to eviction, according to the people to whom I talked, they were tricked into signing a form consenting to eviction. Without proper legal advice and with the promise of receiving some amount of money and a postponment of the eviction for an indefinite term, the people signed that they agree tomoving out. One middle-aged person explained "they took my mother to the Court House. They told her something about some money that they were to give us and they convinced her. They came and took as one by one". On September 15, 2014 the local police and gendarmerie came to enforce the eviction order. This coincides in Romania with the first day of school. Some of the people went with their children to school so the latter would not witness the eviction. The people were forced out of their homes, with little time to take their belongings and, in some cases, even their IDs.

After the eviction, people who lived there legally decided to protest on the street, in front of the house they had been evicted from. The protests consisted in 15 families this is 65 people. As for the rest of the people, they either accepted the financial support in order to pay a rent on the free market or they have found shelter among their relatives. Among them there were 22 children, three of which arevery young. They spent the entire winter, until late March on the street. With the support of some activists, they gathered mattresses, tents, blankets and they set up a "resistance camp" (as the activists call it) on the sidewalk. Despite these things, the people lacked important infrastructure, such as toilets, bathrooms and kitchens to cook. A strong community gathered around them and tried to offer voluntarily support. Activists cooked a hot meal per day, offering to wash clothes for them and donated warm clothes during the winter.

A week after the eviction, the local authorities sent the municipal garbage company to collect the people's belongings from the sidewalk. When confronted, a representative in the municipal council explained that this dispossession of personal goods is motivated because "the public space is abusively occupied by this garbage". People accused them of stealing their goods. One woman explained that: "they told us that we could take them from the local garbage company in maximum two weeks time. They did not tell us though where this company is located. Moreover, they told us that if they would find them again on the sidewalk, they were to confiscate them again and fine us. But where to put them if we have no other place to call home other than this sidewalk?".

After the eviction, the representatives of the NGOs filled in an official request to the General City Hall in order to get the authorities approval to erect big size tents. Bear in mind that this was during the fall, and there was the risk of people sleeping in the rain. The authorities denied their request because tents would have occupied part of the road dedicated to cars. Another request to public authorities was aimed at obtaining a public mobile toilet within the area. After three months following the official petition, the District City Hall agreed to allow the people to install it. After the weather got colder, the people installed small tents on the sidewalk. These proved to be inefficient because they were not waterproof. Therefore, they built improvised cottages, out of scrap wood they found elsewhere throughout the city. No significant changes occurred between January and March in terms of the logistics of the camp.

The people evicted received no visit from any municipal representatives. Some people and the activists who supported them tried to reach the mayor of the District 3 and protested in front of the City Hall, but they received no answer. A coalition of 50 NGOs filled in a request for a public audience with the mayor of District 3 and the mayor of the central administration. They received no answer between late September and mid-March. The real estate investor who bought the building is an investor from Norway. One NGO sought to get the Embassy of Norway involved, by asking them about their point of view on these events. The Embassy answered back and even wrote to the District Administration, offering to meet withboth with the NGO and government officials. The Embassy never heard back from the District Administration.

At the beginning of October 2014, the Ministry for Dialogue with Civil Society pushed for a discussion with the representatives of Districts administration and the central municipal administration. The Minister also invited some of the NGOs involved in advocacy, as well as an evicted person from that community. At the meeting, the representative of District 3 admitted that she only went there on the day of the eviction. She complained that "we could not talk to nobody. How to help if everybody ignored me?" ignoring that fact that applications for social housing were filled in 2001 and that tenants notified local administration of the eviction since 2009. The representative of District 3 further stigmatized and inflicted further violence on the tenants (Wacquant, 2009, p. 24). She explained that she did not return to monitor the situation because "of their aggressiveness and their reluctance to accept the proposed solution". Aside that the only solution was structural violence, what was shocking was that this was that the representative was a social worker.

The only available solution offered by the District 3 representative was to shelter the mothers and minors aged younger than 16 within shelters for abused mothers, and the fathers within the night shelters. The solution also specified that after spending "a few months (sic)" in these institutions, the households will receive housing. The representative quickly added that this will happen "only in case when there is a sufficient house stock". If such housing will not be available, the District administration explained that they will offer financial help, so that they could pay rent on the unregulated rental market. People refused this two-step solution, mainly because it meant separating the families. Another reason was that the men that were to be sheltered only during the night were not allowed inside the center for "abused women". Thus, they were supposed to spend the day on the street, meeting their wife and children only rarely. One woman explained to the social worker that "you have to understand, we have a culture, this is how we are. We have to be together. This how, we, Roma are – our family is our only precious thing in life. We cannot break apart. And what is my man to do during the day, after work? Wonder the streets until the night comes and they are not allowed within the center? And why to go to a center for abused women? Am I abused? I tell you that I want my husband near my children and you want us to be separated. I am abused by the state, not by my husband".

The abusive position of the social worker of the local district deserves further attention for understanding the violence inflicted on these people. At the meeting, the social worker threatened the people to take away their children and intern them into state institutions. She attempted to silence their claims by pointing out that she has the power to separate their children from them. This is her: "you know, we will not wait too long and come to take your children. These are not conditions to raise a child. You should bear in mind this and you should not use your children as a means to blackmail us". Within the interviews that I have conducted with representatives of public authorities (responsible for social assistance), I have identified elements that are in rather contradiction with their mission. For example, there is a current opinion among them that the people asking for social housing are not willingly to work so that they could afford to live independently. On the other hand, people suffering from extreme poverty argue that the private rental sector is inaccessible to them because of their badly paid jobs that could not support them in the current free market-housing sector. Hence, their only support is institutional housing system.

Because the social workers planned to come again on the field accompanied by police, NGOs offered to coordinate individual meetings with the social workers, so that to avoid other possible tensions. One of the firm decisions taken within the meeting was that the people were to be treated with priority, as cases of extreme emergency. After the meeting, during 3 months, all the families had their social inquiries completed, but no final decision on allocating them a social house was made. The official reason was that they are trying to find a building big enough for the community to be placed.

Another reason to refuse the above mentioned solution was the mistrust people have for local authorities. They were sure that if they were to abandon the protest camp, their force would disintegrate and the modest echoes of their cause would be silenced. With no certainty over what "a few months" before their receive social housing really means and a deadline of six months of being allowed in these centers, people feared that they would be once again be thrown in the street. Therefore, they chose to protest collectively until they were given social houses.

On the other hand, they explained to the local authorities that receiving financial help for paying rent is not a solution for their situation, because of rent market racism. One person explained that "part of us have children with disabilities, who is going to let us in their homes? We are Gypsies, nobody trust us with their homes". Another problematic structural aspect is the reluctance of landlords to actually fill in leasing contracts in general. In Romania, officially, less than 1% of the people have their homes rented. Landlords usually avoid paying taxes, renting the house on the black market (Hegedus and Struyk, 2005, p. 1, 6). With rather poor legislation on renting houses and with no control from the state as for a medium price for this sector[6], Romania's rental market is rather contributing to the lower part of economy (Amann, 2013, p. 37).

Whereas "the left hand of the state" is crippled when it comes offering help, "the right hand of the state" (Bourdiueu, 1992) is highly visible for these people. Periodically, there are visits from the Police on the street where they now live. The people were told that they come to "inspect the public health condition". The evicted perceive this as an act of intimidation. What is more, the authorities told the people living there that they have information that their children do not sleep there, but their placed during the night to neighbors or relatives and they are just using them for emotional blackmail. But this actually did not happened as I noticed during my visits on the Vulturilor.

Conclusion

The aim of this article was to give an account of the linkages between evictions, restitution and the complete abandonment of social housing by the Romanian state after 1990. Although social housing has become an "increasingly obscure concept" due to housingprivatization policies throughout Europe (Primaeus and Dielman, 2002, p. 191), the experience of shrinking the social sector varies from place to place. In Romania and in Bucharest in particular, social housing evaporation has led to evictions, intense social suffering andconjugated efforts of local administration to bypass structural problems.

In particular, I described the cumulative macro processes and the everyday unfolding of an eviction from District 3 in September 2014. The *Vulturilor 50* case is only the most recent in Bucharest, similar cases have happened since the restitution law has been enforced in Romania (1990). The public authorities response was late and geared towards moving the problem elsewhere – outside of Bucharest, in temporary shelters in total institutions, at the garbage dump– rather than pay attention and try to address the long series of evictions that plagued poor households since the late 1990s. In this case, "punishing the poor" (Waquant, 2009) went hand in hand with the revanchist attitude towards the Roma who occupy old housing stock in the central area of Bucharest (Berescu, 2011).

6 There is no reglementation on how trates for rental housing are set. Despite the fact tatthe real estate websites stipulates ratesfor houses tfor rent, only a very small part of these are acctually registred as being rented and the value of the contract is much less than in reality so that the taxes are smaller. In these conditions, tenants in Romania lack the means of protection.

Despite such episodes, many commentators still oppose welfare provision for households who are at severe risk of social and economic marginalization. Bearing in mind the high costs for housing in Romania (especially in Bucharest) as my data indicate it is astonishing that many commentators still advocate the further shrinking of social rights. This is not only limited to middle class families who advocate gentrification (although they do not call it as such) of Bucharest, but to the top and lay representatives of local administration. As I have shown above, they do not shy away from symbolic violence, expressing stereotypes, threatening and intimidating residents of the city who lack power.

Based on this episode, the statistical data that I have provided, the lack of any safety net for vulnerable households and the interviews that I carried out with public administrators in Bucharest, one could claim that we are actually faced with an endemic discriminatory attitude towards households who are at risk of being homeless. What is also worrying is that there is no discussion on the political and public agenda about any housing rights, including the right to proper housing. Such cases barely make it to alternative media outlets, and almost never to the mainstream media ones. The limited or non-existent scope of social housing policy became a more salient issue, due to the financial crisis, as more and more middle-income people found it harder to pay their mortgages or to pay their rents, therefore, the state had to focus on helping them (Fentsa, 2011, p. 26).

Being poor and a part of an ethnic minority group often attracts discriminatory measures from Bucharest administration, both in its long term face – bureaucracy and in the form of "everyday state" – Police, social workers, garbage cleaning companies. Such households are often mis-informed and they lack the financial and media power to advocate their rights. They are aware that public authorities treat them with disrespect and that they are being taken advantage of. Their only choice is to wait for state support in the matter of housing (Tsenkova, 2009, p. 150–154).

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This paper was co-financed from the European Social Fund, through the Sectorial Operational Programme Human Resources Development 2007–2013, project number POSDRU/159/1.5/S/138907 “Excellence in scientific interdisciplinary research, doctoral and postdoctoral, in the economic, social and medical fields – EXCELIS”, coordinator The Bucharest University of Economic Studies.

http://dx.doi.org/10.18778/8088-012-2.09

Financial markets

9. The application of a multidimensional comparative analysis for the short selling of stocks

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Abstract

In this article the application of the taxonomic measure of investment attractiveness (TMAI) has been presented. It is the element of multidimensional comparative analysis. An empirical study based on the data from the Warsaw Stock Exchange has been conducted. The time scope embraces years 2009–2014 in which different types of market trends occurred. There was a bullish, bearish as well as the horizontal trend. Calculations have been carried out of almost 80 public shares from sWIG80. TMAI value has been computed for each stock on the grounds of financial analysis. It is the synthetic measure which has been estimated on the basis of a dozen financial ratios e.g. asset

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management, liquidity, profitability, debt management as well as market value ratios. Both have been counted in the research and downloaded from stock market services. All of the ratios have been classified as nominants, stimulants or destimulants. Furthermore, the standardization of variables has been carried out. In the article the "not weighted" type of TMAI has been utilized which means that variables are of the same importance in terms of their final impact on the TMAI's value. Shares with the lowest values of TMAI have been selected to short-sell portfolio according to the assumption that such stocks are potentially the worst investment assets. The aim of the research is to verify the usefulness of the TMAI method for creating short-sell portfolios. The hypothesis states that the portfolio built on the grounds of stocks with the relatively low TMAI value got comparatively lower rates of return than other portfolios and the market benchmark. The verification of the hypothesis has been done in terms of the rate of return achieved. Such an approach enables an investor to sort financial assets from the best to the worst investments. It occurs that in a period given, the performance of companies with relatively low TMAI was much worse than other firms. The rates of return of such shares were especially low 3 years after they had been purchased.

Introduction

Along with the development of the Warsaw Stock Exchange, more and more companies have been listed there. In such conditions, the choice of appropriate stocks becomes even harder. It derives from the lack of explicit rules of stock selection for one's portfolio. Furthermore, the utilization of risk measurement techniques and the rate of return can lead to wrong conclusions. This situation urged investors to seek the effective methods which would help them to make long-term accurate decisions. In this regard, many people believe that a fundamental analysis can be useful to make a good choice. However, without any rigorous criteria, it would be misleading too. So even this method should comply to some procedures. Consequently, the statistical methods became increasingly popular. To most helpful belong: multidimensional comparative analysis and taxonomic methods (Tarczyński and Łuniewska, 2004, p. 60–90). Taxonomy concerns the issues of object classification on the basis of their features. It includes a lot of techniques and it helps in distinguishing homogenous groups of elements. It also can be utilized to order the set of objects and determine a certain measure of synthetic assessment (Proniewski and Tarasiuk, 2012, p. 165).

The article presents an original approach to the Taxonomic Measure of Investment Attractiveness (TMAI) as it focuses on its usefulness for negative selection. It means that unlike studies of the majority of authors who are keen on TMAI issues and use this indicator to build portfolios by buying stocks, the article checks the efficiency of TMAI in terms of indicating companies with relatively worse growth prospects. Then, such investment objectives may be convenient assets for short selling. There is also an assumption taken that all the companies which are studied can be an object of short selling (it is only a premise because actually only some stocks are available for such trade actions). Such an approach constitutes an original research approach. Initially, the TMAI measure was introduced and propagated by the works of W. Tarczyński and taken up by many other authors. Notwithstanding this, the utilization of TMAI has been mainly focused on the selection of companies for long-side portfolios – it has been used to indicate stocks with potentially extraordinary growth prospects. This article presents a different (opposite) approach as TMAI is calculated with the aim to point out shares which would presumably bring extraordinarily weak rates of return. As a result, they might be profitable components of short-selling portfolios.

The aim of the article is to verify the usefulness of the TMAI method for creating short-sell portfolios. The hypothesis states that the portfolio built on the grounds of stocks with a relatively low TMAI value got comparatively lower rates of return than other portfolios and the market benchmark. The verification of the hypothesis has been done in terms of the rate of return achieved.

The empirical part of the article has been based on the comparative analysis, financial analysis and the analysis of Pearson's correlation. Mean and median rates of return of stocks have been computed. Then, these variables have been compared with each other and benchmark values.

9.1. The characteristics of multidimensional comparative analysis

The concept of multidimensional comparative analysis (MCA) is related to the group of statistical methods which aim at the simultaneous analysis of more than 2 variables describing an object or occurrence. These methods are used to examine factors which characterize analysed objects but are not directly measurable. MCA consists of orderly and a homogeneous group of objects (features) which serve to choose an object in terms of a specific criterion. Objects and variables (characteristics) belong to the basic terms of multidimensional comparative analysis. When it comes to stock market analysis, financial ratios calculated for separate companies can serve as variables. Companies listed on the exchange constitute objects. Variables can be both quantitative and qualitative (Tarczyński and Łuniewska, 2006).

The essence of MCA or taxonomic methods is very compound on account of a large number of variables as well as the diversity of methods that can be potentially utilized. Due to the complexity of this matter, the manner of conducting this analysis can be different every time, however, some activities remain stable regardless of the characteristics of an issue methods (Tarczyński and Łuniewska, 2004, p. 60–90).

According to another definition, MCA constitutes a formally consistent set of statistical methods which serve to select information purposely about elements of some groups. First and foremost, it is aimed at detecting the regularity of mutual relations between those elements (Jarocka, 2012; Gorzelak, 1981).

Variables used in a research can have various characters and may be even incomparable. Practically, they can be divided into three groups (Tarczyński and Łuniewska, 2006):

- nominants,
- stimulants,
- destimulants.

Variables having a positive impact on the analysed criterion are called stimulants. The higher is its value, the better it is. Destimulants along with their growing value influence negatively a situation. Features with optimal values in a given range are nominants. Values higher or lower than a stated figure are believed to be undesirable (Tarczyński and Łuniewska, 2006).

The procedure of MCA includes the choice of variables describing the analysed objects. For instance, companies quoted on stock exchanges can constitute objects. Then, the ratios taken to a research should be normalized and ought to build together an aggregate and synthetic measure. The normalization of measures is very vital due to the fact that variables must be mutually comparable and fully standardized. Finishing the previous stage allows for the construction of an aggregate measure which provides a multidimensional description of every object. An object which will be given the highest marks in terms of most analysed features will be granted the highest synthetic grade. It is usually standardised in the range between 0 and 1, where 1 is the best value (Proniewski, 2012, p. 165).

Ratio analysis as the part of financial analysis (fundamental analysis in general) requires taking data from financial statements of companies. As shown in the previous subsection, there are 5 main groups of financial indicators: profitability, liquidity, debt management, asset management and market value. Despite their precise definition, usually it is desirable to comment on their value in the light of the whole financial statement, current situation of a firm on the market and the accountancy policy taken by a company. There can be distinguished two main groups of ratio analysis: one-dimensional and multi-dimensional. In one-dimensional analysis only single ratios are taken into account and they are the objects of conclusion. In multi-dimensional analysis many indicators are used. Mutual connections between them are analysed (Gruszczyński, 2002, p. 131–134).

Multi-dimensional analysis is possible to be conducted after selecting the number of ratios and determining the relation between them. This selection should be done on the grounds of many financial statements. The sample ought to be numerous to be representative. In this type of an analysis practically all available methods of multi-dimensional statistics and econometrics can be used. In the literature, often used is the method of discrimination analysis (Gruszczyński, 2002, p. 134–135).

Multidimensional comparative analysis (MCA) is a scientific discipline dealing with methods and techniques used to compare objects (e.g., enterprises, clients, products) described by means of many qualities (Chałaj, 2002, p. 94). Thus, MCA examines complex phenomena, i.e. ones which cannot be measured in a direct way, and which depend on at least two different variables, observations on which are known. A complex phenomena is, for instance, a competitive position of an enterprise which may be described by means of a group of chosen statistical qualities (Wasilewska and Jasiakiewicz, 2000, p. 276; Turczak and Zwiech, 2009).

In order to assess the taxonomic measure of investment attractiveness (TMAI), Tarczyński uses a set of such features as a relation of hypothetical profit to net profit, dynamics of net profit, rate of return on shares, beta coefficient, current liquidity ratio, fast liquidity ratio, profitability, debt ratio, receivables rotation, stock rotation, rotation of payables, fixed assets efficiency and rate of return on equity capital. This made it possible to create a portfolio of securities based on criterion resulting from synthetic measure (Nermend, 2009). If market data for a certain company is not available to calculate market risk index (beta coefficient), risk of the investment can be described by various financial ratios that are commonly used to evaluate the financial condition of the company – profitability ratios, liquidity ratios, solvency ratios or turnover ratios (Cwynar, 2010).

The procedure of taxonomic measure of development can be split into several stages (Tarczyński and Łuniewska, 2006). The first step is to classify companies by their synthetic development measures. The classification criterion is the measure of economic and financial condition in the fields of: liquidity, profitability, indebtedness and management efficiency. The base should comprise several dozen of companies. For this base, a fundamental portfolio should be constructed which takes into consideration the financial and economic condition of companies, as well as the long-term character of an investment. The synthetic development measure TMAI can be estimated with the following formulae (Tarczyński and Gazińska, 2012):

$$\mathrm{TMAI}_i = 1 - d_i \,/\, d_0 \tag{9.1}$$

where:
TMAI_i – synthetic development measure for the i-th object,
$i = 1, 2, \ldots, n$,
d_i – distance between the i-th object and the model object defined with the formula:

$$d_i = \sqrt{\sum_{j=1}^{m} \left(z_{ij} - z_{0j}\right)^2} \tag{9.2}$$

where:
$i = 1, 2, \ldots, n$,
d_0 – norm which assures that TMAI_i values belong to the interval from 0 to 1:

$$\boldsymbol{d_0} = \boldsymbol{\bar{d}} + \boldsymbol{a} \times \boldsymbol{S_d} \tag{9.3}$$

where:
= standard deviation of d_i.

According to the previous relations, the marginal value for ***a*** constant may be found:

$$\boldsymbol{a} \geq \frac{\boldsymbol{d_{i\max}} - \boldsymbol{\bar{q}}}{\boldsymbol{S_d}} \tag{9.4}$$

where:
$d_{i\max}$ = the maximum d_i value.

Then, the fundamental portfolio takes the form:

$$\mathbf{TMAI} = \sum_{i=1}^{n} x_i \times \mathbf{TMAI_i} \rightarrow \mathbf{min},$$
$$\sum_{i=1}^{n} x_i = \mathbf{1}\ , \tag{9.5}$$
$$x_i \geq \mathbf{0}$$

where:
TMAI = synthetic development measure.

TMAI is the synthetic measure which enables investors to assess objectively companies quoted on stock exchanges in the field of fundamental analysis. It may be used to examine the fundamental power of a given company, therefore, the attractiveness of investments, which means the economic and financial situation of the company. Instead of analysing many ratios separately, it is only one indicator which should be evaluated and interpreted. The main advantage of such an approach is its simplicity. Normally, conducting fundamental analysis of a company is a long and sophisticated process. This, quite reliable indicator may be, at least partially, taken as a substitute (Tarczyński, 1994, 1997, 2002; Mastalerz-Kodzis and Pospiech, 2011).

9.2. Data and research method

In this subsection the scope of the research is discussed (especially time, spatial and concerning the essential facts). Time time scope of the article can be generally outlined as 2009–2014 so shares quotations from this period have been taken into consideration. Financial indicators have been calculated at the end of 2010 and, in this case, only the data from this year has been used. Additionally, stock exchange quotations from 2009 and 2010 have been used in order to calculate the expected rates of return. There is an assumption that the potential investor started his investments on January, 2011 when s/he bought shares. Another presumption is that s/he sells securities after 1, 2 or 3 years of an investment so on January, 2012, 2013 or 2014. So yields of final portfolios have been calculated on the basis of 1, 2 or 3 – year stock quotations. The beginning of an investment has been chosen to be in January so as to start with the beginning of the year.

There are several other reasons why such a time frame has been selected. First, more than 20 years has passed since the Warsaw Stock Exchange was established. This period abounded in bullish and bearish trends so the author wanted to check the method of creating portfolios in diverse market circumstances. Second, the data has been taken from the period of time relatively close to the actual moment of carrying out a research. This criterion has been met by the selection of time frame (5 years) between the end of 2009 and the beginning of 2014. Third, during the period mentioned, the WSE was by far more experienced market than in 1990s. Fourth, the years: 2011, 2012, 2013 and 2014 seem to be just ideal to verify performance of portfolios due to the alternately occurrence of bullish, horizontal and bearish market trends. Wobbling market situation staggered the confidence and trust of investors. In that period, the value of the index lost more than 10000 points and it was below 40000 points. It dropped by nearly 30 percent. Nevertheless, 2012 was by far the better year for the stock market. Until August 2012 there were neither bulls nor bears who had the market under control – it was the period of horizontal movements – there was no distinct trend – WIG changes fluctuated from local dips and tops and their range amounted to circa 16 percent (from top to bottom). One half of the year 2012 was horizontal and in the second half the value of WIG was going up – in the second quarter the upward trend started which lasted to 2013. From the second half of 2012 to the end of the research period at the end of March 2013 an upward trend occurred when WIG rose by 15 percent. Such a period has been chosen because of its specific market conditions. Owing to the above facts, the selection of years 2009–2014 is legitimate – the research could be conducted in a relatively variable economic surrounding – there occurred every possible market trend – upward, downward and horizontal which proves that the conclusions of the research may be drown for every market circumstances. Consequently, it is possible to measure the influence of index options on the efficiency of portfolios in the various market conditions.

To do so, and to have objective results, a large number of companies is required. On the whole, almost 80 companies have been chosen from stock market indices quoted on the Warsaw Stock Exchange. All of them are listed in table 9.2. Generally, 426 companies were listed on the WSE in 2011 so the research embraces circa 18 percent of the total number of firms. To companies selected belong those which are the members of the sWIG80 – index of 80 companies with the lower level of capitalization. Companies from this index have been selected because it was the assumption to conduct the research on the basis of medium-sized companies. Furthermore, in comparison with firms which are not members of any index mentioned above, they are by far more liquid in the market (turnover of their stocks is satisfactory) and their capitalisation is several times higher. Moreover, larger companies from WIG20 and mWIG40 are most often selected for research so selecting enterprises from sWIG80 may constitute an additional contribution to the studies over TMAI effectiveness.

However, some companies did not meet one basic criteria set in the research to be incessantly quoted on the stock market between 2011 and 2014 and, as a consequence, they had to be expelled from the examined group of firms.

The study has been carried out with the use of the data from Polish capital market and it can be especially interesting for Polish readers due to the fact that only companies quoted on the Warsaw Stock Exchange have been taken into consideration. Conducting the research has been possible on the grounds of the satisfactory liquidity of quoted stocks which, above all, plays a crucial role for institutional investors.

When it comes to the most essential source of data, quotations of stocks from gpwinfostrefa.pl and stooq.pl have been utilized. Financial information about companies has been downloaded from internet portals such as bankier.pl, money.pl and the official site of the Warsaw Stock Exchange. Another source of data constitutes financial statements of companies, especially yearly consolidated reports from webpages of every company. Some indicators of fundamental analysis have been calculated on the basis of the author's own study and others have been taken from the stock database *Notoria Serwis*. To calculate these indicators the data from 2010 has been obtained.

The research consists of 5 main stages. The study has been divided into stages in order to make it transparent and to provide the clear distinction between selection, calculation, creation of portfolios and conclusions. Moreover, it indicates the extensiveness and complexity of the research as well as the difficult nature of investment issues. Realizing each stage one by one has been necessary to build portfolios of companies quoted on the Warsaw Stock Exchange. It begins with the choice of time frame which financial data have been gathered from. The next is the selection of companies which are the objects of the research. Then, rates of return of stocks for each company have been calculated. The next steps concern activities related to the estimation of the taxonomic measure of investment attractiveness (TMAI).

At the beginning of the research (**stage 1**) it was necessary to select the time frame of the research. It was divided into two parts:

- period 1 (January, 2009 to December, 2010) from which financial data was gathered. It served to calculate financial ratios,
- period 2 (January, 2011 to January, 2014) served to collect data of stock quotations with the aim to check investment results of portfolios.

The time frame is very vital owing to the fact that the results of the research would vary significantly in different market conditions – normally the rate of return of stocks is by far higher in the upward trend than in a downward trend. As a consequence, the time range from January, 2011 to January, 2014 (3 years of testing) is good enough to verify the accuracy and reliability of an investment system. Auxiliary calculations such as financial indicators, have been prepared on the data from 2009 to December, 2010, taken both from financial reports and the *Notoria* database as well as some other sources.

Another thing is related to the choice of companies that have been building their final portfolios. All firms selected to the research were the representatives of the sWIG80 index. Nevertheless, some companies, have been excluded due to their withdrawal from the stock market during the period examined. Consequently, the number of stocks taken to the research does not precisely amount to 80.

Stage 2 is devoted to financial analysis. It consists of a selection of financial indicators and their calculation for each company. The author based the research mainly on the ratios taken from the stock information database *Notoria Serwis*. Some of them were also obtained from web portals: http://bankier.pl and http://money.pl. In the case of the part of the ratios presented the author conducted his own calculations. The *Notoria* database consists, inter alia, of consolidated financial reports of companies and financial ratios. Table 9.1 presents indicators utilized in the research as well as groups they belong to and formulas to estimate them. On the whole, there have been 23 indicators calculated for each enterprise. For the total number of 23 indicators there are: 4 liquidity ratios, 7 activity ratios, 4 debt management ratios, 6 profitability ratios and 2 market value ratios.

Stage 3 concerns the calculation of rates of return of companies for the data from 2011–2014. The historical data of stock quotations has been utilized from 4 years (2011–2014). Moreover, by such a manner returns on the WIG, WIG20 and sWIG80 index have been counted so as to provide comparison between the performance of portfolios created and market benchmarks. Importantly, while calculating rates of return of shares, corporate actions have been taken into consideration. It means that such events as dividends and splits influence stock prices so prices have been each single time recounted so as to assure that corporate actions did not have a direct and immediate impact on the rate of return calculated.

9.3. The application of the taxonomic measure of investment attractiveness

This subsection is devoted to the description of the application of the taxonomic measure of investment attractiveness (TMAI). However, this part of the article focuses chiefly on the practical side of this application, not the theoretical one. It is connected to **stages 4–5**. The manner of the TMAI calculation has also been presented.

From the wide range of financial indicators that would possibly match this research, 23 have been selected. They have been listed in table 9.1. Nevertheless, obtaining values of these ratios is not sufficient to process further computation of TMAI. Some of these ratios are positive for the assessment of the company when they rise. For other ratios, the lower is their value, the better it is for the company. There is also other group of ratios which should amount to the value from the specific range believed to be the most favourable. As it is visible, the interpretation of ratios is not clearly explicit so with the aim of conducting TMAI, ratios, treated as variables, ought to be transformed into converted indicators that may be homogeneously interpreted. Variables which are positive for companies when their value rise are called stimulants. On the contrary to this, variables that are assessed positively when their values decline, are called destimulants. Some indicators have desired values in the certain range – these are nominants. Crucially, destimulants and nominants should be transformed into stimulants so as to lead to the situation that higher values of every ratio signify better financial condition of companies. To convert destimulants into stimulant the following formulae can be used (Tarczyński and Łuniewska, 2006, p. 12):

$$Z_{ij(s)} = 1 - Z_{ij(d)}$$

$$Z_{ij(s)} = \frac{1}{Z_{ij(d)}} \tag{9.6}$$

where:
$Z_{ij(s)}$ – the value of destimulant converted into stimulant,
$Z_{ij(d)}$ – the original value of destimulant.

To convert nominants into stimulant the followi ng formulae can be used (Tarczyński and Łuniewska, 2006, p. 12):

$$Z_{ij} = \frac{\min(\mathrm{nom}_j; Z_{ijN})}{\max(\mathrm{nom}_j; Z_{ijN})},$$

$$Z_{ij} = -\,|\,Z_{ijN} - \mathrm{nom}_j\,|. \tag{9.7}$$

where:
Z_{ij} – the value of nominant converted into stimulant,
nom_j – nominal value of *j* variable.

Table 9.1 presents the division of ratios utilized in the research into stimulants, destimulants and nominants.

Stage 5 is comprised of the final calculation of TMAI. TMAI is the synthetic indicator which includes several or more indicators in itself. It can serve as a relative measure to compare stocks and to draw a conclusion which one offers brighter investment prospects and potentially a higher rate of return. It is important to stress that there are 2 types of that indicator:

- TMAI with weights,
- TMAI without weights.

The financial ratios shown in table 9.1 have an influence on the TMAI value. In the approach to count this indicator 'without weights' each variable (financial ratio) has the same impact on the final value of TMAI. This method is based on the assumption that, in fact, variables do not differentiate results to a large extent – their significance is comparable (Tarczyński and Łuniewska, 2006, p. 44–45). The method of TMAI calculation 'without weights' has been used in this article.

Type of indicator	Indicator	Group of ratio	Formula	Preferred value range (for nominants only)
Stimulants	Gross profit on sales margin	Profitability ratio	Gross profit on sales / Sales	
	Gross profit margin	Profitability ratio	Gross profit / Sales	
	Operating profit margin	Profitability ratio	Operating profit / Sales	
	Return on Sales (RoS)	Profitability ratio	Net income / Sales	
	Return on Assets (RoA)	Profitability ratio	Net income / Total assets	
	Return on Equity (RoE)	Profitability ratio	(Net income / Shareholders' equity) * 100%	
	Net working capital	Liquidity	Current assets – current liabilities	
	Asset Coverage Ratio	Liquidity	(Total assets – intangible assets – current liabilities – debt obligations) / total debt outstanding	
	Times-interest-earned (TIE)	Debt management	EBIT / Interest charges	

Type of indicator	Indicator	Group of ratio	Formula	Preferred value range (for nominants only)
Nominants	Current ratio	Liquidity	Current assets / Current liabilities	1.5 – 2.0
	Quick ratio	Liquidity	(Current assets – Inventory) / (Current liabilities)	1.0 – 1.2
	Super quick ratio	Liquidity	(Current assets – inventory – prepaid expense – net accounts receivable) / current liabilities	1.0 – 1.2
	Days Sales Outstanding (DSO)	Activity ratio	Receivables / Average sales per day	7.0 – 17.0
	Debt ratio	Debt management	Total debt / Total assets	0.57 – 0.67
Destimulants	Inventory turnover ratio	Activity ratio	Sales / Inventories	
	Operating cycle	Activity ratio	Days inventory outstanding + days sales outstanding – days payable outstanding	
	Liability turnover ratio	Activity ratio	(Current liabilities / costs of revenues) * 360	
	Cash conversion cycle	Activity ratio	Inventory conversion period + receivables conversion period – payables conversion period	
	Current assets turnover ratio	Activity ratio	Sales / current assets	
	Assets turnover ratio	Activity ratio	Sales / assets	
	Debt / EBITDA ratio	Debt manage ment	Total liabilities / EBITDA	
	Price / Earnings (P/E)	Market value	Market price of one share / Earnings per one share	
	Market / Book value ratio (M/BV)	Market value	Market price per share / Book value per share	

Table 9.1. Types of ratios applied in the research
Source: own study based on Gabrusewicz, 2002; Brigham and Houston, 2005, p. 78–89; Dębski, 2011; Gajdka and Walińska, 2000; and websites: Smallbusiness, Advanced AR funding; Investowords and Investopedia.

9.4. Key empirical findings

Table 9.2 presents the value of TMAI for each company as well as their rates of return. There is an assumption that shares were bought at the beginning of 2011 (at the first session at the opening price). This date is the reference point for the rate of return computation. The profitability has been calculated for each stock at three different dates: after 1, 2 and 3 years so at 2nd January 2012, 2nd January 2013 and 2nd January 2014.

Enterprise	Rate of return after 1 year (%)	Rate of return after 2 years (%)	Rate of re turn after 3 years (%)	Tmai
AB SA	–23.07	–2.09	27.24	0.367
ABC DATA	–41.07	–43.57	23.51	0.347
AGROTON	–46.55	–71.26	–94.40	0.372
ALCHEMIA	–42.50	–37.50	–33.75	0.314
ALMA	–29.31	–43.03	–24.03	0.335
AMICA	–22.98	31.55	186.66	0.336
APATOR	–5.58	80.70	111.28	0.348
ARCTIC	–42.05	–51.97	–77.30	0.331
ARMATURA	–56.11	–59.74	–44.88	0.309
ASSECO BUSINESS SOLUTIONS	–23.07	–2.09	26.30	0.376
ASSECO CENTRAL EUROPE (ASSECOSLO)	–27.81	–7.53	5.84	0.353
ATM	–46.40	39.89	70.96	0.316
AUTOMOTIVE COMPONENTS	–48.30	–31.21	104.88	0.339
AZOTY TARNÓW	–7.43	83.09	117.33	0.350
BARLINEK	–71.39	–75.94	–66.31	0.298
BBI DEVELOPMENT	–41.30	–17.39	–13.04	0.398
BOMI	–72.24	–97.79	–99.88	0.308
CALATRAVA (IB SYSTEM)	–5.26	0.00	–94.74	0.313
CC ENERGY (KAREN)	–68.35	–74.68	–86.08	0.287
CENTRUM NOWOCZESNYCH TECHNOLOGII S.A.	–24.25	–12.41	–45.52	0.338

Enterprise	Rate of return after 1 year (%)	Rate of return after 2 years (%)	Rate of re turn after 3 years (%)	Tmai
CHEMOSERVIS-DWORY	–54.35	–58.70	–60.87	0.310
CIECH	–18.07	4.54	46.24	0.288
CITY INTERACTIVE	17.85	–5.16	–55.98	0.381
COGNOR (CENTROSTAL)	35.42	–9.17	–49.17	0.278
COMARCH	–33.80	–10.38	20.38	0.336
COMP	–3.01	–10.68	–1.50	0.333
CORMAY	172.23	107.46	39.06	0.315
DEBICA	–12.50	5.42	88.93	0.340
DOM DEVELOPMENT	–29.60	–14.08	39.94	0.381
EFH	–62.61	–84.35	–93.48	0.323
ERBUD	–75.06	–76.44	–42.41	0.336
FAMUR	33.71	121.91	146.63	0.324
FARMACOL	–43.00	–18.53	69.43	0.363
GANT	–61.35	–76.63	–96.41	0.443
GRAJEWO	–46.13	24.06	168.87	0.336
HAWE	–21.50	–5.00	–15.25	0.350
IDM	–56.71	–92.95	–96.98	0.654
INTEGER	43.54	131.49	304.02	0.431
INTERCARS	9.65	19.72	164.20	0.354
IPOPEMA	–46.55	–40.77	–48.80	0.633
JUTRZENKA (COLIAN)	–40.41	–43.52	–8.55	0.352
JWCONSTRUCTION	–66.07	–74.58	–67.86	0.323
KOFOLA-HOOP	–43.59	–15.71	10.26	0.309
KORPORACJA BUDOWLANA DOM	–58.48	–60.78	–90.77	0.150
KREZUS	140.00	636.00	500.00	0.663
KRUSZWICA	–22.83	–56.11	–4.66	0.347
KULCZYK OIL VENTURES	–16.88	–14.29	–24.68	0.155
LC CORP	–41.61	–21.48	11.41	0.501
LENTEX	–19.83	–4.22	79.32	0.322
LUBAWA	–47.41	–48.15	25.93	0.300

Enterprise	Rate of return after 1 year (%)	Rate of return after 2 years (%)	Rate of re turn after 3 years (%)	Tmai
MENNICA	–9.48	87.01	28.18	0.373
MILKILAND	–68.79	–67.67	–71.42	0.349
MIRBUD	–54.45	–68.70	–60.31	0.317
MNI	–46.15	–54.77	–48.00	0.349
MOSTOSTAL WARSZAWA	–73.33	–79.08	–92.52	0.345
MOSTOSTAL ZABRZE	–53.45	–58.55	–28.73	0.309
NEUCA	–7.10	33.04	303.33	0.373
OCTAVA	68.34	–64.32	–59.30	0.428
OPTIMUS (CD PROJEKT RED)	–15.92	5.10	177.07	0.281
PBS FINANSE (BEEFSAN)	–58.39	–61.93	–68.13	0.262
PGF (PELION)	–44.97	–39.40	111.99	0.318
POLAQUA	–72.40	–80.81	–78.05	0.240
POLICE	32.77	65.27	231.93	0.325
PZU	–5.98	41.79	62.52	0.661
RAFAKO	–39.37	–33.94	–49.61	0.319
SANOK	57.41	272.22	366.67	0.351
STALEXPORT	–7.58	5.30	86.36	0.335
STALPROFIL	–40.89	–27.29	0.57	0.299
SYGNITY	19.22	–4.24	31.68	0.299
ŚNIEŻKA	–43.25	0.09	20.19	0.351
TRAKCJA	–83.41	–85.61	–68.54	0.324
VISTULA	–61.54	–48.08	–10.10	0.329
WAWEL	17.70	95.73	209.45	0.363
ZELMER	–25.89	9.36	10.34	0.343

Table 9.2. Statistics of companies from sWIG80
Source: own development based on the research.

Table 9.3 includes the similar data as table 9.2, however, it has been aggregated in groups. The second column concerns the fraction of stocks which had the lowest TMAI value. The figure '6%' denotes that the line with data covers information about stocks which are embraced in a group of shares which had the lowest TMAI value. So, in this case, it focuses on the 6% of the firms with the lowest TMAI (6% of sWIG80 equals to the number of 5 companies). As an example, a line with 50% means that the data concerns almost 40 companies out of 80 in the sWIG80 index. There are presented mean and median rates of return 1, 2 or 3 years after buying shares. There are significant differences between the I. and the XIV. group of stocks. To compare properly the data in the table, it is desirable to contrast two extreme values – for group I. and XIV. When it comes to mean rate of return, after 1 year it varies from -34.15% for I. to -26.6% for XIV. After 2 years it varies from -45.4% to -12.68%. The rate of return counted at the beginning of 2014 has the most considerable deviation. The market value of the first group fell by more than 62%. Contrarily, the market value of the XIV. group rose by 22%. When it comes to median rates of return, the differences are also significant. For the 1-year change the spread in the median profitability between I. and XIV. group amounts to almost 20%. It is even higher for 2-years and 3-years change, 45% and 68% respectively. The variation in the rate of return level of I. and XIV. group cannot be coincidental because the data listed in the table 9.3 indicate the steady, one-directional trend. With decreasing TMAI value the mean and median rate of return of a group plummets too. It is clearly visible that lower TMAI is connected to worse stock performance, whereas higher TMAI supports generally better returns. Such a favorable trend regarding 3-years rate of return is presented in chart 9.1 and chart 9.2 with mean and median profitability respectively. These findings are also confirmed by the data in table 9.4. It presents the rate of return of 3 indices on the Warsaw Stock Exchange: WIG, WIG20 and sWIG80. Naturally, in this research sWIG80 plays the most important role as the benchmark because it is related to the performance of companies which were the objects of the study. It includes medium enterprises that are characterized by less capitalization and less liquidity than companies from WIG20 and mWIG40. The comparison between the data in both tables proves that shares with the lowest TMAI value (e.g. group I., II., III. etc.) have by far lower rates of return (average and median) than benchmark (sWIG80). Interestingly, for higher groups i.e. XIII. or XIV. the mean return is higher than sWIG80 rate of return. Presumably, such a situation can be caused by the relatively large stake of companies with high TMAI. It would signify that, on the contrary to the low TMAI values, the high one's characterize stocks with relatively good growth prospects.

Another important thing is the correlation analysis. The Pearson's correlation between rate of return of stocks and their TMAI values varied between 24% to 36%. It appears that the relation is positive, however, not very strong. With growing TMAI value, in general, rates of return grew too. Just the opposite situation occurs when the TMAI is low. Then also returns are likely to decrease. Stocks from the first groups (such as I., II., III. etc.) would bring handsome profits if included in a short-sell portfolio.

No. of the group	The percent of companies with the lowest TMAI (%)	Mean			Median		
		The rate of return after 1 year (%)	The rate of return after 2 years (%)	The rate of return after 3 years (%)	The rate of return after 1 year (%)	The rate of return after 2 years (%)	The rate of return after 3 years (%)
I.	6	−34.15	−45.40	−62.16	−58.39	−60.78	−68.13
II.	13	−38.54	−39.53	−23.93	−49.64	−44.04	−57.74
III.	19	−38.86	−41.31	−20.00	−47.41	−48.15	−28.73
IV.	25	−28.44	−33.41	−24.76	−45.50	−42.82	−39.32
V.	31	−30.95	−30.98	−13.71	−44.97	−37.50	−33.75
VI.	38	−30.65	−27.73	−6.47	−45.69	−38.45	−39.32
VII.	44	−30.37	−28.01	−6.31	−43.59	−39.40	−28.73
VIII.	50	−31.63	−25.60	1.68	−43.04	−35.72	−26.70
IX.	56	−32.18	−26.12	3.87	−42.50	−33.94	−24.03
X.	63	−32.62	−25.32	3.49	−42.27	−35.72	−19.64
XI.	69	−30.77	−17.48	12.29	−41.07	−31.21	−8.55
XII.	75	−29.63	−15.63	17.53	−40.98	−22.91	−3.08
XIII.	81	−28.14	−12.91	21.44	−39.37	−14.29	0.57
XIV.	88	−26.60	−12.68	22.00	−39.89	−16.55	−0.47

Table 9.3. The profitability of companies in terms of TMAI value
Source: own development based on the research.

Index	% price change		
	1–year	2–years	3–years
WIG	−20.83	−0.06	7.99
WIG20	−21.85	−5.87	−12.51
sWIG80	−30.47	−14.54	17.32

Table 9.4. Rates of return of the benchmarks
Source: own study based on the data from Stooq.pl portal.

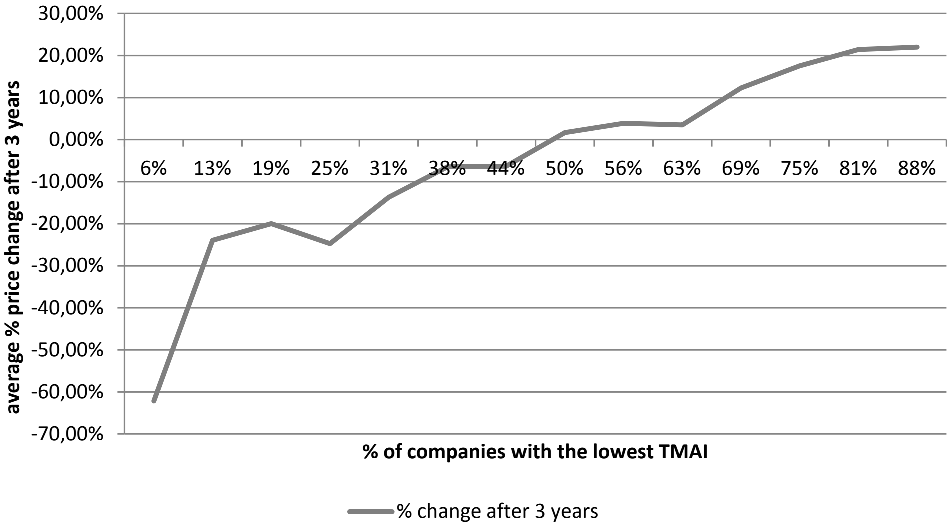

Chart 9.1. The mean profitability of companies in terms of TMAI value
Source: own development based on the research.

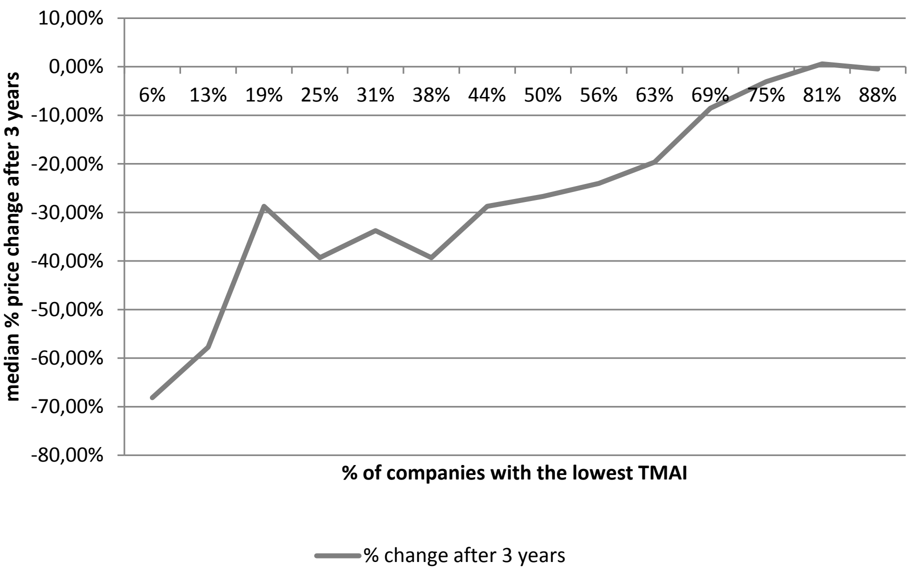

Chart 9.2. The median profitability of companies in terms of TMAI value
Source: own development based on the research.

Conclusion

In the article TMAI serves as a tool for stock selection. However, apart from this ratio, there are also other crucial factors which need to be taken into consideration while making investment decisions. To these factors belong, inter alia: risk, the rate of return and the desired level of diversification. These concepts are crucial in understanding the efficiency of stock portfolios.

One of the important issues which have not been raised thoroughly in the article is the "weighted" variety of TMAI. Sometimes there occur some reasons to suppose that variables are of different importance. It can derive from previous researches or the author's knowledge. In such cases variables must have various influence on the final synthetic measure. To take it into account, special weights of each variable should be introduced. In other words, weight is the stake in the variability of the synthetic measure. One type of weight is the expert's weight (granted by researchers or practitioners being proficient in the given subject) and the second is a statistical weight which is estimated with the use of statistical tools. Variables of the highest changeability are preferred and are given top weights due to their strongest impact on diversifying TMAI final value (Tarczyński and Łuniewska, 2006, p. 44–45). The application of "weighted" TMAI would bring interesting results. Undeniably, this issue would give rise to further discussion.

On the whole, the research gave an empirical evidence that TMAI, in certain circumstances that appeared on the Polish capital market in 2009–2014, can be a very useful tool for selecting companies to short-sell portfolios. It proved that in the market conditions which occurred during 2009–2014 on the Warsaw Stock Exchange, it was helpful in building stock portfolios which had extraordinary falls in value. This would be economically justified as companies with the lowest TMAI value have in general the worse financial situation and tend to be managed in a less efficient way which leads to downturns in their stock prices. Therefore, TMAI can be used to take both long and short positions in the instance of its extreme values. Very high values would suggest buying stocks. In turn, very low values indicate that it would be worth short-selling a particular stock. Of course, it is important to emphasize that in spite of the fact that a correlation analysis proved the existence of this relationship, interdependence of these variables is rather weak or moderate. It seems that in such a context TMAI can be a useful, however, there should also be used other methods which would confirm its indications.

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10. One-off events in the market comparison method

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The aim of the article *One-off events in the market comparison method* is to focus on one-off events occurring in public companies on the basis of which ratios are calculated to estimate companies' value by the market comparison method. The author of the publication tries also to answer how these events should be taken into account in the calculation of market multiples. In the first part of the paper, single economic events are defined, the occurrence of which causes significant changes in the underlying indicators. With the aid of examples from the Polish capital market it is shown what influences the final result of the estimation of the value of a company. Based on a critical review of practical approaches to consider the one-off events in the comparative method and based on the simulation of the variability of the final result of the valuation depending on the adopted approach, the author

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presents a solution to the problem approached in the article. The presented work is an especially important topic from a practical point of view. It complements the company valuation theories in the field of application of the method of market comparisons for estimating the value of the company.

Introduction

Investing is one of the basic human activities in the field of economics (Jajuga and Jajuga, 2006, p. 7), where by investment we shall understand the current renunciation of certain values in order to achieve additional benefits in the future (Hirschleifer, 1965). The economic market investments are considered a necessary condition for company development. However, due to the uncertainty of future projections, making investments carries an inherent exposure to risk with regard to the activities of each entity operating in the economy (Jajuga, 2007, p. 13). That is why it is essential to evaluate all proposed investments before their implementation.

A part of this analysis shall be an attempt to estimate the risk of all new project taken into consideration by company to realize and determine the value of the expected rate of return on its conduct. In order to assess the potential benefits of the implementation of the project a valuation shall be made. K. and T. Jajuga define valuation as finding a fixed value of the object (Jajuga and Jajuga, 2006, p. 8). This approach is consistent with the formula proposed earlier by Sieben, Löcherbach and Matschke who identified it as an assignment of the valuation of a certain object – the object of valuation specified value, usually expressed in the form of a sum of money.

Depending on the nature of an investment: be it physical, financial or intangible, more detailed definitions of valuation are introduced. Business valuation, as defined by Kamela-Sowińska is "a measurement of the value of the company and its assets, and the effects of its decisions to the extent of quality, which will provide the recipient of this information the opportunity to evaluate the results of the actions taken in the past and the selection of a preferred embodiment for the decision in the future" (Kamela-Sowińska, 2006, p. 17). Malevich, in turn, by the valuation of the company understands "the set of operations analysis and calculation designed to determine the value of the company or individual assets in order to perform change of ownership (sale-purchase), structural transformations (making contributions in kind, liquidation company, division, formation of joint ventures), measurement of property taxes and stamp duty and the other purposes under the provisions of law and the functioning of enterprises, e.g. insurance, presentation of shares on the balance sheet, and the like" (Malevich, 1993, p. 12). These two definitions due to their extent and descriptive nature are not precise, which hinders the possibility of their use. Therefore, in this paper, the term valuation of the company will be understood as each measurement value of the company using financial models (Zadora, 2010, p. 35).

The current theory of valuations of companies includes four basic methods: assets, income, market comparisons and real options. As a criterion for the selection of a particular method one can include: the availability of data, the economic and financial situation of the company and valued measurement objective (Zadora, 2010, p. 89–127).

The method which is most widely used by practitioners to estimate the fair value of the equity of a company is a market comparison method. Among the recommendations of the valuations issued by brokerage houses in the period from 1 January to 30 September 2010, included in the study (Głębocki, Grudzinski, Kundera and Sylwestrzak, 2011, p. 579), 222 valuations from 224 were prepared by the market comparisons method. Moreover, regarding the recommendations of brokerage houses concluded from February 2001 to January 2013, comprising 230 valuations of companies listed by 24 brokerage houses[1], it can be noted that all of them were based on the market comparison method. Therefore, significant practical use of the market comparison method justifies further research on improving the efficiency of the estimators of the company found by this approach.

10.1. Market comparison valuation model

A basic assumption in the comparable method of company valuation is the hypothesis that the sameassets shouldbe soldon the market atthe same price (Szczepankowski, 2007, p. 233). The use of thesemethodsdoes not requirepreparingthe multi-annualforecasts anddetermining the value ofthe variousparameters of the model, as in the case of market valuation using the income methodof valuation. At the same time, in contrast to the assetsmethod, it isnotonly basedon thefinancial informationcontained inthe company's balance sheet, butalsoincludes elements ofthe income

1 55 by Millennium Brokerage House, 34 by BRE Investment House, 25 reports were published by Bank BGZ Brokerage Office and 21 by AmerBrokers SA Brokerage House.

statementand cash flows. Accordingly, these methodsare indicatedby several authors, asthe simplestandmost commonly usedmeasurement methodsof enterprise value (English, 2001, p. 289).

According to the market comparison valuation model, the value of a company is determined on the basis of information about the values of multipliers from other units, for which a market value is known[2]. The value ofa company by comparative methods is determined as follows (Nowak, 2010, p. 14):

$$EC = B \times m \tag{10.1}$$

where: EC – the fair value of the equity of a valued company, m – the multiplier expressing the relation of the market price of comparable companies or selected assets to their economic size, B – the value measured at base category for the company.

The distribution of comparative methods of company valuation is determined by the way of construction of the multiplier to determine the market value of comparable companies. In this study the multiplier is defined as a the ratio of price that investors pay for one share of the company to the appropriate economic size (depending on the specific multiplier it may be e.g.: volume of sales, net profit, book value), attributable to the share (Dunal, 2014, p. 4).

In the literature on of the valuation theory there is no precise definition of a referential (comparable) company. The analysis of the market comparison method applicable at the biggest Polish Closed Investment Funds[3] specializing in private asset management market allows you to enter the following definition of comparable companies (reference):

A company comparable to the valued company is understood as a public or non-public one (whose stocks or shares have been traded in the last three months) that meets all of the following criteria:

2 These are public entities, whose value is determined according to the current exchange rate of their shares or non-state actors, whose shares (stocks, respectively) were the subject of the transaction no earlier than three months before the date of valuation. Specified period due to the quarterly financial reporting system.

3 On the basis of a report prepared on Investment Funds by Online Analytics and the Chamber of Fund and Asset Management in November 2013 (and http://www.izfa.pl/files_user/rap_mies/2013–12–11_fi_aktywa.pdf; access of 1.11.2014). The analysis took IPOPEMA TFI, Copernicus Capital TFI and TFI Forum.

– It operates in the same or a similar i ndustry;
– It shows a similar level of operating efficiency as measured by operating margin (in the range of 30% to 300%);
– It achieves sales revenue within a reasonable range of the scale (between 1/10 and 10 times the value of the company reference);
– It achieves a comparable return on equity of the company (at the level of 30% to 300%).

Depending on the source of information about the market value, two approaches can be mentioned: the market multiples method and the comparable transactions method. In the former technique, the multipliers used for the valuation are constructed based on the current share price of reference entities established on the stock market. In the letter method, the market value of reference entities is determined based on the amount of the transaction (buy/sell) part or all of its shares (and stocks respectively). This transaction does not have to occur on the public market. As a comparable transaction, however, the account sales which were carried out earlier than three months before the date of valuation shall not be considered

The valuation process using market comparisons or comparable transactions may employ indicators which can be constructed according to various criteria. As the basis of the multiplier the following items can be used: net profit, EBIT, EBITDA, the book value of the company, the sales value or volume of cash flow to shareholders. The multipliers in the valuation of the company by market comparisons may also be based on the characteristic sizes of the sector in which the measured company operates, e.g.: EV / number of hectoliters of beer, EV / number of subscribers, EV / number of active users per day[4]. In addition to the financial information used to determine the multipliers, the primary criterion for their division is the source of the valued capital. The first group of indicators (Equity Value) is used to determine the amount corresponding to the equity donors. The second group of multiplayers allows us to evaluate the company by all investors. Because of the possibility of constructing an indicator based on practically any financial information included in the financial statements, only those approaches are presented which are most frequently recommended in the literature and have practical applications.

4 Polish Federation Valuers: Common National Valuation Principles (PKZW) Interpretative Note 5 General principles of business valuation, p. 11.

Group of indicators	The design of the multiplier	Description
Equity Value indicators	price to net earnings – P / E	It is the most commonly used relative valuation multiplier, one of the main methods for rapid valuation of listed companies – an important element of the fundamental analysis of shares. The net profit is the most respected accounting synthetic efficiency of the company. It is used mainly for testing the company's potential to generate income.
	price to book net value – P / BV	The net asset value is defined as the difference between the book value and the book value of liabilities. This multiplier is more stable. Compared with earnings multipliers, it can be used when the profits are negative. The main advantage of this index is evaluated to ensure the efficient use of assets.
Enterprise Value indicators	goodwill to EBIT (operating profit) – EV / EBIT	EBIT profit shows how a company generates from operations and shows the value of the business in isolation from the capital structure. The principal advantage of this method is the possibility of the valuation of the company in terms of efficiency in the operational area. But it does not allow us to fully consider the company's ability to generate cash flows in all business areas.
	goodwill to EBITDA (operating profit plus depreciation) – EV / EBITDA	EBITDA shows a surplus generates by an operating company. This is a very good indicator, whose use is becoming increasingly popular. EBITDA can be also treated as surplus, which is distributed among the creditors, owners, reinvestments needs of the company. Compared to the EV/ EBIT multiplier, it allows for the evaluation of companies with substantial assets, with a corresponding high level of depreciation.
	goodwill to sales revenue – EV / S	The EV/Sales multiplier is independent of the capital structure. It can be used even when the P/E and P/BV multipliers cannot be used. This multiplier is a clear measure independent of the adopted accounting principles, but does not account for the levels of profitability.

Table 10.1. Commonly used indicators in the valuation of the comparative method

Source: own.

EV (Enterprise Value) is equal to the sum of the market capitalization of the company (to be fixed by multiplying the current share price and its quantity) and interest-bearing debt, plus the value of equity and net of minority interests held by the company's financial and cash equivalents (Panfil, 2009, p. 85).

Estimating the value of the company by the multiplier can also be carried out by the Q-Tobin method. It is understood as the valuation of the company based on the value of assets (Sudarsan, 1999, p. 150). This method applies a so-called the Tobin's Q coefficient, which corresponds to the relation of the market value of an entity to the replacement value of its assets. If the ratio exceeds one, then the company has intangible assets which, in accordance with the market valuation should contribute to the entity's growth in the future. Due to the inherent difficulty in determining the replacement value of business assets the Tobin Q coefficient can be expressed as the ratio of the market value of equity to book value of the net assets of an entity (Zadora, 2010, p. 83). This way to calculate the company value is however not used in practice as is shown in the study of brokerage houses recommendation.

10.2. Market comparison valuation under one-off events

The widespread use of the market comparison method to estimate the fair value of the company, as it has been already pointed out in the beginning is a consequence of the elimination of the fundamental shortcomings of assets[5] or income[6] methods and relatively simple procedure of calculation. The practical application of this method consists of the following steps (Dunal, 2014, p. 6):

– the choice of multipliers used in the valuation[7], determine the comparative group of companies, for which there are known market values used in the multiples method, according to the criteriaoutlined

5 Combining the value of the company's assets owned by it (Szablewski and Tuzimek, 2008, p. 144), without taking into account how it is maintained, i.e. Whether it is profitable to have if it brings profit to its owner.

6 Identifying the goodwill of the company with incomes generated by it (Zarzecki, 2008, p. 105–106), require from the valouer to prepare financial projections and to estimate the discount rate for determining the present value of projected cash flows (e.g. The cost of equity for DCF in terms of FCFE), which are risky. Deviation of the actual results of the company from the predicted values and | or the occurrence of the load, or loss of efficiency of the estimator of the discount means that application of this method to estimate the fair value of the company can be mistaken.

7 In accordance with: National Common Valuation Principles (PKZW) Interpretative Note 5 General principles of business valuation p. 10 valuation should not be based solely on sartorial multipliers. It is recommended that there should be taken into account in the valuation of at least two indicators on the basis of different design, e.g. Based on the market value of the transaction concluded on the public market and the value of the entire company.

in the previous section. In practice,you should try to make as large a group as possible, but not less than two-piece,
- the determination of multipliers for the comparison group and calculate the average level. Calculations of the values of the individual multipliers should be prepared for each of the companies included in the reference group on the basis of prices at the valuate date. To determine the average multipliers most cases there is used the median, which is less sensitive to extreme[8] values in relation to the arithmetic mean,
- calculate the value of the company,
- introducing adjustments as needed such as discount and premium.

Discounts and premium changes in the field of company value (Byrka-Kita, 2013, p. 13–23, 41–53) are introduced mostly due to the lack of liquidity, the different scales of activity between the valued companies and references, and the diversity in their business models[9].

In addition to determining the value of discounts and premium included in market comparisons method toughest and the most discussed problem is the choice of reference entities. Among the public companies there would not be two enterpriser similar in all respects one another. These differences may occur both at the level of a financial, business, scale of operations, sources of financing, but also in the form of unmeasured value[10] that deferrable companies in terms of their potential development in future, and also in the category of value.

Assuming that you have selected a group of companies comparable to the valued company and established a valuation multiples, you can prepare the calculation of their value. Ratios are determined based on the financial information of references companies (preferably covering the period of the last four quarters ending prior to the date of valuation) and the closing price of the valuation date.

Multipliers of each type are calculated in the same manner, as follows: the ratio of the respective economic size of the company or its exchange rate to a specific business or financial information for the feature size of its activities (e.g. Number of hectoliters of fuel, or the amount of transported tons of cargo for the shipping company). For example, the rate of:

8 Extreme values, i.e. that differ significantly from the average level, should not be fully taken into account, as they can cause the load (underestimation or overestimation) of valuation.

9 E.g. sales of manufactured products through its own distribution network or by using franchise facilities.

10 E.g. the intellectual potential managers and/or other team staff.

P/BV is calculated as the closing price on the valuation date fixed for the book value of equity[11] per share.

P/S is determined as the quotient of the share price valuation to sales revenue per single share.

EV/S is determined by dividing the value of the company to sales per share, the company's market capitalization[12] plus interest-bearing debt and minority shareholders capital[13] of the company minus cash and its equivalents.

Each financial indicator used in the comparative valuation has its interpretations in terms of investment. The general principle, however, is the same for each of them. If the value of a ratio is higher, then the benefits from investments in shares of the company measured by this indicator are lower. For example, if the value of the index[14] P/E equal M means that by purchasing these securities we pay M monetary units for each unit of net profit of the company. In other words, the expected 1/M rate of return on the investment is or that the investment will pay for itself after M years.

Each multiplier is calculated based on the financial information for the last twelve months before the date of the valuation[15] and closing price of company shares established at the valuation date (or as close as possible to that date). Because of this time interval, the share price received to determine market indicators takes into account the occurrence of events that have not yet been included in the financial results. Such situations can both cause underestimation and overestimation of calculated multipliers. For example, the publication of information on the significant destruction of the company's assets, for example in a fire, will immediately[16] cause the fall of the shares

11 Determined on the basis of the last balance sheet of the company prepared before valuation.

12 Determined as the product of the number of shares and the price of its single paper.

13 Is determined by the need to increase by the company's minority shareholders results directly from the definition of the carrying amount the item, i.e. of the net assets of the subsidiary included in the consolidated financial statements, which belongs to shareholders other than the entities of the group (Art. 3. 46 of the Accounting Act).

14 And in the denominator of this ratio should be taken net profit achieved in the last twelve months ending prior to the date of valuation, attributable to equity holders of the parent (in other words, there should be excluded the part of the profit (respectively loss) attributable to non-controlling interests).

15 For the sartorial indices, taking into account information specific to a particular industry, e.g. The number of active users for the telecommunications industry.

16 The assumption that information on the market isequally available to all participants and that they include this information immediately in their investment strategy in the literature is defined as the efficiency of the market (Fama, 1970, p. 383–417) and is

prices. This change will not be visible in the financial information based on which the indicator is calculated. Accordingly, the value P/BV is lower than it should be. It follows from a decrease in the value of the counter: price fixed, following a reduction in the value of assets of the company as a result of the destruction, in the absence of changes in the denominator in computing per share, which does not involve the loss of property. An event that causes the opposite effect to the above can be, among other things: winning litigation on high amount for which in the financial information was established financial reserves.

In general, the occurrences of situations of significant value, which are repetitive, will be called one-off events[17]. This category includes both events which are difficult to predict and also predictable situations, such as: dividend payments, issuance of shares, or conversion of debt into securities. The calculated level of the multiplier in the case of the occurrence of one-off events can be either overestimated or underestimated, depending on its nature. As a consequence, a company's value estimated by market comparison method can be incorrect. To minimize this risk, it is necessary for all one-off events, to determinetheir impact and an adjustment of the output level of the financial data of reference entities.

In the case of random one-off events due to their unpredictability it is not possible to provide universal way of considering them in the calculation of the impact of market multiples. Therefore, in the rest of the work under consideration there will be only one-off events arising in connection with the payment of dividends and the new issue of shares. In the first case an adjustment is necessary when investors are not entitled to get dividends, theirvalue not having been included yet in the financial information used to calculate the multiplier. The chart below shows the time interval when the change in the calculation of multiples should be made, for example for Unibep SA.

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divided into distinguished three forms of informational efficiency: weak, semi-strong and strong, which specify the type of information to which the market reacts. The hypothesis of market efficiency in the theory of valuation is adopted, inter alia, in the CAPM.

17 This concept is wider than the accounting category – which defines extraordinary events as the financial impact of unpredictable events arising outside the operating activities of the entity and not related to the general risk of running, in contrast to that one-off event we will treat every situation of significant value, regardless if it occurs with varying frequency and whether it is connected with company activities or not.

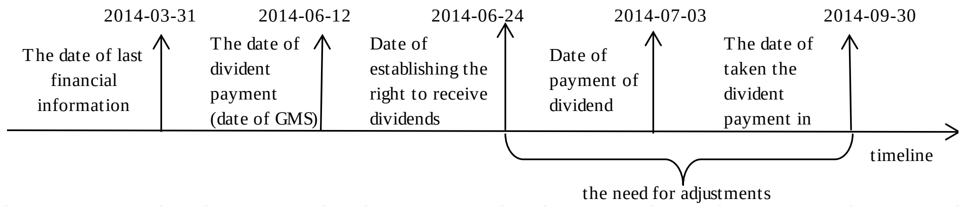

Figure 10.1. The interval, of necessity of correction for the payment of dividend
Source: own.

The second correction due to the issuance of shares (or conversion of debt into shares) should be placed in a situation where the issue (conversion) occurs between the valuation date and the date of preparation of financial information used to calculate the index. Graphically this area of need for change in the calculation of market multiples (for example for Marvipol SA) are presented in the chart below:

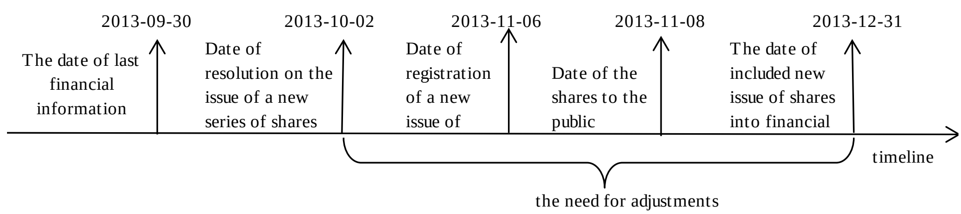

Figure 10.2. The interval, of necessity of correction for the issue of shares
Source: own.

In addition, if between the date of preparation of the financial statements and the date of company valuation there occurs a split[18] or respite[19] of shares of the reference companies to be calculated the multiplier should be considered correct (after the spilt or respite i.e. the current) number of shares of the company, not the quantity indicated by the reference entity in the last published report.

18 Also called the distribution of the shares. This is an operation carried out by a joint stock company, which consists in the fact of lowering of the nominal value of the shares with the same amount of share capital (Jajuga, 2006, p. 11).

19 Otherwise reverse stock split. This action is contrary to split, it is characteristic for a joint stock company and it serves to increase the nominal value of the shares, while maintaining the same amount of share capital.

In the next section of this article there will be proposed authoring proposal to introduce corrections due to the payment of dividends and the issue of shares by comparable companies to the calculation of the indicators for market comparison method.

10.3. The impact of one-off events on the result of estimation

The main purpose of the issue of shares by the company is to raise capital for further development of its business (Kachniewski et. al., 2008, p. 85). Companies which have already been present on the public market can make further issues to raise additional capital, but also to reward managers (managerial issue), or all employees (employee issue). Regardless of the factors that make a company decides to issue new shares, it results in increase of company founding in amount equal to the product of the number of issued shares and the issue price[20] of a single paper. On the liabilities side the share capital will increase by the amount equal to the nominal value of the issued shares and reserve capital in a value of the excess of the issue price over the nominal value-agio. If, raising a capital is gained through the conversion of debt into shares there will be a change in company capital as in the previous case in company capital and in company liabilities of the company, which are decreased by the part of the debt, which is converted into shares. To sum up the issue of shares (depending on the specific) causes an increase in the company's equity and short-term investments[21] (reduction of debt for the conversion of debt into securities of the company). According to the market efficiency assumption, the occurrence of such events is immediately reflected in the company shares price. Therefore, for the correct calculation of market multiples for such an entity should be made adjustments in its financial statement. Assuming that reference company issues of n shares at a price p PLN for each, there should be made the following adjustments in the rolling[22] financial statements:

$$\text{cash after adjustment} = \text{cash before adjustment}^{23} + \\ + np \text{ equity after adjustment} = \text{equity before adjustment} + np \quad (10.2)$$

20 On the assets side if the payment of the nominal value of shares is paid in a non-cash way it will result in changing of different position depending on the kind of contribution.

21 Or other items of assets depending on the way of contribution.

22 Including last twelve months closed at the end of the last quarter before valuation.

23 In the event of the conversion ofdebt:
debt of the company after adjustment = liabilities of the company before adjustment – $\boldsymbol{p}$.

At the same time the number of shares should be taken at their current (at the valuation date) basis. In the following tables there will be presented the value of selected multiples in three variants:

– for the corrected financial statement and the current number of shares,
– for uncorrected financial statementsand number of company shares at the valuation date,
– acceptance of the number of shares from the company's most recent financial statements, while there are not taken into account adjustments.

Name of the Company	EV / S	P / BV	EV / EBITDA	P / E	P / S	Date of share price	Number of shares in millions
Marvipol S.A.	1.36	0.95	10.82	7.51	0.54	2013–11–20	41.55
Próchnik S.A.	1.35	0.92	10.73	6.67	0.48	2013–11–20	310.73
Unibep S.A.	4.19	1.81	28.01	36.02	4.67	2013–06–30	34.19
Rovese S.A.	4.09	1.88	27.71	32.74	4.24	2013–02–28	811.44
Grupa Azoty S.A.	0.28	1.59	8.79	19.11	0.31	2013–02–28	99.20

Table 10.2. Corrected financial statement and current number of shares
Source: own.

Name of the Company	EV / S	P / BV	EV / EBITDA	P / E	P / S	Date of share price	Number of shares in millions
Marvipol S.A.	1.41	1.04	11.20	7.51	0.54	2013–11–20	41.55
Próchnik S.A.	4.52	2.07	30.58	36.02	4.67	2013–11–20	310.73
Unibep S.A.	0.28	1.60	8.81	19.11	0.31	2013–06–30	34.19
Rovese S.A.	1.02	0.71	10.49	-23.95	0.90	2013–02–28	811.44
Grupa Azoty S.A.	0.91	1.85	10.55	19.38	0.80	2013–02–28	99.20

Table 10.3. No corrected financial statement andcurrent number of shares
Source: own.

Name of the Company	EV / S	P / BV	EV / EBITDA	P / E	P / S	Date of share price	Number of shares in millions
Marvipol S.A.	1.35	0.92	10.73	6.67	0.48	2013–11–20	36.92
Próchnik S.A.	4.09	1.88	27.71	32.74	4.24	2013–11–20	282.48
Unibep S.A.	0.28	1.59	8.76	19.02	0.30	2013–06–30	34.02
Rovese S.A.	0.44	0.26	4.56	-8.59	0.32	2013–02–28	291.17
Grupa Azoty S.A.	0.62	1.20	7.25	12.52	0.52	2013–02–28	64.12

Table 10.4. No corrected financial statement and the number of shares at the date of preparation of last financial information

Source: own.

Comparing the level of multipliers depending on how they were calculated it can be noted that there is a considerable differences between them. The adoption of the current number of shares without making any additional changes causes: that P/E and P/S are not loaded. Multipliers calculated under this approach shows that they have higher values compared to the multipliers set on the adjusted financial information. Consequently, it would also inflate the final assessment of the value of the valuated company. Of course, this discrepancy depends on the value of the issued shares. The higher it is, the greater will be the difference in question. The following table shows the percentage change in multipliers determined on the basis of the adjusted financial information to indicators calculated based on uncorrected financial information.

Name of the Company	EV / S (%)	P / BV (%)	EV / EBITDA (%)	P / E (%)	P / S (%)	The value of emissions in million PLN
Marvipol S.A.	–3.41	–8.48	–3.41	0.00	0.00	20.83
Próchnik S.A.	–7.33	–12.82	–8.40	0.00	0.00	9.04
Unibep S.A.	–0.18	–0.26	–0.18	0.00	0.00	0.45
Rovese S.A.	–50.98	–29.25	–50.98	0.00	0.00	868.24
Grupa Azoty S.A.	–23.94	–33.41	–23.94	0.00	0.00	1 543.52

Table 10.5. The effect of adjustments to the value of the multiplier for the same number of shares

Source: own.

A change in the standard approach to calculate the market multiples due to the payment of dividends, as I have already pointed out, it is necessary when the purchaser of a share does not get the right to receive dividends, and its payment was not included in the financial information[24] used to calculate the indicators. The decision on dividend payment (without the right to receive it) is reflected in the current share price[25] of the reference entity. The impact of this event (D by the amount of money which will be paid to shareholders – dividend) therefore it should be included in the financial results of the company, as follows:

$$\begin{gathered}\text{cash and cash equivalents after adjustment}^{26} = \\ = \text{cash and cash equivalents before correction} - D \\ \text{equity after adjustment} = \text{equity before correction} - D\end{gathered} \tag{10.3}$$

The following tables present the conditions of the payment of dividends and the impact of adjustments in this field an example of few polish public companies, as follows:

Name of the Company	The dividend of millions	Date of adoption of the resolution on the payment of dividends	Date of entitlement to the dividend	Date of payment of dividend
Wawel S.A.	30.00	2014–05–12	2014–05–12	2014–06–03
Budimex S.A.	302.53	2014–04–24	2014–05–06	2014–05–21
Żywiec S.A.	133.53	2014–04–24	2014–05–08	2014–05–22
Pekao S.A.	2 614.20	2014–06–12	2014–06–18	2014–07–04
LPP S.A.	169.39	2014–09–25	2014–09–05	2014–09–25

Table 10.6. Information on dividend payment
Source: own.

24 E.g. the company did not pay shareholders advances on future dividends, or has not established obligations for the payment of future dividends.
25 Which is lower than in situation when by purchasing shares investor can receive a dividend, which would be a part of the return on such an investment.
26 When the value of the dividend paid to shareholders exceeds the accumulated funds of the company at the date of the last financial information, the negative value of cash means that the company incurring additional debt or finance a part of the payment to the shareholders from current activity. From the point of view of the accounting designation of indicators such situation does not cause any conflict.

Name of the Company	EV / S	P / BV	EV / EBITDA	P / E	P / S	Date of share price
Wawel S.A.	2.41	4.13	13.13	18.69	2.52	2014–06–30
Budimex S.A.	0.43	8.36	5.52	9.94	0.65	2014–06–30
Żywiec S.A.	1.47	27.43	11.45	15.65	1.13	2014–06–30
Pekao S.A.	5.64	2.13	13.73	16.60	5.02	2014–06–30
LPP S.A.	4.09	13.70	22.31	40.29	3.98	2014–09–30

Table 10.7. Multipliers calculated for adjusted financial statement for the payment of dividend
Source: own.

Name of the Company	EV / S	P / BV	EV / EBITDA	P / E	P / S	Date of share price
Wawel S.A.	2.36	3.82	12.86	18.69	2.52	2014–06–30
Budimex S.A.	0.37	4.58	4.71	9.94	0.65	2014–06–30
Żywiec S.A.	1.43	14.15	11.14	15.65	1.13	2014–06–30
Pekao S.A.	5.36	1.90	13.03	16.60	5.02	2014–06–30
LPP S.A.	4.05	12.13	22.11	40.29	3.98	2014–09–30

Table 10.8. Multipliers calculated for not adjusted financial statement for dividend payment
Source: own.

Comparing the values of multipliers calculated for adjusted financial information with the payment of dividend to indicators calculated normally we get:

Name of the Company	EV / S (%)	P / BV (%)	EV / EBITDA (%)	P / E (%)	P / S (%)
Wawel S.A.	2.13	8.22	2.13	0.00	0.00
Budimex S.A.	17.32	82.52	17.32	0.00	0.00
Żywiec S.A.	2.71	93.83	2.71	0.00	0.00
Pekao S.A.	5.37	12.18	5.37	0.00	0.00
LPP S.A.	0.93	12.96	0.93	0.00	0.00

Table 10.9. The difference between the multipliers adjusted and not adjusted for dividend payment
Source: own.

Indicators P/E, P/S are insensitive to the way of accounting also for this kind of one off event. It is of course a consequence of their design In practice it should be remembered to use consolidated financial information and cash flows attributable to the parent company, e.g. for the position of net profit[27]. For other indicators the difference depends on the size of the dividend payment. A particularly significant impact it has on P/BV.

Conclusion

When applying the market comparisons method to estimate the fair value of the equity of a valuated company, you should keep in mind that it is based on the assumption that the assets of a similar nature should have a similar price. In reality, however, due to the different way of development of each company, potential of employees and managers, the scale of operations, business model, etc. it is not possible to find two similar companies. That is why the company value estimated accordance to market multiple method is loaded from the beginning. Basis on the examples presented in this paper if we do not include corrections in financial statement of references companies connected with occurrence of one-off events we can get even more unmatched valuation.

In practice, during the valuation it must be remembered that the absence of adjustment due to the new issue of shares will gives us overestimation of the value of multipliers. The lack of adjustment for the payment of a dividend in turn gives us understatement of market indicators. Resistant indicators, i.e. those which will not change due to the above mentioned one-off events areP/E and P/S. As a result of the research I recommend to include those multipliers in the final estimate of the value of the company. It is important however, to have in mind recommendations of the National Common Principles of Valuation (PKZW) to market comparison method has to be based at least on two different groups of indicators. Examples presented in this paper show that the omission in the calculation of multipliers one-off event such as dividend payments or issue of new shares has a significant impact on their final value. Therefore, it is especially important to check how the market indices are calculated in the case when we use predefined multipliers values published by the financial agencies, such as: Bloomberg, Morningstar, MSN, etc.

27 In this case as the basis for *E* should be taken net profit attributable to equity holders of the parent, because
only this profit/earnings will be entitled to investors in connection with the acquisition company shares.

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http://dx.doi.org/10.18778/8088-012-2.11

11. Reduction in the level of risk consciousness among mortgagors

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Abstract

The aim of this article is to analyse risk reduction mechanisms that are used by mortgagors. Two basic types of mortgage borrowers were identified: those with low creditworthiness and those with high creditworthiness. A qualitative method was used in the study based on in-depth interviews that were conducted with 20 mortgagors, which made it possible to provide a typologically representative picture of the risk reduction mechanisms used by this group. Finally, two strategies were identified, i.e. the imitation strategy and the professionalization strategy, as well as two effects that are also aimed at reducing the risk.

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Introduction

Mortgagors are a specific social group whose boundaries are not fixed (its degree of openness can vary). This group's permeability is determined by the LTV (loan-to-value) ratio. When the LTV ratio exceeds 100%, this means that real estate buyers can obtain a mortgage in an amount that exceeds a given property's value. In this way the group of mortgage borrowers becomes open to purchasers who have no funds for a down payment. As the loan-to-value ratio declines, the group becomes increasingly more closed. This group is usually characterised by having long-term members, which is connected with the mortgage loan repayment period. Once taken out, a mortgage becomes a permanent part of an individual's life.

The aim of this paper is to analyse risk reduction mechanisms related to taking out and paying a mortgage. An objective way of measuring this risk is based on economic indicators such as the level and volatility of interest rates, loan margin, exchange rate for foreign currency mortgages, and monetary inflation. Mortgage-related risk can also be assessed subjectively, i.e. by borrowers themselves. Such subjective assessments do not have to be, and they are not consistent with objective risk assessments. Mortgagors can form various mental images of real or purported threats which reflect their notions, prejudices, stereotypes and misconceptions related to the functioning of the market. These result from an individual's level of education, ownership situation, professional experience, age or the way in which one earns his/her living. Although subjective assessments have an influence on consumer decisions, they often differ from the assessments that are made by experts, who treat such subjective judgements as irrational. Subjective ways of assessing risk allow borrowers to develop risk reduction mechanisms. It can be argued that these subjective assessment methods influence people's decisions about taking out long-term loans to a greater extent than objective indicators.

This analysis mainly deals with credit risk reduction mechanisms that are used by real estate buyers. In order to analyse these mechanisms, the author used in-depth interviews with mortgagors. The number of individuals who were interviewed was insufficient to obtain a statistically representative sample; however, the obtained results made it possible to identify several basic risk reduction mechanisms that were used by the studied mortgage borrowers. The presentation of results will be preceded by an analysis of the differences between particular types of borrowers and of the functioning of the real estate market. This study was conducted in May, 2014, as part of an internship at the Institute of Sociology, Adam Mickiewicz University in Poznań. The studied group consisted of 20 respondents. The values of mortgages they had taken out were PLN 60,000 to 400,000, whereas the repayment terms were 8 to 35 years. Respondents had taken out mortgages in Polish zlotys and Swiss francs, and the longest amount of time the mortgages had already been in repayment was 9 years. The properties had been bought in Poznań, Warsaw, Swarzędz, Brześć Kujawski, Kutno, Opalenica, Kwilcz, Błażejewko and Chomęcice.

11.1. Mortgage borrowers' position in the social structure

Borrowers differ in their creditworthiness, which is assessed by bank officers who decide whether to grant or refuse to grant a loan in a specific amount. Stanisław Kozyr-Kowalski's (1999) economic and sociological theory of ownership will be employed to analyse creditworthiness. This theory allows one to identify two basic sources that are used to assess bank customers' creditworthiness, i.e. ownership of labour-power and the private ownership of the means of production. These are the fundamental factors that determine the level of income of potential borrowers. One can identify two basic types of mortgage borrowers:

1. Borrowers with low creditworthiness. The ownership of labour-power with a market value that is close to the average wage level for employees is the main determinant of low creditworthiness, because this means that an individual is not able to make savings in his/her household budget. As for the credit market, people who are paid at this level are considered to be customers who do not have the funds, or do not have sufficient funds, to make a down payment on a home. They cannot apply for a mortgage at any time of their choosing and have to try to seize their chance when bank executives decide to relax their lending policy. A requirement that borrowers make a specific down payment is a sign that mortgage lending criteria have been tightened, and this means that those customers who do not receive financial support from their families or from other sources will be excluded from the market.

The number of households with savings in Poland is decreasing. According to a survey conducted by the global research company Ipsos, 70–80% of Poles reported that they had no savings in the years 1995–2012. The proportion of respondents who had savings in an amount that was equal to their income for the last 2–5 months was between 12.64 and 20.52%. A total of 3.42–7.43% of Poles reported that their savings equalled the amount of their income for the last 6–11 months, whereas 2.15–4.10% had saved an amount equal to their annual income. The results of *Social Diagnosis* for 2000–2011 are consistent with these findings.According to this research survey, every fourth household had savings (22.1–23.5%) in the years 2000–2005. During the next period, this proportion increased and 36.1% of households had savings in 2011, and more than half of them had saved an amount that did not exceed their three-month income. Eurostat data show that the gross household savings rate in Poland, which is expressed as the ratio of savings to disposable income, fell significantly, i.e. from 12.87% in 1999 to 1.7% in 2011. Since 2002 the savings rate in Poland has been lower than the UE average. In 2010 only five countries in the European Union had a lower savings rate than Poland (Anioła and Gołaś, 2012, p. 26–29, 37–38). This means that a vast majority of Polish households are not able to generate a significant amount of funds on their own to make a potential down payment on a home.

For these property buyers, a mortgage is a key factor in the process of reproducing labour-power, which is their only source of income. The necessity of making regular mortgage payments determines the way in which borrowers manage their household budgets and constitutes an important criterion for assessing a customer's reliability for bank officers. Discontinuous employment or irregular income is an obstacle to discharging one's liabilities to a bank. Any increase in interest rates or the exchange rate of the foreign currency in which a mortgage has been taken out poses a direct threat to the economic condition of mortgagors with low creditworthiness.

When a labour-power owner's income exceeds the average wage, ceteris paribus, his/her creditworthiness as well as the margin of economic safety for his/her household also increase. Whether this will be a continued trend depends on many factors such as keeping one's job, being further promoted within a given organisation, or one's health.

Among borrowers with low creditworthiness are most employees, retirees, pensioners and jobseekers. The creditworthiness of many natural persons who run their firms as sole traders is also low and similar to that of employees. Sole traders in Poland represent about three-fourths of all entrepreneurs. There is no minimum capital contribution required for running a one-person business. Among those who decide to start such a business can be labour-power owners who did not manage to find employment with production and non-production organisations. Not all of them, however, secure a long-term position in the system of the private ownership of the means of production.

2. Borrowers with high creditworthiness. The private ownership of the means of production is the main determinant of high creditworthiness because it allows an individual to obtain income that significantly exceeds the average employee wage. Those who formally are employees but who convert earned income into financial capital also have high

creditworthiness. They can invest financial capital in such objects of ownership as different kinds of means of production and durable luxury consumption goods. Unlike savings, which are an addition to wages, the private ownership of capital can permanently replace one's own labour-power as a source of income. Ownership of this kind is only associated with employment income that is significantly higher than the average wage for employees.

The real estate market has a high "hoarding" value. The high level of prices that is maintained in this market might provide protection against monetary inflation. If real property is acquired at the right time, this makes it possible to earn profits related to an increase in its market value.

Borrowers with high creditworthiness may treat the acquisition of real property as an investment method which is an alternative to production investments. During certain periods, this method may generate greater returns on capital investments than the means of material and intellectual production. For borrowers with low creditworthiness, however, the acquisition of property serves the purpose of satisfying their basic need of life and is not an investment. Price appreciation in the housing market increases, but usually temporarily, the value of the real property which is used as security for a mortgage loan.

Borrowers with high creditworthiness have enough funds to make a down payment, if it is required by bank executives. They can demonstrate that they have sufficient income to pass the verification procedure and fulfil the formal requirements that are laid down by mortgage lenders. Their future income may allow them to pay off part of a mortgage earlier. They also have greater bargaining power in negotiations with bank officers. Their high creditworthiness makes them desirable and valuable customers, who can be attracted by a broader range of services than other consumers. As a result, such borrowers can negotiate more favourable terms than other property buyers who also use this kind of financing. Most of all, they can get access to a mortgage at any time of their choosing and they do not have to wait until mortgage lending criteria are relaxed. They can seize extraordinary opportunities such as a downturn and a decline in prices in the real estate market. Since they have funds for a down payment, they can shape the structure of their mortgage obligations. A loan mortgage allows them to avoid "freezing" the entire cash for the purpose of making transactions of this kind.

As for borrowers with high creditworthiness, household budget management is an integral part of the process of reproducing the private ownership of capital. Among these mortgage borrowers are business owners, managers, specialists and high-ranking officials whose profits and earnings exceed the average wage for employees.

11.2. Functioning of the real estate market

The real estate market should be regarded as a luxury consumer market. This market follows a high-price strategy which makes it impossible for price-sensitive customers to afford a home with their current income and savings without additional financial instruments.

This can be illustrated by the housing affordability index which is measured as the ratio of the average housing price per square metre to the average wage in the corporate sector. In 2007 this index fell to its lowest point, i.e. 0.45. For example, if we assume that the value of this index remains constant, the average buyer would have to accumulate the necessary funds to buy a flat with an area of 60 square metres for more than 11 years by saving all his/her earnings. In 2012 the housing affordability index was at 0.60, which means that if the index value was constant, the average buyer would have to save all of his/her earnings for more than 8 years in order to be able to buy the above-mentioned flat. The need to save up for a flat of their own does not relieve consumers who are very sensitive to prices of the necessity of reproducing labour-power on which their livelihood depends. In reality the period that is determined by using the housing affordability index becomes much longer. It is impossible for one-person households to save all of their earnings. If one does not have his/her own flat, the amount of his/her savings decreases by the amount of rent. The costs associated with raising children extend the time that is needed to collect the appropriate amount of money to buy a home.

According to the NBP, the housing affordability index for 7 Polish cities, which reached a low in 2007, had not increased to the level from before 2006 by 2013. According to the Home Brokers agency's analysts, flat prices have fallen by an average of 26% since 2008. However, the decline in housing prices after the boom years did not offset their reduced affordability.

From the perspective of the lifetime of a consumer whose sensitivity to prices is growing, the purchase of a flat only with the money he/she has been putting aside for years is not very effective, even if the consumer is able to save this amount of money him-/herself. The real estate market is governed by the rules of luxury consumption and its functioning falls outside Joseph Schumpeter's model, according to which capitalist production increases the purchasing power of the working masses.

Mortgages which are offered by banks constitute a sanction that prevents buyers with high price sensitivity from being excluded from the housing market. In Poland the mortgage affordability index, which is calculated in relation to the average monthly wage in the corporate sector, reached the highest values in the years 2005–2006. At that time, the cumulative index of change in the criteria used by banks as part of their lending policy assumed positive values, which means that banks relaxed their policy as compared to the previous period. The housing affordability index reached its lowest value in 2007 (Łaszek et al., 2014, p. 13). Therefore, the cure turned out to be worse than the disease. Banks' lax lending policy and greater access to mortgages were important factors influencing the demand in the real estate market, which led to an increase in property prices. Finally, these factors limited the purchasing power of a vast majority of labour-power owners in the housing market.

Banks' lending policy is a significant factor that influences the purchasing power of price-sensitive consumers. On the one hand, it prevents them from being excluded from the market due to their wage and savings level; on the other hand, it imposes income- and domination-related restrictions on them. These restrictions are usually much more severe and long-lasting in the housing market than in the mass consumption market. The possibility of incurring excessive debt related to buying a flat can have financial consequences for the next generations of the family.

Even though banks' lax lending policy opens up the real estate market to price-sensitive consumers, it also creates demand, which results in an increase in real property prices. A sharp downturn in the housing market exposes these buyers' ownership position. Moreover, real property's hording value is completely reduced for mortgage borrowers for whom a constant increase in housing prices is the only security for the transaction. And this is what happened when the housing bubble burst in the U.S. and in Poland. For many labour-power owners an investment in a the real estate market with rising property prices was to be a means of changing one's ownership situation. But instead of earning income from selling or letting out a flat that would be comparable to the profits made by private owners of the means of production, they became burdened with the necessity of making increasing mortgage payments under conditions of falling property prices. There was an increase in the risk of over-indebtedness among these mortgagors, which in the end leads to household bankruptcies.

11.3. Risk reduction mechanisms used by mortgagors

Credit risk can be generally defined as a temporary or permanent threat of losing the ability to discharge financial liabilities on time, which can occur at different stages of the mortgage loan life-cycle. A reduction in a borrower's risk perception during the decision-making phase is a condition of entering into a mortgage agreement. A mortgage borrower also uses certain "effects" that increase his/her subjective sense of security during the mortgage loan term. One can identify the following credit risk reduction mechanisms:

1. Imitation strategy. When making decisions, a borrower is influenced by the behaviour of people who have already taken out mortgages and who become the main source of knowledge for him/her. He treats their opinions as authoritative. These are people from a borrower's immediate family as well as social and neighbourhood milieu. The imitating individual chooses the same bank and the same mortgage product, and this kind of strategy is visible in the following answer provided by one of the respondents:

"[A] close friend of ours had a great impact on our decision. She'd taken a similar mortgage loan, from the same bank and on similar terms" (X 20).

Another person admitted:

"I talked to my sister who also has a mortgage and with my friends who'd decided, or who'd been forced to decide to buy a flat in this way" (X 3).

According to respondents, this imitative behaviour somewhat compensated for their lack of knowledge and competence and helped them to prepare themselves for negotiations with bank officers:

"I used the experience of my family members who'd taken out mortgage loans from different banks. I found their advice and comments on the whole process helpful" (X 4).

The experience of people who have already purchased a home is of crucial importance for borrowers following the imitation strategy:

"I talked to my husband's sister a lot. She'd just bought a flat so she was a valuable source of information for me" (X 15).

It is particularly important for consumers who employ the imitation strategy to know some people who have already taken a mortgage. These consumers believe that talking to such people is a convenient way of verifying the reliability of a given bank's products which does not require extensive financial knowledge. People in their immediate environment who have mortgages are regarded as particularly credible because they are impartial. This is what makes them different from professional financial advisers who provide information as part of their paid employment. Therefore, one cannot be sure what their real intentions are:

"Of course, they'll praise everything and encourage you to take out a mortgage loan. After all, this is their job" (X 14).

This imitative behaviour reduces the perception of risk on the part of potential borrowers. They follow their friends' or relatives' example and this makes it easier for them to make the final decision. Additionally, they start comparing themselves to others, which motivates them to take out a mortgage:

"Some people in our family had a mortgage and they somehow got by, so why can't we?" (X 14).

A decrease in their risk awareness is based on everyday social consciousness. In Kozyr-Kowalski's (2001) opinion, this construct encompasses beliefs and ideas which are a manifestation of people's life experience and which are checked against this experience. Our thinking is influenced or even manipulated by those who professionally create social consciousness, which contains elements of scientific knowledge, but which is also not free from misconceptions, stereotypes and ordinary ignorance. Everyday social consciousness provides justifications for the decisions made by mortgagors who use the imitation strategy and is a source of knowledge about practical ways of dealing with particular situations. As a result, they become more market-oriented and learn about the problems they may encounter when applying for a mortgage, the procedure of granting mortgage loans, the legal "tricks" that are used in mortgage loan agreements, and bank officers' strategies. Borrowers may be able to more effectively go through the formalities by drawing on the experience of their predecessors.

On the other hand, everyday social consciousness poses certain threats. It can lead to "herding behaviour" in the mortgage market, which is when consumers reinforce one another's belief that current market conditions are unchangeable; for example, several years ago consumers were convinced that the Swiss franc's exchange rate against the Polish zloty would always remain low. The prevailing ideas that are held by market participants can reduce an individual's sense of responsibility for his/her mortgage obligations. These individuals expect favourable institutional arrangements because others also have similar problems. When mortgagors refer to everyday social consciousness, this may lead to self-deception, i.e. they may have unrealistic visions of both the immediate and distant future. For example, they perceive an increase in property prices as a constant trend, but they do not notice that they themselves are the main driving force behind this trend.

2. The professionalization strategy. A mortgagor relies on the opinions of advisers for whom such advisory services are a source of income and follows the guidelines provided by them. Financial advisers are more credible than the other mortgage borrowers:

"Of course, at the very beginning my wife and I tried to find out on our own what the situation was going to be like after taking a mortgage. We also asked those friends who had already taken this kind of loan. Finally, we decided to ask a professional, a financial adviser, for help because advisers are knowledgeable about this topic" (X 8).

Such advisers become borrowers' "market guides" who provide knowledge and information about this market's functioning:

"We found this woman who was a financial adviser. We went to see her and said that we wanted to take out a mortgage and buy a home. Later on, we visited her and she showed us products offered by different banks. She told us what to do, which margin was lower and which bank had a good reputation. We basically relied on her for everything" (X 9).

Mortgage borrowers can also use comprehensive services that are offered in the housing market:

"One real estate agent also offered some help. He put me in touch with a professional mortgage adviser who then ran a simulation of how much a mortgage would cost for several banks" (X 12).

Here, borrowers' level of risk awareness goes down as a result of referring to professional social consciousness, which is built by people who have a certain "certificate" of education that is legally and socially recognised. Such a certificate often creates an opportunity to close a particular professional group to others. Those who have specialist knowledge and information as well as access to these can monopolise specific jobs. The high status of science and scientific ways of learning about reality in the hierarchy of social values attracts customers to these professionals. However, if mortgagors want to utilise this knowledge, they must bear additional costs. Their low creditworthiness, especially when they do not have funds for a down payment, can make them follow the imitation strategy rather than the strategy of professionalization. However, even the most professional help will not change banks' strict lending policy. These customers have to wait until banks relax their policy, which will allow them to enter the market. The help of advisers is much more important for those purchasers who are always able to meet the criteria that are set out by banks and who can choose a convenient time to take out a mortgage loan. The information and simulations presented by financial advisers can increase these customers' ability to use the real estate market's hording value.

Professional social consciousness is not free from bias, prejudice or self-interest. John Maynard Keynes (2003, p. 130–145) noticed that instead of curbing the unpredictable whims of an ignorant who had been left on his/her own in the market, professional experts strengthened his/her belief that there was a specific market convention at a given time and place. Professional social consciousness may significantly prompt mortgagors to practice self-deception, which is a driving force behind housing bubbles.

Some purchasers are in a favourable position because there are professionals among their relatives:

"My mother works in a bank and I had access to the information. No, I did not look for advice in commercial banks, but I trusted my mom and took out a mortgage from the bank she works at" (X 11).

Financial professionals can also belong to one's social group:

"A friend of ours did it for us. He works in a bank. He did us a favour, and because he knows all those, let's say, mortgage tricks, he gathered information about mortgage products and helped us to choose the best option" (X 13).

3. The Compensation effect. Having one's own house or flat makes up for the sense of risk which is connected with the obligation to discharge financial liabilities. This fact changes borrowers' way of life in various aspects:

"Well, yes, we have a great house and we are leading a better and more comfortable life now" (X 14).

The location of the home that has been purchased may reduce one's commuting distance:

"I don't have to spend so much time in the car. I'm paying the mortgage with the money I would otherwise be spending on transport" (X 12).

Having more time allows one to revive his/her social and cultural life.

"I live closer to work. I can enjoy social life and I meet with people more often. More people can visit me now because we live closer to each other. I can get to the cinema more easily. A lot has changed. And I can get home from work earlier because it takes me fifteen minutes to get there" (X 11).

A mortgage loan is the cost that one has to pay for having a sense of control over one's own life:

"I enjoy less economic comfort, but my capacity for self-determination has increased" (X 5).

In exchange for taking on mortgage obligations, property buyers who are in either marital or non-marital relationships can start living on their own and become independent from other family members or free from the control of others:

"We live in our own home. Nobody tells us what to do" (X 8).

According to Kozyr-Kowalski (1999), the corporeal and sensuous nature of ownership is most common as far as everyday social consciousness is concerned. This notion can be represented as a human being's attitude towards his/her body. An individual treats what he/she can touch and look at every day as well as what he/she can decide about as his/her possessions. When trying to compensate for the obligation they have taken on, i.e. to make regular mortgage payments, mortgagors like to stress the prestige they gained as a result of buying their own home and compare themselves to those who do not own a property:

"Now that I know that I have my own flat I'm living a more comfortable life. This is important today for young people, and it is a big problem for them. Everybody dreams of having their own flat. I already have mine" (X 4).

The "corporeal" way of perceiving ownership is more firmly entrenched in everyday social consciousness than the legal understanding of this concept:

"I know that I will actually own this flat only after making the last payment. I am responsible for this property. I know it belongs to the bank but I don't think about it every day. We don't think about it a lot because we didn't really have any other choice. After all, we've finally settled and we can furnish the flat in any way we like. We lived in a rented flat before and we didn't have this opportunity. So, in part, we definitely feel we own this flat" (X 20).

Everyday social consciousness can go beyond the formal, legal understanding of ownership because people find many ways to derive income from the property they hold:

"I feel that this property belongs to me. I'm registered at this address and I have all the papers. I can decide what this flat will look like and how it will be decorated. I can also, for example, let out one of the rooms and make a profit which I'll be able to partially spend on making mortgage loan payments" (X 4).

Mortgagors may compensate for the burden of discharging financial liabilities by radically changing their current personal life. The new home becomes the centre of their lifeworld and the source of new image schemas that they use to interpret reality:

"No, we do not spend our free time in front of the TV or by going to the cinema, and so on, but we dig our garden, plant vegetables, paint the walls or decorate the attic. This has an impact on our daily life. (…) It's a good thing to have one's own house! You have this feeling that there is a place on earth where you come back after work or holiday… This is where we live!" (X 9).

4. The investment effect. Mortgage borrowers believe that the value of the homes they bought secures them against the risk of losing funds for mortgage payments:

"As I said, a flat is an investment. If one fails, it can be sold or rented out, which will cause an influx of cash. The money can then be used to pay off the mortgage, or one can gain a stable source of income if the flat's been let out. So far I can't see any minuses. I'm happy that I have my own flat. This gives me a sense of stability in life" (X 4).

Among the factors that encourage a consumer to take out a mortgage is a belief that the property's price was good:

"I still managed to buy a flat at a good price. If I sold it today, I'd be able to pay off the mortgage and I'd still have some cash left. (…) I pay the mortgage, and I explain it to myself in this way" (X 3).

When mortgagors carry out a valuation of the property they have purchased, they also take into account the fact that it is situated in a good location. They feel that location is another factor that increases the value of property:

"I was lucky because the district where the home is situated is constantly developing, and the property prices are still growing. And if I wanted to let out this flat, the payments of rent would easily cover the mortgage payments" (X 1).

As far as everyday social consciousness is concerned, people have no qualms about regarding public, municipal or commune-owned facilities as assets that increase property prices:

"The property's market value is now slightly different than it was on the day when it was bought. Homes in this location have slightly gained in value, about 10%, because many public purpose investments have been made here – several places where people can spend their time actively and new trade-related and transportation infrastructure. This is why the cost of the mortgage is now lower than the increased value of the flat due to its location" (X 12).

Mortgagors also count the funds they have spent in relation to the finish and decor as well as the cost of their labour as assets that increase the expected value of their homes:

"I also invested extra money in decorating the flat. If I sold it now, in its current form, I would certainly get a price that exceeds the value of the mortgage" (X 5).

In everyday social consciousness, it is property purchase prices, not current market value of properties, that are used as a reference point when carrying out a valuation:

"The price was not excessive. The very location of this house is very important – there is no house in front of it, no neighbour. I think that now it can be even slightly more expensive if we wanted to sell it, because house prices are going up. Considering how much extra money we invested in this house, we would get more than the mortgage value" (X 9).

Mortgagors tend to overestimate the value of the homes they have purchased. Apart from material assets, they also take into account their own misgivings which are connected with these assets but which are also not important to potential buyers at all. As for everyday social consciousness, practical knowledge and real worldly wisdom is constantly counteracted by human destructive tendency towards self-deceit.

11.4. The protective functions of fixed mortgage interest rates

Borrowers' everyday social consciousness provides opportunities for bank executives to increase their income. The U.S. market can provide many examples of this tendency. There are two basic types of mortgages, i.e. fixed-rate mortgages (FRMs) and adjustable-rate mortgages (ARMs), in this market. Among the most popular kinds of mortgages are 30-year fixed-rate mortgages with the option to pay the loan off earlier. Among adjustable-rate mortgages one can identify hybrid ARMs, which offer an initial interest rate that is constant for the first 2–5 years or the possibility of paying only the interest during the initial period of time.

In the years 1990–2010 the proportion of adjustable-rate mortgages was lower than that of fixed-rate mortgages with the exception of the year 1994, which is when the proportion of ARMs was 60% to 70%. Since then, there has been a significant decline in their proportion; however, it was more than 40% in 2000 and 2004–2005. In the years 2009–2010 the proportion of ARMs was less than 10% (Moench, Vickery and Aragon, 2010).

Long-term fixed-rate mortgages have specific consequences that are related to the risk that banks incur. This risk can be connected with a mismatch between income, which is spread over time and which is derived from the constant stream of mortgage payments, and banks' current liabilities to their depositors and other customers. Bank risk is also associated with the loss of interest income due to early repayment (Moench, Vickery and Aragon, 2010).

On the other hand, adjustable-rate mortgages attract borrowers because they give them options which FRMs cannot provide. An ARM offers a promise that the borrower will be able to buy a larger number of square metres for a smaller amount of money. The option to make lower mortgage payments during the initial period allows a borrower who meets specific criteria to obtain a larger mortgage amount. ARMs offer potential savings, relative to FRMs, provided that the interest rate based on which mortgage payments are calculated does not increase. They are attractive to borrowers with limited purchasing power or to those who had already taken out a loan. The risk resulting from changes in interest rates is the cost that must be incurred. Therefore, it is not surprising that ARMs dominated the nonprime mortgage markets, where mortgages were available to purchasers with considerably low creditworthiness (Moench, Vickery and Aragon, 2010).

In 2004, in a speech at a conference of the National Credit Union Association Alan Greenspan said: "American consumers might benefit if lenders provided greater mortgage product alternatives to the traditional fixed-rate mortgage". According to data from the Mortgage Bankers Association, more than 40% of adjustable-rate mortgages which had been taken out by customers with lowered credibility (the subprime market) were in arrears in the years 2003–2009. In the prime market, i.e. among borrowers with higher creditworthiness, the proportion of mortgages in arrears grew from 0.63% in 2005 to 18% at the end of 2009. Also in 2009, a total of 5% of fixed-rate mortgages were in arrears in the prime market, whereas the proportion of subprime FRMs in arrears was not higher than 25% (Bergstresser and Beshears, 2010, p. 2–3, 19).

Bank executives are able to use mortgage borrowers' low level of knowledge, which is a feature of everyday consciousness. Many of those customers who have taken ARMs do not understand how these kinds of mortgages function. According to Daniel Bergstresser and John Beshears, this is true of borrowers who know little about economic issues and are very trusting.

The behaviour of those who professionally create social consciousness supports this hypothesis. The National Association of Realtors in the U.S. expressed the opinion that lenders who grant mortgages of this kind have more flexibility in determining margins, indices and indicators, which confuses consumers and pushes them into the debt trap (Bergstresser and Beshears, 2010, p. 3). Hybrid ARMs are particularly dangerous. Borrowers are attracted by the initial period during which payments are lower, which is possible because they will have to be fully paid later. After the initial period, this realisation comes as a shock to the household budgets of property buyers who are neither financially nor cognitively prepared for a significant increase in the payment amount. A survey that was conducted by the Consumer Federation of America in 2004 shows that ARMs are more often chosen by young people who have lower income and are less educated (Finke, Huston, Siman and Corlija, 2005, p. 18).

The protective value of fixed-rate mortgages is visible in the U.S. mortgage market. Fixed interest rates make consumers' mortgage obligations more stable, thus safeguarding their household budgets against the effects of sudden changes in the value of mortgage payments. If borrowers take out mortgages in their domestic currency, in which they earn their living, this strengthens the protective value of a fixed interest rate. A fixed interest rate protects a borrower against negative situational sanctions which can be used by bank executives to a greater extent than a variable (adjustable) interest rate. Overdue mortgage payments can lead to foreclosure or make it necessary to provide collateral for the loan or purchase payment protection insurance. A fixed-rate mortgage represents fixed expenses in one's household budget, therefore it allows one to make short- and long-term plans, save money or undertake actions in advance to mitigate the effect of a decrease in household members' income. A variable interest rate introduces more uncertainty in the process of managing the household budget, and this in turn increases the likelihood that a certain type of negative sanctions, which is an additional burden on a household, will be used. As for hybrid ARMs, this is accompanied by a shock associated with the necessity of making "real", i.e. higher, mortgage payments after the initial period. Possible fluctuations in the interest rate reduce the stability of one's household budget expenses and create a risk of a temporary, and finally permanent, loss of creditworthiness on the part of a property buyer if his/her obligations exceed his/her financial capabilities.

Fixed mortgage interest rates allow one to overcome the information asymmetry between consumers and bank executives. A mortgage borrower makes a decision while knowing the entire obligation value. A fixed interest rate provides information which, to a large extent, protects a borrower against "flexibility" in calculating mortgage payments. A variable interest rate increases the opportunity for manipulating information and the customer. When it is used, those who offer mortgage loans fuel property buyers' unrealistic expectations concerning a constant decline in the value of mortgage payments or a continuously low level of these payments in the immediate and distant future. These expectations may influence the way in which borrowers manage their household budgets, also with regard to other areas of consumption, thus reinforcing their tendency to run up excessive debts. Unlike in the case of fixed-rate mortgages, a consumer who has taken out an adjustable-rate mortgage only knows the amount of the first, initial mortgage payment. Therefore, these consumers' creditworthiness may be overestimated, which can also be a consequence of the low level of education of some of the borrowers who choose ARMs and their poor knowledge of economic issues. They may regard the low mortgage payments that are to be made at the initial stage as a constant trend and treat them as the only reference point for estimating the whole amount of the debt. For bank executives, low initial payments are a marketing strategy which they use in order to attract customers and the costs of which can be recouped at later stages of the mortgage loan life-cycle.

For a mortgage borrower it is the moment of taking out a mortgage loan that counts. The protective value of fixed mortgage payments is even more evident against the background of an increase in variable interest rates. This means that one derives income benefits from choosing a fixed-rate mortgage, and not an adjustable-rate mortgage. The stage of life one is in is a decisive factor in purchasing a home. Property buyers do not always have the chance to take out a mortgage when the level of mortgage rates is most optimal. For example, a loss of income advantages during a period when the variable interest rate is lower than the fixed interest rate for the mortgage one has taken out is the cost that a given consumer must incur in exchange for being protected against a decline in his/her creditworthiness. Here, the risk resulting from a change in the interest rate is reduced. The mortgage borrower knows the total amount of his/her obligation and mortgage payments represent fixed expenses in his/her household budget. Since borrowers can avoid "surprises" related to an increase in the value of mortgage payments, this is conducive to pursuing a strategy which is aimed to pay off the mortgage loan at an earlier time. With this end in view, a mortgage borrower can build up savings while managing his/her household budget during periods in which he/she earns a higher income. These savings constitute funds which can be used to make mortgage payments and which are not affected by an increase in mortgage interest rates.

Since ARMs have higher arrears rates than FRMs in the U.S. market, this makes it impossible to put forward a hypothesis that the type of mortgage interest rates is not important for borrowers in the long run. Variable-rate mortgage payments pose a greater threat to household budget liquidity than fixed-rate mortgage payments. The need to wait for a reverse trend and a reduction in mortgage interest rates can be unbearable for many households. Potential long-term income advantages may be thwarted by current problems associated with maintaining a household. For mortgage borrowers with low creditworthiness it is the amount of the current mortgage payment that is important.

In Poland borrowers have been deprived of the protective value of fixed mortgage interest rates. For example, most variable-rate mortgages that are taken out in Polish zlotys are calculated based on the three-month WIBOR rate. The downward trend that lasted from 2001 to 2014 can be cited as an argument supporting the assertion that variable interest rates were beneficial to borrowers during this period. In 2000 the WIBOR rate was higher than 16%, whereas in 2002–2014 it decreased below 8% and reached a low of 2.06% in November 2014. A decrease in WIBOR performed a protective function with respect to borrowers during this period. On the other hand, it should be noted that foreign currency mortgages, especially Swiss-franc mortgages, had a similar protective effect on property buyers during a certain time period. The reversal of the trend and the increase in the exchange rate of the Swiss franc against the Polish zloty shows that protective properties that are based on changeable parameters are limited in time. The protective value of these parameters was also reduced due to various forms of "flexibility" in calculating mortgage payment amounts. For example, the amount of debt that was denominated in Swiss francs was calculated based on the so-called currency spread. The customers were obligated to buy the currency from the bank from which they took out a mortgage and pay more than they would have paid if they had exchanged money at bureaux de change or other banks. While this spread was not that burdensome when the Swiss franc's exchange rate was low against the Polish zloty, it constituted an additional burden for borrowers with mortgages in Swiss francs when the exchange rate started growing. Similar forms of "flexibility" are also practiced with regard to variable-rate mortgages that are taken out in Polish zlotys. Bank executives may delay their reaction to a decrease in WIBOR by postponing a reduction in mortgage payments.

Banks in Poland have only recently started to offer fixed mortgage interest rates. The continued low WIBOR rates increase the chance that it will be possible to use protective properties of mortgage interest rates of this kind in the future. However, banks do not offer a fixed interest rate throughout the mortgage term, but only for a period of 2, 5 or 10 years. After this period has elapsed, a variable interest rate period begins, or customers can again choose a fixed interest rate option in certain banks regardless of the previous interest rate value. However, customers are not much interested in mortgages of this kind.

Most of all, such mortgages have higher interest rates than variable-rate mortgages, but this is a standard practice in mature mortgage markets. What is problematic is the difference between these mortgage interest rates. Bank executives mitigate the risk of interest rate variability by shortening fixed interest rate periods. The hybrid nature of some of these products may give mortgage borrowers a shock associated with the necessity of making higher payments after the end of the initial period. A reluctant attitude towards fixed-rate mortgages, apart from limitations related to products that are offered by banks, shows that there is a certain market convention in Poland that indicates that a low WIBOR rate must be a stable trend.

Conclusion

The view that a downturn in the housing market usually occurs once in a generation in a given country because this is the amount of time that must pass for people to forget negative experiences is a product of professional social consciousness. Under conditions of "turbo-capitalism", housing bubbles can start emerging at a much earlier rate. The strategies and effects which are identified in this paper and which lead to a reduction in mortgagors' level of risk consciousness not only do not protect consumers against the risk but may also significantly increase this risk. Mortgage borrowers with low creditworthiness are not protected by the imitation strategy, which involves making decisions based on the behaviour of other market participants, even if all these consumers have similar economic status. Moreover, the professionalisation strategy does not have to protect bank customers from the shackles of a given market convention. The compensation effect usually does not have any importance as far as income is concerned, whereas the investment effect leads one to overestimate the value of the property that has been purchased.

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http://dx.doi.org/10.18778/8088-012-2.12

The determinants of an organization's value

12. Analysis methods to assess the competitiveness of enterprises

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Abstract

This paper analyzes the existing methods for assessing the competitiveness ofenterprises. In the comparative analysis of methods are determined the disadvantagesand feasibility of using each method. The author confirmed that at this time thereis no generally accepted evaluation system to assess the competitiveness of enterprises. The author to expediently and efficiently determine the level of competitiveness of an enterprise offers a method entitled "Assessment of the competitiveness of industrial products", developed by K. Nurmagambetov.

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Introduction

The assessment of an enterprise's competitiveness has important significance for the survival and development of enterprises, and also has an important reference value for enterprises decision-making. The assessment of competitiveness of an enterprise permits it to solve the following crucial issues:

1) to determine its position on a specified market;
2) to develop strategic and tactical measures of for effective management;
3) to choose partners for the organization of joint products production;
4) to attract facilities for prospective production;
5) to make programs of an enterprise's entrance into new sales markets, etc.

Many publications cover the questions of the assessment of an enterprise's competitiveness. These publications differ by the level of methodological and theoretical generalization: from fully formed theories (such as Porter's theory of competitive advantage and competitive advantages based on values theory etc.) to papers containing strictly particular aspects of competitiveness. Many papers are connected with analyzing the factors of an enterprise's competitiveness when enterprises differ from each other by the nomenclature of considered factors (from several pieces to two-three dozen) according to their classification and grouping (Maksimov, 1996; Baumgarten, 2005; Fathutdinov, 1999).

There are various methods for assessing the competitiveness of enterprises. Each method has its own characteristics: the authors justify the use of different approaches for the calculation of indicators of an enterprise's competitiveness, the need to consider various factors to assess, etc. Not all of the existing methods of enterprise competitiveness evaluation completely appropriate for a particular organization. Therefore it is very important to choose the method that is most suitable to the position and the activities of the organization.

The purpose of the article is based on the comparative analysis of different methods for assessing the competitiveness of enterprises to offer the most appropriate method to use.

12.1. Comparative analysis methods for assessing the competitiveness of enterprises

Currently there is no generally accepted method of assessing competitiveness. There are many methodologies for assessing the competitiveness of an enterprise used in practice or proposed by some authors as research development. Every company evaluates its competitive position in its methodology, and the nature and effectiveness of its use does not advertise. The evaluation of the competitiveness of the enterprise is a complex multifactorial problem, which leads to the interpretation and evaluation of a set of indicators that characterize different aspects of the enterprise, which form its competitiveness.

The study and research of competitiveness of enterprises, as well as its assessments focus on the work of M. Porter (1979), Ph. Kotler (1985), G. Azoev (1996), K. Nurmaganbetov (1997), M. Gorynia (1998), R. Fatkhutdinov (1999), Z. Pierścionek (2006) and others who develop theoretical and methodological aspects of the evaluation of competitiveness of products and enterprises. However, despite a lot of published material on this important topic, a recognized and universal technique for comprehensive assessment of the competitiveness of enterprises does not currently exist. This circumstance is explained by the complexity of the problem.

The theory of competitive advantages, authored by M. Porter, considers that business entity competitiveness must completely and most effectively use all available resources (Porter, 1985). The mathematical aspects of the theory of comparative advantages are reflected in research papers by P. Samuelson and W. Stolper (Samuelson 1994). But this concept is abstract and difficult to implement in practice. It is more appropriate for competitiveness assessment of companies which primarily operate in international markets. Moreover, this methodology is difficult to use when assessing the competitiveness of exporting enterprises as existing preferences characterize not only the company under study, but also the attractiveness of the industry as a whole.

There are a large number of firms, for which, by the ever-changing production and the lack of technical documentation the most effective evaluation method is the competence approach (Larichev and Moshkovich, 1996). The main nonformalised method is based on the results of the expert evaluation.

Some authors consider time as one of the coefficients of achieving enterprise competitiveness. The separate directions of optimization of the time parameters of enterprise activities are as follows: speed of its adaption, terms of payments, duration of production cycle, speed of decision making, etc.

On the basis of analysis of the international experience, it is possible to provide a classification of the basic approaches and methods of enterprise competitiveness evaluation.

The most widespread method is investigation of the enterprise competitiveness on the basis of the theory of international division of labor.

A prerequisite for the achievement of a strong competitive positions by the enterprise is availability of advantages which give a chance to provide rather low manufacturing expenses in comparison with competitor.

There are widespread methods of the enterprise competitiveness evaluation based on the theory of effective competition. According to this theory the most competitive are companies where the best arranged work of all services and divisions. On the efficiency of each of the services is influenced by a number of factors, resources of the firm. Evaluation of the effectiveness of each of the units involves an assessment of the effectiveness of the use of these resources (Lobanov, 2001). There are two basic approaches to the determination of competitiveness criterion within the framework of this theory: structural and functional.

According to the structural approach, enterprise status can be evaluated in the light of knowledge of the industry monopolization level, i.e., concentration of production and capital, and the barriers to new enterprises entering the market. The basic obstacles on the way of new competitors are as follows: the profitability of large-scale manufacturing; degree of production differentiation; absolute advantages in cost of existing enterprises; amount of capital required for organization of effective manufacturing.

The functional approach consists in determination of the price-cost ratio, the level of the use of production capacities, production output, rate of return, etc. According to this approach, enterprises with more efficient production and sales and effective financial management are more competitive.

There are worth noting methods of enterprise competitiveness evaluation that are based on firm and industry equilibrium theory and the theory of production coefficients. The criterion for competitiveness within the framework of such an approach consists in possessing by the manufacturers of production coefficients which can be used with greater productivity as compared to the competitors. According to the equilibrium theory analyzed are the following: credit interest rates; relative cost of purchased tooling; relative rates of wages; relative cost of material resources (Chursin and Makarov, 2015).

Competitiveness of the enterprise is also evaluated according to quality of production with the help of the polygonal profiles method. This method is one of a few techniques to provide visualization of evaluation. Unlike other approaches, this method provides an investigation of the market segments, an evaluation of a possibility of changing production profitability, and the sale with allowances made for market requirements, as well as an analysis of the marketing network. The method is based on the identification of criteria of meeting requirements in relation to a concrete product, on the establishment of a hierarchy of demand, their comparative significance within the spectrum which an ordinary consumer can evaluate. The scientific literature, as a rule, presents polygons of comparative characteristics of the enterprise competitiveness according to eight vectors of competence: concept, quality, price, finance, trade, after-sale service, foreign policy, and presale preparation (Pechenkin, 2011). The basic drawback of the specified method consists in the fact that it does not take into account the effectiveness of industrial activity of the enterprise and is acceptable for the enterprises with only one type of product.

Being of interest are the so-called matrix methods of assessment of enterprise competitiveness based on the use of matrix tables organized by rows and columns of elements (Dubinina, 2013). There are many matrix models, which can be used to assess the level of competitiveness of the enterprise: matrix "The growth of the industry/market share" (model BCG); matrix "market attractiveness/competitive position" (model GE/McKinsey); directional policy matrix or "industry attractiveness/competitiveness" (model Shell/DPM); matrix "stage of the market/competitive position" (model Hofer/Schendel); matrix "stage of the life cycle of products/competitive position" (model ADL/LC). Using matrix methods, executives have the opportunity to assess the level of competitiveness of potential of not only their company, but also its closest competitors, which will help to develop a strategy of market behaviour.

The said methods are evident and simple in terms of calculations. The advantages of these methods darken their drawbacks too: visualization is provided at the expense of a simplified solution with the loss its accuracy. Such methods make it possible to successfully identify the status of goods in the market and prospects for the development of these goods according to their life cycle, showing the position of several competitors and giving representation of their opportunities. The reality is that the application of such methods is effective in combination with other more accurate methods, they illustrate.

A separate group includes the methods which based on the evaluation of competitiveness of enterprise products. This group of methods is based on the idea that competitiveness is higher, the higher the competitiveness of their products. To determine the competitiveness of products uses various marketing methods, which are based on finding the ratio price-quality (Fathutdinov, 2004). The calculation of the index of competitiveness for each type of products is carried out using a parametric and economic competitiveness index. In turn, these indices are determined by summation of the partial indices for each evaluated parameter with the given weighting coefficients. Each of the partial indices on the relevant parameter is taken as the ratio of the actual values of the estimated parameter to the value of the corresponding index of competing products (or other products, selected as basis for comparison). In this case the parametric index is determined on the basis of technical evaluation (quality) parameters of products of economic value (Tkachuk, 2015). The list of cost and technical parameters, as well as the weight of each of the parameters set by the expert.

Methods classified under this approach are defined as complex due to the fact that the assessment of the competitiveness of enterprises under each of the methods is conducted by identifying not only current but also potential competitiveness of the enterprise. The approach is based on the assertion that competitiveness is the integral value in relation to current competitiveness and competitive potential (Ivanov, 2008).

Hence, this analysis of specified approaches and methods shows that the problems of assessing competitiveness of the enterprises yield a relatively complete picture in the modern literature. As a whole, the competitiveness of the enterprise is determined given the influence of market coefficients. However, as a rule, these coefficients do not provide a complex quantitative evaluation of their competitiveness. Besides, a common drawback of the specified methods is that they are not adapted to being used in conditions of formation of market relations and give incomplete characteristics of the enterprises being estimated.

Thus, each of the approaches to the assessment of competitiveness of enterprise has both advantages and limits of efficient application and disadvantages. The main methods of evaluation, their disadvantages and feasibility of using are shown in table 12.1. Some methods and approaches within certain limits, duplicate others, but these differences are, in our view, complementary rather than mutually exclusive.

Method	Benefits	Disadvantages	Feasibility of using
The method is based on an analysis comparative advantage	Allows you to compare the scale of enterprises	Static these estimates. Makes it impossible to assess the process of enterprise adaptation to environmental conditions	It is possible to apply the method to assess the competitiveness on a macro level
The method is based on equilibrium theory of firm and industry	Used at the sectoral level	Takes into account mainly the external conditions of the company, virtually excluding the impact of the internal environment factors	The most widespread such an approach is to assess compe-ti-tiveness at the industry level

Method	Benefits	Disadvantages	Feasibility of using
The method is based on the theory of effective competition	Comfortable and covers the main activities	Does not assess the dynamics indicators	It is possible to use the method to assess the competitiveness of enterprise
The method is based on the theory of product quality	Evaluates competitive based on customer value product	It seems that competitiveness is identified with the competitiveness of goods on competitive products – from their quality	The method is used to assess the competitiveness of enterprises
The matrix method	May apply not only to products but also to businesses, compa-nies, and industries. Allows you to conduct a qualitative analysis competitive position	The complexity of the process of formation and selection strategies for certain quadrants matrices, static character matrix, taking into account only two parameters	Used to previous research a particular situation in a particular type of business or enterprise rapid assessment
The integral method	Easy calculations; unambiguous interpretation calculations	Not allow for a detailed analysis Is difficult to conduct for companies with a large product range of products	Used to express the evaluation of 2 businesses
The financial and economic method	We give an objective and complete assessment of the strengths and weaknesses of the company. Preparation of market rating. Easy-to use and affordability	Not captured elements of the marketing mix. Remains unattended management company	Application is possible and necessary
Method of rating score	Quite accurately determines the position of the company under analysis compared to its competitors for a particular parameter at a define time	Complexity in calculat-ing the initial and receiving data	It is possible for the target comparison enterprises of the industry or region
Method on the basis of the expert method	Allows quickly and without much time and labor to obtain the information necessary to develop adminis-trative decisions	Does not take into account operational and financial performance	It can be used when required to take quick decisions

Method	Benefits	Disadvantages	Feasibility of using
Benchmarking Method	Allows you to know where your enterprise stands when compared to your competitors	Simply helps you to spot areas which need improvement. It does not contribute in solving the issues in hand	The method brings the focus thethe areas which should be given special attention

Table 12.1. Comparative characteristics of methods for assessing the competitiveness of enterprises
Source: own study on the basis Nesterenko O. (2014), *Comparative analysis methods for evaluation enterprise competitiveness*, "Scientific Journal of Odessa National Economic University", Vol. 19, No. 4, p. 86–94.

The methods presented in table 12.1 are only part of a large number of approaches to assessing the competitiveness of an enterprise. All these methods are united as a fact, as the need to consider a variety of source data.

Taking into account the results of the comparative analysis of the methods the author suggests that for a more expedient and productive method of determining the level of competitiveness of enterprise competitiveness of manufactured goods can be used the "Evaluation of the competitiveness of industrial products" method developed by K. Nurmaganbetova (1997).

The advantage of this method is that it takes into account the most important factor affecting the competitiveness of the enterprise – the competitiveness of goods. However, this approach allows us to obtain a complete understanding of the advantages and disadvantages in the enterprise, as a company's competitiveness takes the form of goods and affects the competitiveness of technological, organizational and economic aspects of the enterprise market.

Consider the example of this method. An example would be carried out on the basis of enterprise LLP "Alma Protex" (Datastream, 2014; LLP "Alma Protex") and its products – apples.

Competitiveness of fruit is determined by three main factors: the ability to meet the particular needs of the potential buyer, price and sales organization.

Meeting the needs is provided by consumer properties of fruits, quantity, relevance and value of which are different for each product. A set of consumer characteristics, their levels determine, ultimately, the level of use value or utility of the fruit to the consumer. Naturally, for the consumer it will be a more attractive product with higher levels of use-value.

The indicators characterizing the level of consumer properties (LCP) of fruit (apples) are as follows: taste, energy and biological value, appearance, smell, preservation ability and freshness.

Indicators of the level of organization of the sale (LOS) of apples are as follows: culture and level of service, availability of goods to the consumer, time and place of sales organization, assortment and promotional activity.

Price is a monetary expression of value of goods. The potential buyer, choosing apples at the market tends to buy apples with a higher level of consumer properties, sales organization and lower costs.

In this method was proposed the following formula to calculate the level of competitiveness of product manufactured in an enterprise) (Petukhov and Nurmaganbetov, 2006, p. 88):

$$\boldsymbol{Є}_{g/c} = \left(\frac{LCP_g}{LCP_c}\right)^{\alpha} \times \left(\frac{P_c}{P_g}\right)^{\beta} \times \left(\frac{LOS_g}{LOS_c}\right)^{\gamma} \tag{12.1}$$

where:
Ct_g – indicator of competitiveness of an apple of given firm,
LCP_g and LCP_c – assessment (in grades) of levels of consumer properties of an apple of given firm and competitor,
P_g and P_c – price of an apple of given firm and competitor,
LOS_g and LOS_c – assessment (in grades) of levels organization of the sale of an apple of compared firms,
α, β, γ – level of value of *LCP*, its price, *LOS*.

Coefficients α, β, γ are determined by experts in the field of marketing.

The above formula (12.1) quantifies the preference for consumer the product of given firms with respect to similar products of competing firms. If the value of indicator ($Ct_{g/c}$) equal to unity the estimated product has equally competitive with comparable products of competing firms. The greater extent of the figure ($Ct_{g/c}$) more than unity, the more the given product is competitive. Evaluated product will be uncompetitive at the value of indicator ($Ct_{g/c}$) less than unity.

Level of consumer properties (*LCP*) can only be measured in arbitrary units and only with the help of expert judgment: in points or relative ratios. *LCP* is determined by the following formula (Petukhov and Nurmaganbetov, 2006, p. 89):

$$LCP = q_1^{m1} \times q_2^{m2} \times q_3^{m3} \times ......q_n^{\mathbf{m}} \tag{12.2}$$

where:
LCP – the level of use-value of apples,
$q_1, q_2, \dots, q_n$ – numerical score of individual consumer properties of apples,
*m*1, *m*2, …, *mn* – coefficients of relative value of consumer properties of apples.

If *LCP* = 10, level of consumer properties of apples fully correspond the level of customer requirements, i.e. apples has the required utility. If *LCP* = 0 this means that for the consumer apples are completely unsuitable.

Let's consider calculation of *LCP* of apples of given firm and firm – competitor. Expert score of *LCP* of apples is shown in table 12.2.

No.	Properties of the product	LLP „Alma Protex"	Competitor company	Coefficient of relative importance
1	Appearance	6.7	7.2	0.159
2	Preservation ability	5.1	6	0.147
3	Smell	6.9	6.5	0.156
4	Taste	6.1	5.9	0.178
5	Freshness	5.7	6.1	0.157
6	Energy and biological value	7.6	6.5	0.203
				1.000

Table 12.2. Assessment of levels of consumer properties of apples LLP "Alma Protex" and apples of Competitor, scored on a 10-point scale
Source: calculated by the authorbased on the results of Experts.

L

$$LCP_g = 6.7^{0.159} \times 5.1^{0.147} \times 6.9^{0.156} 6.1^{0.178} \times 5.7^{0.157} \times 7.6^{0.203} =$$
$$1.35 \times 1.27 \times 1.35 \times 1.38 \times 1.31 \times 1.51 = 6.32 \qquad (12.3)$$
$$LCP_c = 7.2^{0.159} \times 6^{0.147} \times 6.5^{0.156} \times 5.9^{0.178} \times 6.1^{0.157} \times 6.5^{0.203} =$$
$$1.37 \times 1.30 \times 1.34 \times 1.37 \times 1.33 \times 1.46 = 6.34$$

The price of one kilogram of apples:

$$P_g = 1.22€; P_c = 1.25€. \qquad (12.4)$$

Level of sale organization is also measured in units, and with the help of expert assessment: in points or relative ratios. Calculation of the LOS is carried out in the same way as *LCP* by formula (12.3) (Petukhov and Nurmaganbetov, 2006, p. 89):

$$LOS = b_1^{k1} \times b_2^{k2} \times b_3^{k3} \times ...b_n^{kn} \qquad (12.5)$$

where:
LOS – the level of organizations of sales of apples,

$b_1, b_2, \ldots, b_n$ – numerical score of different indicators characterizing the level of organization of sales of apples,
$k1, k2, \ldots, kn$ – coefficients of the relative importance of indicators of the level of organization sales of apples.

If $LOS = 10$, the level of consumer properties of apples fully corresponds to the level of customer requirements, i.e. apples has the required utility. If $LOS = 0$ this means that for the consumer the apples are completely unsuitable.

An expert assessment of the organization levels of apples soldby afirm, as well as the average score of the same indicator of competing firms are given in table 12.3.

No.	Indicators characterizing the level of organization of the sale	LLP „Alma Protex"	Competitor company	Coefficient of relative importance
1	Availability of goods to the consumer	6.3	7.3	0.15
2	Assortment	5.5	6.8	0.32
3	Promotional activity	4.3	5.2	0.1
4	Culture and level of service	6.2	6.3	0.18
5	Time and place of sales organization	6.4	7.21	0.25
				1.00

Table 12.3. Evaluation of levels of the organization of sales of apples LLP "Alma Protex" and apples of Competitor, scored on a 10-point scale
Source: calculated by the authorbased on the results of Experts.

$$\begin{aligned} LOS_g &= 6.3^{0.15} \times 5.5^{0.32} \times 4.3^{0.1} \times 6.2^{0.18} \times 6.4^{0.25} = \\ &= 1.32 \times 1.72 \times 1.16 \times 1.39 \times 1.59 = 5.82 \\ LOS_c &= 7.3^{0.15} \times 6.8^{0.32} \times 5.2^{0.1} \times 6.3^{0.18} \times 7.21^{0.25} = \\ &= 1.35 \times 1.85 \times 1.17 \times 1.39 \times 1.64 = 6.66 \end{aligned} \tag{12.6}$$

Next it is necessary to determine the level of competitiveness of the products LLP "Alma Protex" in relation to the products of competitors by formula (12.1). Expert methods set the value of coefficients of relative importance of individual components of the products competitiveness: α = 0,37, β= 0,35; γ = 0,28. Substitute the values into the formula (12.1).

$$Ct_{g/c} = \left(\frac{6.32}{6.34}\right)^{0.37} \times \left(\frac{1.25}{1.22}\right)^{0.35} \times \left(\frac{5.82}{6.66}\right)^{0.28} = 1 \times 1.01 \times 0.96 = 0.97 \quad (12.7)$$

This suggests that apples of given firms are unattractive compared with apples of competing firms (although to a lesser extent). Therefore, this product is a non-competitive product.

The level of competitiveness of a given firm can be elevated due to reduced of prices, improved consumer properties of apples, raises the organization of the sale.

The proposed method of evaluation of enterprise competitiveness level is based on product competitiveness. This method allows us to analyze the influence of varied factors affecting the level of competitiveness, in particular, the parameters of an external situation coupled with internal activities. In the above example were considered the main factors affecting the competitiveness of the product. Also, it is possible take into account other important factors. It depends on the type of product, on the expert opinion and on the needs of customers. This indicates that the method is universal and can be used in other areas without any problems. The main advantage of the proposed method can be considered that on the basis of determining the coefficient of the competitiveness of the product, an enterprise evaluates its capabilities and determines the most effective ways and means to improve the competitiveness of products.

In addition, important advantages of the method are its clarity, transparency and possibility of adaptation to any industry that enables ease of usage by domestic enterprises.

Conclusion

The above study demonstrates the existence of a large number of different methods for assessing the competitiveness of enterprises which differ both in the way of assessment (formal and non-formalized) and the nature of the initial interpretation of the results (based on comparative advantage, matrix, and integral methods). The variety of methods to assess competitiveness of enterprises is primarily due to the objectives that contribute to in the estimates, the number of companies competing in the industry and the accessibility of information received.

Existing methods for evaluating an enterprise's competitiveness in modern conditions have certain limits of effective using and disadvantages, the main of which is their static nature, not taking into account the parameters of product quality, credibility of the relevant trade mark, level of social responsibility, the intensity and effectiveness of advertising and so on.

In order to solve certain problems associated with the assessment of the competitiveness of the enterprise was proposed the "Evaluation of the competitiveness of industrial products" method developed by K. Nurmaganbetova. The main advantage of the proposed method can be considered that on the basis of determining the coefficient of the competitiveness of the product, an enterprise evaluates its capabilities and determines the most effective ways and means to improve the competitiveness of products.

Therefore, an important task to solve this problem, in our view, is to create an appropriate methodological framework of criteria and evaluation of competitiveness of the enterprise, choice of adequate instruments which meet the requirements of the modern market environment and contemporary trends in the industry, as well as the formation of specific criteria for the evaluation and selection parameters of assessment – competitive advantages of enterprises.

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http://dx.doi.org/10.18778/8088-012-2.13

13. The competencies of global managers in multinational corporations

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Abstract

Purpose:

Multinational corporations have become one of the most important drivers of continuous globalization and constant developments in the global economy. Doing the business globally, across borders in diversified environment they have given rise of and put an emphasis on such concepts as "global managers" and cross-cultural management. The aim of the article is to identify of the key competences of global managers in cross-cultural management of multinational corporations.

Design/methodology/approach:

The methodology for this study is a review of the relevant literature on global management competencies. The authors looked into the

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knowledge, competencies and skills of global mangers in multinational environment.

Findings:

A critical analysis of the literature enabled an identification of the key competencies of successful global managers such as cultural self-awareness, intercultural communication or global mindset. It showed also the role of cross-cultural management in multicultural enterprises

Research limitations/implications:

The literature review conducted in this paper reveals the gap in the research on global managers' competencies and their impact on the performance of multinational corporations.

Original value:

The competences of global managers of multinational corporations are not studied very often; however they seem to be very important source of success of the MNCs. The literature review gives an insight to the current state of knowledge in this field required for managers working in culturally diverse teams in multinational corporations.

Introduction

Multinational corporations have become one of the most important drivers of continuous globalization and constant developments in the global economy. They are doing business in many countries, at the crossroads of different cultures. There is a need to diagnose what type of managerial competence will effectively manage intercultural teams. Globalization also puts an emphasis on the development of skills that are universal and have a global character, regardless of culture (Lankau, 2009).

Although about 4,000 researches have been conducted, but a cross-cultural leadership theory has not been created yet. The existing theories are based mainly on Anglo-American cultures therefore they do not explain the behavior of managers in other cultures.

To fill the gaps described in the research and the creation of leadership theories that explain the cultural conditioning of leadership, Professor Robert House launched a GLOBE research project (Mączyński and Łobodziński, 2009). Based on cultural diversity studies have shown that if a company wants to be successful in other markets it must take into account the social and cultural conditions of these countries (Yüksek and Bekmeier-Feuerhahn, 2013).

Experts in international business agree that managers in order to succeed in global business will need the flexibility and appropriate attitudes towards practices and values, which may be drastically different to those to which they are accustomed to. Being a global manager is not only about where they are managing people but how they are doing it (Javidan and House, 2001).

13.1. Cross-cultural management

Nowadays as a result of globalization, mergers and acquisitions, population migration managers face the challenge of managing in a multicultural environment. Cooperation with both superiors and subordinates from different nationalities, working in new markets characterized by local conditions entails the acquisition of additional qualifications by managers that will allow them to work in multinational environment (Szaban, 2012).

Managers and leaders as well as their subordinates are part of the national communities. Therefore in order to understand their behavior, managers should know the specificities of the population, as this knowledge may be necessary to understand the methods and procedures used in the management style used in the country in question (Hofstede and Hofstede, 2007).

Quinn's studies have shown that no one management style is effective in all cultures. Only managers that have been able to play all the roles were able to manage cross-culturally (Quinn, 1991).

In the literature, the most frequent national management styles are American, European, Chinese and Japanese. Modern management theories do not take into account the different models of organizational culture of companies and the national culture of their employees. In each country, the term management means something else. Thus, the use of management style of one culture in another may be ineffective. Management theories should always be interdisciplinary (Hofstede, 1993).

Cross-cultural management discipline has been distinguishes in the 80s of the twentieth century (Kostera, 1997). There are three phases of development of it. In the 80s we had the phase of cultural divergence when the differences in national cultures were highlighted, it was clear that the need was to adapt the management style to the nationality of the people with whom we work with. In the 90s, there were two new approaches. The first was the convergence of nations which meant the cultural assimilation as a result of globalization, which resulted in the emergence of the global manager that regardless of the culture from which it derives may represent a set of convergent traits.

At the same time, another approach emerged which promoted cultural diversity and stated that management should be adapted to local conditions, and should learn from other cultures. Currently, the dominant approach is the "combined approach" which reconciles the cultural convergence of divergence (Jakob, 2003). Trompenaars' studies have shown that if something works in one culture, there is a small chance that it will work well in another (Trompenaars, 1993).

The definition of cross-cultural management presented by W. Burggraaf: "Cross-cultural Management is a link between knowledge, experience and skills necessary to act appropriately in the context of national and regional cultures, taking into account the differences among cultures, at all levels of the organization and across organizations". Nancy Adler (2008) writes that cross-cultural management explains human behavior in organizations around the world and shows people how to work with colleagues and clients from many populations of different cultures.

Cross-cultural management is applied in multinational companies in order to solve problems rising between members of organization in both internal and external environment. Cross-cultural management is a new type of management that takes into account the cultural differences between staff in management in general, with a view to improve communication in the company and in its international exchanges (Greblikaite and Daugeliene, 2010).

The main cross-cultural problems of multinational companies are (Thomas, 2008):

- Culture – in business appropriate management of culture is essential.
- Management systems which differ depending on company size, activity, tasks.
- Work standards that vary depending on country.
- Practices in business differs among companies, cultures and countries.
- Implementation of ethics in business is difficult and a complex process.

Cross-cultural management's role is to fight these cross-cultural barriers or move them. Other important role of cross-cultural management is to avoid the formation of such barriers in multinational companies (Thomas, 2008).

Due to increasing globalization processes global managers face an environment that is more and more complex, dynamic, uncertain and competitive than ever before. The influence of culture on management can be most difficult to deal with because culture has a broad influence on behavior and on other environmental factors. It is very important to employ global managers having competences that will help them manage effectively in culturally diversified environment.

13.2. Key competencies of global managers

As a starting point, a global manager is defined as someone who works with or through people across national boundaries to accomplish global corporate objectives (Steers et al., 2010). Managers wishing to manage effectively in a multicultural environment, above all, should be aware of existing cultural differences and thus, both the benefits and barriers that can arise from them. According to the research organizations strive for diversity as they see it as their competitive advantage through innovation and the creativity of their employees. Therefore, the manager managing such a group should be able to take advantage of the variety of the team to develop innovative, unconventional solutions that will contribute to the success of the team and organizations (Bateman and Snell, 2012). The diversity may result from the cultural differences. In order to learn from the diversity manager should realize these differences and understand their background (Hofstede and Hofstede, 2007).

Some managers do not realize the significance of cultural differences and ignore them. A starting point is to gain a competence of cultural self-awareness. It is an understanding of the influence of one's own cultural conditioning. An appreciation of one's own cultural beliefs, values, assumptions is a prerequisite for an appreciation of other cultures (Adler, 2002; Cant, 2004; Sokuvitz and George, 2003; Moran and Riesenberger, 1994).

Very often managers, who have already succeeded in one environment are elected to carry out international projects, based on their experience, intuition and values assuming that they will be able to do the same thing in another culture or multicultural environment. However, it is not enough to work in an international environment, they must possess intercultural competence (Zarzu, 2013).

Steers suggests that effective global management is the integration of managerial skills with additional multicultural or cross-cultural competencies which allow people to use their managerial skills across a diverse environment. Intercultural competence is a profound understanding of how companies and management practices differ across cultures. This differentiates the successful from the less successful global managers (Steers et al., 2010).

Figure 13.1. Global management skills by Steers et al.
Source: Steers R. M., Sanchez-Runde C. J., Nardon L. (2010), *Management Across Cultures.Challenges and Strategies*, Cambridge University Press, New York, p. 37.

Intercultural competence can be defined as the ability to understand intercultural situations and the ability to adapt to it (Has, 2012). The process of acquiring these competencies should consist of such steps as the understanding of own culture, understanding the norms and values of other cultures, coping with diversity, a willingness to tolerate diversity, avoiding ethnocentrism, a preparedness to work and cooperate in a heterogeneous environment and the last step but not least the development of empathy (Zarzu, 2013). Intercultural competence is also a behavioral skills, affectivity, charisma, ability to cope with uncertainty and fears. Managers with such competences will perform better in the market than those who do not have them (Has, 2012). The need for an intercultural competence is noticed mainly among managers who aspire to the highest managerial positions in multinational corporations (Zarzu, 2013).

Intercultural competencies for global managers by Harris (Harris et al., 2004):

– A cosmopolitan outlook – Successful global managers are sufficiently flexible to manage well across divergent cultural environments. They understand the contradictions, dualities, paradoxes specific for the global business environment.
– Intercultural communication skills – Successful global managers should understand at least one foreign language. Additionally they should understand and appreciate the complexities of dealing with people from other cultures. They know how to listen as well as talk. They are able to both interpret the context of messages and the content.
– Cultural sensitivity – Successful global managers appreciate cultural diversity. They build relationships with culturally diverse people by using their experiences in different national, regional, and organizational cultures. Relationship building is critical.

- Rapid acculturation skills – Successful global managers adjust quickly to different surroundings. They understand the risks of insular thinking and action. They seek help when needed.
- A flexible management style – Successful global managers understand how national cultures affect the management process.
- Cultural synergy – Successful global managers know how to build cross-cultural teams. They capitalize on cultural diversity and understand the importance of building and using global networks.

One of the most comprehensive studies on intercultural leadership was carried out in the framework of the project GLOBE research. Leadership is defined as a person's ability to influence, motivate and enable others to contribute to the effectiveness and success of the organization of which they are members.

Studies indicate attributes of managers that were prototypes of the leaders in 62 different cultures, such as charisma, ability to communicate vision and willingness to change. According to the GLOBE research other universal leadership positive qualities include to be a trustworthy, just, honest, foresight, plans ahead, inspiring, with a vision, to be encouraging to action, positive, dynamic, a motive arouser, a confidence builder, motivational, dependable, intelligent, decisive, effective bargainer, win-win problem solver, administratively skilled, communicative, informed, coordinator, team builder, excellence oriented. Studies have also shown that there are many attributes of managers that are specific to a given culture[1] (Dickson et al., 2012).

The GLOBE research has also identified universal negative leader attributes such as loner, asocial, noncooperative, irritable, nonexplicit, egocentric, ruthless and dictatorial.

Cultural acument is an essential element for success in the management of people from different cultures, managers will need knowledge of the similarities and differences between cultures. They must also be aware of the consequences of existing differences and the ability to act and decide accordingly in a culturally sensitive way (Javidan and House, 2001).

A global mindset includes specific knowledge, skills and abilities that are essential in managing in multinational companies. It is also the capability to influence others unlike yourself (Javidan and Walker, 2012). Global mindset refers to one's ability of thinking on the global scale (Mohamed, 2012). In the beginning the global mindset was conducted by at the individual level. Recently research on global mindsets has been considered by top management teams (Bouquet, 2005; Levy, 2005). The construct of

1 Similar tests were also conducted Den Hartog (1999), Dorfman (1997).

Global Mindset[2] consists of three major dimensions: Intellectual Capital, Psychological Capital and Social Capital (Javidan and Walker, 2012).

Intellectual Capital consists of (Javidan and Walker, 2012):

1. Global Business Savvy: Knowledge of the way world business works
– Knowledge of global industry,
– Knowledge of global competitive business and marketing strategies,
– Knowledge of how to transact business and manage risk in other countries,
– Knowledge of supplier options in other parts of the world.
2. A cosmopolitan Outlook: Understanding that the manager's home country is not the center of the universe
– Knowledge of cultures in different parts of the world,
– Knowledge of geography, history and important persons of several countries,
– Knowledge of economic and political issues, concerns, hot topics, etc., of major regions of the world,
– Up–to–date knowledge of important world events.
3. Cognitive Complexity: Global is just more complicated than domestic–only.

Psychological Capital consists of (Javidan and Walker, 2012):

1. Passion for diversity: Do not just tolerate or appreciate diversity, but thrive on it
– Interest in exploring other parts of the world,
– Interest in getting to know people from other parts of the world,
– Interest in living in another country,
– Interest in variety.
2. Quest for Adventure: The Marco Polos of the world
– Interest in dealing with challenging situations,
– Willingness to take risk,
– Willingness to test one's abilities,
– Interest in dealing with unpredictable situations.
3. Self–Assurance: The source of psychological resilience and coping
– Energetic,
– Self–confident,
– Comfortable in uncomfortable situations,
– Witty in tough situations.

Social Capital (SC) – the behavioral aspect of Global Mindset consists of three building blocks (Javidan and Walker, 2012):

2 Construct prepared by Global Mindset Project (GMP) started in late 2004 at the Thunderbird School of Global Management.

1. Intercultural Empathy: Display "global" emotional intelligence
- Ability to work well with people from other parts of the world,
- Ability to understand nonverbal expressions of people from other cultures,
- Ability to emotionally connect to people from other cultures,
- Ability to engage people from other parts of the world to work together.
2. Interpersonal Impact: Difference maker; seldom ignored across boundaries
- Experience in negotiating contracts in other cultures,
- Strong networks with people from other cultures and with influential people,
- Reputation as a leader,
- Credibility.
3. Diplomacy: Seeks first to understand, then to be understood
- Ease of starting a conversation with a stranger,
- Ability to integrate diverse perspectives,
- Ability to listen to what others have to say,
- Willingness to collaborate.

Global mindset emerged as a key competitive advantage for multinational corporations competing globally (Levy et al., 2007; Begley and Boyd, 2003). Additionally, the global mindset of global managers is considered as a main source of a long-term competitive advantage (Gupta et al., 2008; Levy et al., 2007; Begley and Boyd, 2003; Jeannet, 2000; Paul, 2000; Murtha et al., 1998; Rhinesmith, 1996, 1995; Bartlett and Ghoshal, 1989). In consequence multinational corporations need a huge number of managers with a global mindset so that they can handle the increasing diversity not only globally but also locally (Javidan and Bowen, 2013; Wiseman, 2012).

A widely described feature of a global manager is the intercultural communication. Ability to communicate with different cultures through awareness of diversity, by gaining knowledge about the values and symbols of other cultures and the ability to use them. It is a skill that can be learned (Hofstede and Hofstede, 2007).

Level of spoken language by members of intercultural teams is not without significance. Different degrees of proficiency and communicative competence can lead to obstacles to effective team building and cooperation. Good knowledge is not always enough, it is also needed to build a good relationship and common understanding so called Rapport (Cohen and Kassis-Henderson, 2012). The level of language proficiency is important but not sufficient, as culture is not only the language, but also the values, beliefs, norms. Intercultural communication does not mean that the whole group should adopt the same language or the same values but rather a common understanding, acceptance of the culture of each member of the group and the ability to learn from diversity (Zarzu, 2013). Effective communication consists of listening skills, the ability to transfer information in a manner understandable to the recipient, and the ability to give and receive feedback (Javidan and House, 2001). The GLOBE study results are an interesting clue how to conduct an effective intercultural communication. A manager knowing the levels of the cultural dimensions for the country, knows what to expect and how to deal with people from different cultures in multinational corporations.

An important aspect of management in the international environment is the way the manager delegate tasks, makes decisions, discusses the problems and give feedback. So all these things add up to communication behavior. It has been distinguished task-oriented approach and relationship-oriented approach, characterized by empathy and respect towards the employee. The way of communication is particularly important in the management of intercultural teams, as the problems arising from difficulties in intercultural communication can cause high costs (Zhao and Parks, 1995).

According to a study by Ruben and Kealey (1976, 1979, 1989) and by Kiechel (1994), Kim (1989), Zhao and Ober (1991) emerged the following dimensions of communication competencies that are predictors of success in intercultural management:

- Adaptation – the ability to learn and adapt and behave in accordance with the standards and practices of the community in which we work,
- Showing respect – in many ways through eye contact, posture, showing an interest,
- Empathy – the ability to understand the situation and feelings of the other person by giving and receiving feedback,
- Interaction Management – the ability to negotiate, conduct meetings, communicate decisions,
- Interaction posture – the ability to respond in a descriptive and not judgmental way,
- Orientation to knowledge – flexibility with which explains things to different people in different situations in order to achieve the same results,
- Role behavior – ability to perform both roles aimed at maintaining relationships and roles focused on the task realization and the ability to avoid self–centered attitude.

Another competence of the global manager is the flexibility, which should manifest itself in the ability to adapt management style to the conditions other than domestic. In order to make good decisions and properly evaluate situations and causes of behavior and way of thinking of individual employees a manager should also have the patience (Szaban, 2012).

According to the research of Snell and Batemann the most desired features of global managers working in the cross–cultural environment are:
- Sensitivity to other cultures, the ability to understand them,
- A good understanding of the business, which they lead,
- Courage in making difficult decisions,
- Ability to extract from the employees what their best,
- Trustworthiness,
- Orientation to the organization's success,
- The ability to take risks,
- The ability to learn new and learn from others,
- Ability to use information from subordinates,
- Taking challenges despite working in unknown conditions,
- Openness to criticism,
- Acting and thinking in a flexible way.

Global baseline competencies	**Global skills and knowledge capabilities**	**Global mindset**
Catalytic learning capacity	Ability to lead multicultural teams	Comfort with cultural complexity and its contradictions
Sense of adventure	Sophisticated networking competence	Opportunity sensing for the uncertainty of global markets
Entrepreneurial spirit	Cultural literacy	Systems thinking in global contexts
Sensitivity and responsiveness to cultural differences	Context-specific leadership capabilities	Extended time perspective

Table 13.1. Global leadership capabilities by Conger and O'Neil
Source: Conger J.A., O'Neil C. (2012), *Building the bench for global leadership*, "People & Strategy", No. 35(2), p. 52–57.

Conclusion

Competencies, traits, skills that a good manager should possess, vary from culture to culture. There are various prototypes of successful managers. Studies show that a factor such as culture has an impact on the perception of leadership behavior and attributes that are considered effective (Lankau and Chung, 2009).

Studies show that the characteristics of a good leader vary depending on the culture from which the respondents come from. In one culture one characteristic may be seen as an advantage for others it can be a disadvantage, and vice versa. This results from the study J. Schramm-Nielsen, E. Jackofsky, J. Slocum, I. Tollgerdt-Andersson. Leadership style appropriate for one cultural group may not be motivating and relevant to the group with a different programming of the mind (Hofstede and Hofstede, 2007). So there is no one style of management that can be applied to all cultures.

However, a critical analysis of literature has enabled the authors to identify the key intercultural competencies of successful global managers such as cultural self-awareness, intercultural communication or a global mindset.

Today, many companies carry out training to sensitize managers to cultural diversity. The competences of global managers of multinational corporations seem to be a very important source of success of the MNCs.

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http://dx.doi.org/10.18778/8088-012-2.14

14. Change management in multicultural organisations

Aneta Parkes*

Abstract

This article presents some of the change management tools, which can be useful especially in the environment of multicultural organisations, to manage the process of change. At the beginning of the article the change management and multicultural organisations will be defined. Then the change management process will be characterised and the chosen tools of change management will be described. The choice of these tools is based on personal work experience and interviews with change leaders who have been managing changes in multicultural organisations.

Key words: change management, multicultural organisation, process of change, change agent, diversification, non-verbal communication, and visual communication

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Introduction

The goal of this article is to present some of the effective solutions, which can be used in the process of organisational change management. The change is considered to be a permanent phenomenon in organisational life. Managing the process of change helps to direct the energy towards the desirable effect. The change leaders I spoke to, confirmed, that their common task is to implement different kinds of change in their client's organisations. They are asked to design, plan and lead the change, so the organisation can grow and develop.

In this article I would like to present some of the tools of change management, which are frequently and efficiently used by the change leaders who are working for multicultural, global organisations. They are using the same tools and methods of management as in the monoculture organisations, for example communication tools. But, at the same time, they have to be flexible and they should modify the way they are using these tools, because of the differences of the world's organisational and national cultures.

14.1. Change management and multicultural organisations

Organisational change can be defined as any important modifications within an organisation's area, for example area of people (Griffin, 2002). The range of changes in organisation can be various: they can influence management system in total, or its chosen elements like: technical, social or economic subsystems. Changes can be driven on different levels, for example from the level of individuals to the level of organisation as a whole (Wawrzyniak, 2010, p. 498; Parkes, 2016).

Change management is being described as an „approach to shifting/transitioning individuals, teams, and organisations from a current state to a desired future state. It is an organisational process aimed at helping stakeholders to accept and embrace changes in their business environment" (en.wikipedia.org/wiki/Change management).

John Kotter underlines that change management is about keeping change under control, so we can avoid distractions or change impact on the people. And he is underlining another important issue – the difference between management and leadership of the change. „Change management, which is the term most people use, refers to a set of basic tools or structures intended to keep any change effort under control. The goal is often to minimize the distractions and impact of change. Change leadership, on the other hand, concerns the driving forces, visions and processes that fuel large – scale transformations" (Kotter, 2011). So if change management is about control, the change leadership is about vision and empowerment of people. Change leaders may be asked to lead the change within organisations, which requires specific personal skills, talents and leader's personality. I had a chance to meet and work with that kind of leaders. In my opinion, they have not only managed the projects, but have had enough charisma to be the driving force for the organisational change (cf:. Parkes, 2016).

Multiculturalism in organisation can be described, according to R. Winkler (2008, p. 18), as different practices and traditions existing next to each other in one organisation. Due to the fact that every organisation has not only an original organisational climate, but also it's own organizational culture (autonomic in terms of the culture of the country, in which the organization acts, and the cultures of the countries which the participants come from), we will have to deal with the phenomenon of organisational multiculturalism for example in global corporation with subsidiaries around the world (Jakonis, 2010, p. 89).

Multicultural organisation is characterized as a place, where people of different cultural backgrounds can contribute freely and achieve their potentials for their own benefit and the benefit of the organisation (www.businessdictionary.com/definition/multicultural-organization.html). Other definitions describe a multicultural organisation as „characterized by pluralism, full integration of minority-culture members both formally and informally, an absence of prejudice and discrimination, and low levels of inter-group conflict" (Fine, 1995, p. 42).

These kinds of organisations are more and more common in the contemporary world. The international processes of economical integration as well as trade exchange, government cooperation or cultural diffusion, create a global international environment for business (cf.: Koźmiński, 2010, p. 542). Paradoxically, the globalization is considered as both „a cause and a result of multiculturalism and pluralisation" (Lundy, 2003, p. 71). Globalization, demographic trends, immigration and migration etc. lead to the shape of organisations and their workforce, which is characterised as heterogeneous on dimensions such as gender, race, ethnicity and nationality (www.ferefencefor business.com/small/Mail-Op/Multicultural-Work-Force).

Multiculturalism is seen mostly as a potential for an organisation, but it can cause many challenges as well. For example challenges of managing people with different cultural basic assumptions, which requires knowledge and understanding of cultural diversity. And as there is no prewritten recipe for managing people from different cultural background, there is no recipe to manage change in that kind of environment. As M.G. Finn is writing: „Bringing our own cultural assumptions into our awareness and learning to recognize the cultural assumptions of others is a difficult and sometimes painful process. Working together to create a multicultural community within an organization requires patience, hard work, and an organization-wide commitment to change" (Fine, 1995, p. 2). I could add to that that the change management process requires a talented consultant/leader, who is acting as an efficient change agent and is using change management tools in the ways, which are suitable to the specific cultural environment.

Managing in a multicultural environment, dealing with differences and similarities between different cultures is defined as a cross-cultural management (Kostera, 2010, p. 588). This author underlines, that the main problem of cross-cultural management is to find the best way of acting according to the specific conditions of individual countries. And she is describing three different ways of cultural interaction in the circumstances, when the organisation is multicultural, multinational, when is having subsidiaries in more than one country or cooperating with the partners from different cultures. These ways could be:

1) Model of cultural domination;
2) Model of cultural coexistence;
3) Model of cultural cooperation (Kostera, 2010, p. 607).

According to change management in multicultural organisations, the model of cultural cooperation seems to be the most effective solution. The attitude of change leaders I spoke to, was always respectful and appreciative towards different cultures. They perceived cultural diversity as interesting and enriching and as a source of strength and development.

14.2. Ch. Handy's model of the change management process

One of my favourite models of change management, or change in general, is The Sigmoid Curve, presented by Charles Handy and firstly published in London, 1994. This is the model, which was used to describe the cycle of life of products, organisations or even relationships (Handy, 2002, p. 50; Parkes, 2016). Talking with the change leaders, they also pointed out that kind of model as a general model to described cycle of life of organisations as well as the cycle of life of their projects.

By the Sigmoid Curve, Ch. Handy explains the need to manage change during the life cycle or activity (www.managetrainlearn.com). The cycle of life starts from initiation and slow growth, than it riches period of progress and success, moving to maturity and to the period of decline. The phases of the process can be called: inception – growth – maturity – decline (www.scu.edu.au). Sigmoid curve is the S-shape curve, which is showing the need to constantly re-invent, especially when things are going well. This is the paradox of change – starting new action when we reach the top of success of the present one, before the peak and before it starts going downhill. „With the vision and courage to start a new cycle before the peak, you have energy, time and resources while the existing cycle is running on automatic" (www.managetrainlearn.com). As we can see on the illustration below, a new cycle should start at the strongest point A, where there is time, resources and energy „to get the new curve through it's initial explorations and flounderings before the first curve begins to dip downwards" (Handy, 2002, p. 51). As the author is writing: „Wise are they who start the second curve at the point A, because that is the pathway through Paradox, the way to build a new future while maintaining the present" (Handy, 2002, p. 52).

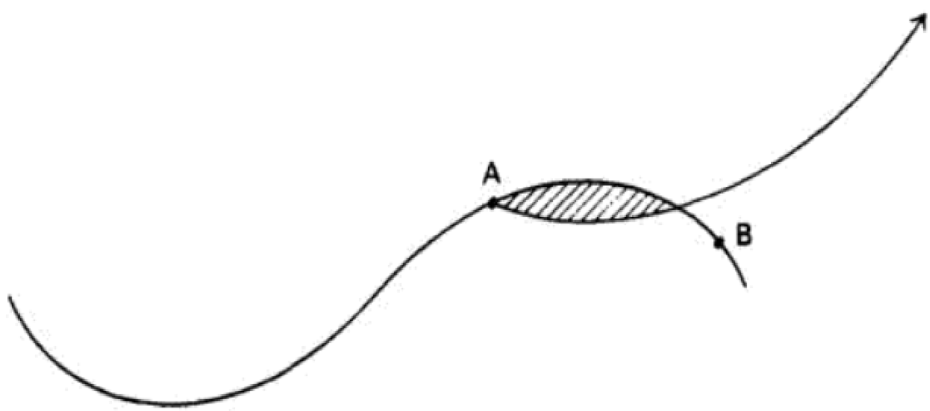

Figure 14.1. The Sigmoid Curve
Source: Handy Ch. (2002), *The Empty Raincoat. Making sense of the future*, Arrow Books, London.

According to Ch. Handy, only in that way constant growth and development is possible. We have to start a new initiative before the first one begins to drop down. It means making changes while we are celebrating the success. But, this is the secret of a constant growth (Handy, 2002, p. 51; Parkes, 2016). And, in my opinion, this is a secret of efficient change management process.

It is important to make a change directly at the point, where we have started reaching the top. According to Ch. Handy, the paradox of success means, that „what got you where you are won't keep you where you are" (www.scribd.com). So, the second curve or the new initiative, requires new methods, new people or new ways, and than progress is possible (Parkes, 2016).

The model of a change management process can look exactly the same as Sigmoid Curve: firstly initiation and the phase of slow but persistent implementation of the change. Then further growth, to the point, when we can say that the changes have been implemented. After reaching the top or after the accomplishment of the change implementation, there can be some time of maturity and a time of forcelebrating success, but sooner or later the change will loose its potential and energy and become more like routine, and it will not be innovative any more. According to Ch. Handy's theory, it will burn out automatically. To stay successful, it is important to start new changes at that stage, when we are celebrating the success of a previous change. Being constantly in the phase of starting new projects, we are permanently in the energy of innovation, creativity and achieving. And it means that constant change is good for our organisation, because it's stimulating and progressive (Parkes, 2016).

14.3. Change management tools in multicultural organisations

As I wrote previously, the tools of change management in multicultural organisations are exactly the same as those in other structures. What can be different it is the way of using them, which has to be adjusted to culturally varied environment. For example different communication tools can work better in different cultures. The change leaders I talked with, pointed out communication tools, as being very important in change management in multicultural organisations. There was the importance of the change agent's role underlined as well.

A change agent is mostly perceived as an internal author of changes. Change agents can be leaders, members of staff supporting change or outsiders who are implementing changes in organisations. In the last case it can bring a lot of benefits, for example using an external force to keep an organisation moving in the right direction, when there are limited internal resources of strength and innovation. The expert can become the internal agent of changes over time, especially if the relationship with an organisation is structured by using long-term projects, as a vehicle to move the organisation in the desired direction.

The roles and tasks of the agents can be different:

– they may only advocate changes,
– they may sponsor changes,
– or implement them (Randall, 2004, p. 227).

Their roles are mostly based on providing the power to the project of change. „This promotional power is provided by three types of promoters" (Reiss, 2012, p. 103) who can be seen as: experts, champions or sponsors. As we can see below, the experts are mostly focused on tasks and they are skill-based promoters. Acting as an expert it is the perfect and the most common role for a leader to follow in the process of change management. The champions are focused both on tasks and people and they are process responsible promoters. Their role is to coordinate the transition. If leaders can act in the role of experts and have skills to develop as champions, then they are a very strong force to make change happen. The sponsors are classified as people-orientated and they are power and resources based promoters. Power promoters are mostly the representatives of top management, who are change agents in the sense that they provide resources and they decide who is going to manage the change within an organization.

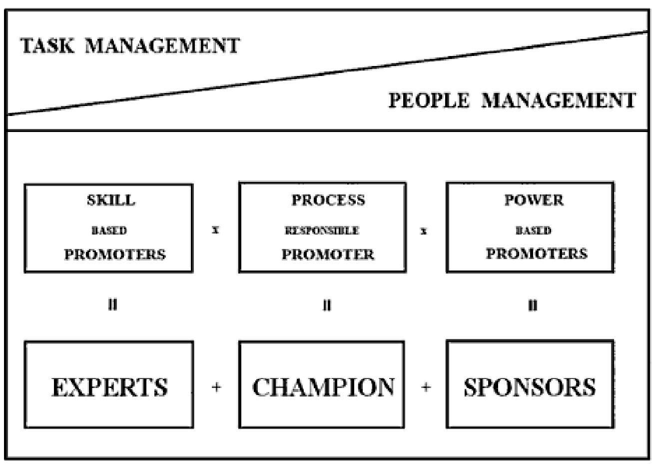

Figure 14.2. Triad of promoters in Change Management Process
Source: Reiss M. (2012), *Change Management, A Balanced and Blended Approach*, Books on Demand GmbH, Norderstedt, p. 103.

Acting as a change agent in a multicultural organisation, there is a need to be aware of cultural differences in people's cultural basic assumptions, patterns of adaptation or integration, shared patterns of perception, thoughts and feelings (Schein, 2004, p. 18). It is important to be aware that diversification is very valuable, and it can be used for example to increase group dynamics. People with varied skills, points of view, heritage or attitudes can create a lot of innovations. Despite that, the disadvantage of diversity can be for example poor internal communication, especially when there are language barriers or different unconscious assumptions about non-verbal communication rules. Despite that, business benefits of diversity are much greater than potential problems. For example: „access to different perspectives and sources of knowledge, a greater understanding of diverse groups (…)" or „better team outcomes on creative and problem-solving tasks" (Anderson and Metcalf, 2003, p. 29). And diversity of the team, which is wisely managed by the change agent, can be the source of all assets required to achieve the goal.

„Managing diversity is a leadership approach that creates an organisational culture that respects diversity and supports multiculturalism" (Schermerhorm, 2010, p. 270). Thanks to that, minorities and all organisational members can reach their full potential. It is beneficial for organisations if the leader can „view diversity as a strategic imperatives" (Schermerhorm, 2010). This process starts from creating mobility for minorities, and then there is the phase of building relationships with respect for diversity and the last part of the process is managing diversity, which means that we want to achieve full utilization of diverse human resources (Schermerhorm, 2010).

Ernst & Young suggest building diverse leadership teams with strong global experience as a part of global expansion strategies of companies. And in reverse: „Multinationals from developing economies are increasingly looking to inject foreign talent into their leadership teams to help support their regional and global growth ambitions, says Ernst & Young's Nigel Knight" (www.ey.com). They are stating, on the basis of their survey, that respondents can see the link between diversity and reputation or financial performance (www.ey.com).

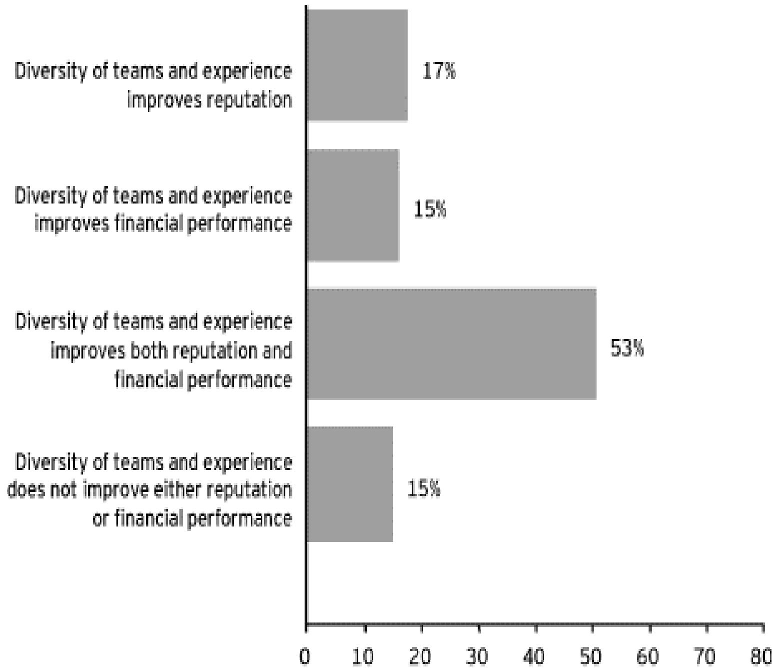

Figure 14.3. Globalization Survey 2010, Q: Which of the following statements best describes your assessment of the link between diversity and reputation/financial performance?
Source: http://www.ey.com/GL/en/Issues/Business-environment/Winning-in-a-polycentric-world--globalization-and-the-changing-world-of-business---4--Diverse-leadership-teams.

The communication field is another important subject in multicultural organizations, especially if their employees are people talking different languages, which is very common in a global business environment. The official language is then the language of the representatives of top management/owners, so leaders are mostly chosen as a speaking the same language as these groups. But if there is a subsidiary in different country, people employed there, are going to use their native language, so then the organisation has two or more languages and mixed culture from the starting point. In multicultural organisations we can expect to see a lot of different cultures and languages. With this variety of different native languages, even with one standard business language in written and oral communication, there are still a lot of possibilities to make mistakes, misunderstandings or having other obstacles in leading a proper and efficient communication.

„Communicating skilfully and genuinely is the mark of a successful leader. It's part technique and part integrity" (Deeprose, 2001, p. 158). There is the need to listen more than talking, and when we have to face the variety of languages there is a higher importance of well-interpreted non-verbal communication signals.

These non-verbal signals can come from: body language, eye contact, facial expression or voice tone, and they have to match the cultural background of the partners of the communication process. It is even more important to focus on non-verbal signals than verbal ones, because according to Albert Mehrabian's experiment, we are influenced mostly by non-verbal communication. A. Mehrabian estimated that the influence of verbal words used in face-to-face communication is only 7%, whereas the influence of the tone of voice – 38% and body language like gestures, facial expressions, eye gaze etc. – 55%.

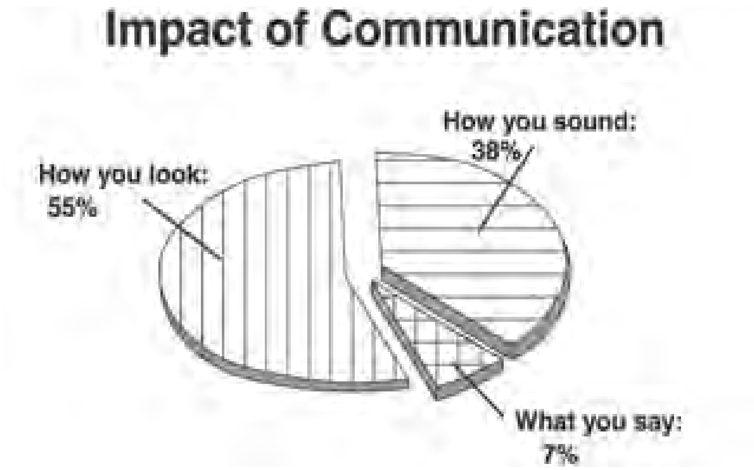

Figure 14.4. The Visual Impact of Communication, adapted from Nonverbal Communication by Albert Mehrabian (1972)
Source: http://westsidetoastmasters.com/resources/talk_your_way/lib0009.html.

Another technique is to write an email or report on the key conversation to sum up what was said and to confirm that everybody understand the topic in the same way. Some people are better in oral communication, another in the written one, in native as well as in foreign language. And there is still a lot of misunderstandings in native language as well, so what can we say when we are using a few different languages? Misunderstandings are highly likely to happen. So it is required to write the main conclusions from our discussion so we can reconfirm what we agreed in our conversation. Thanks to that we have two different ways to receive and understand the information – oral and written.

The next powerful tool is visualisation, sometimes called visual communication or visual control, which are different phenomenons, but they all are applying to using symbols, graphics, drawings or models to be efficient in communication, especially when language can be a problem. So, the secret of efficiency is not about using words, but it is more about using pictures, which represent them.

Visualization can be done with the use of pen and paper or through electronic media. It is called as visual thinking, based on the current theories of visual perception (compare: Tergan and Keller, 2005, p. 13). Visualization is the visual representation of abstract data, information, process description, problem solving etc. By organisational visualisation I mean using pictures instead of the words to present or explain something to the others. Visualization of data for example can be done through mind maps, which are defined as diagrams to visually outline information (http://en.wikipedia.org/wiki/Mindmap). It is a pictorial method with a long-time history in: learning, brainstorming, memory, visual thinking or problem solving. Mind maps can be used to „generate, visualize, structure and classify ideas and as an aid to studying and organizing information, solving problem, making decisions or writing" (http://en.wikipedia.org/wiki/Mindmap). Another example of visualisation is the milestone plan, which is a great tool to manage complexity and diversity as well as a process of change (Reiss, 2012, p. 130).

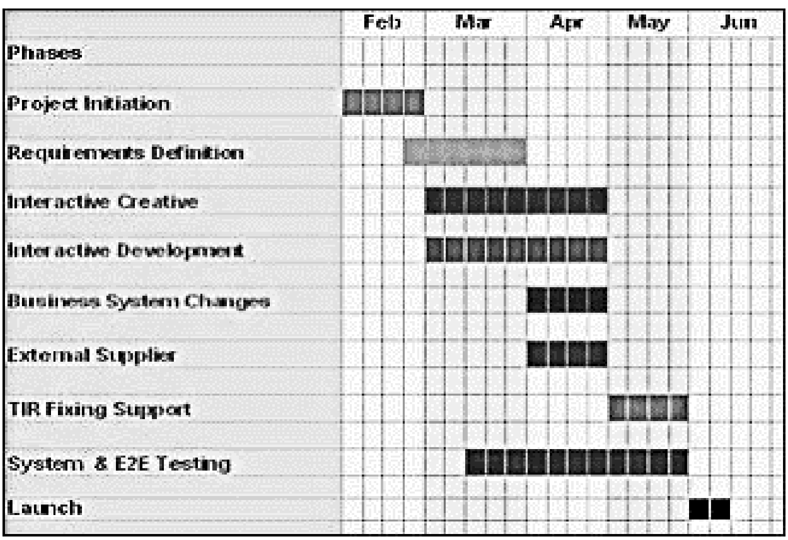

Figure 14.5. Example of milestone plan – Project Management Milestone Plan
Source: http://www.my-project-management-expert.com/creating-a-project-plan-2.html.

Visual communication can be characterised as a „communication through visual aid and is described as the conveyance of ideas and information in forms that can be read or looked up. Visual communication relies on vision, and is primarily presented or expressed with two-dimensional images, which includes: signs, typography, drawing, graphic design, illustration, colour and electronic resources. It also explores the idea that a visual message accompanying text has a greater power to inform, educate or persuade a person or audience. (…). Visual communication takes place through pictures, graphs and charts, as well as through signs, signals and symbols. It may be used either independently or as an adjunct to the other methods of communication" (http://en.wikipedia.org/wiki/Visual_communication#cite_ref-0). The types of visual aids can be: objects, models, graphs, maps, tables, photographs, drawing/diagrams or others, which can be presented through such media as: different kinds of boards, hand-outs, video excerpts or computer presentations (http://en.wikipedia.org/wiki/Visual_communication#cite_ref-0).

Visual control is a technique of communication, and it's based on using visual signals instead of text or other written instructions. These signals can be of many forms like: different coloured lines on the shop floor, different coloured clothing, color-coded pipes and wires, lights, boards, *kanban* and *heijunka* boxes (http://en.wikipedia.org/wiki/Visual_control). „Visual control methods aim to increase the efficiency and effectiveness of a process by making the steps in that process more visible. The theory behind visual control is that if something is clearly visible or in plain sight, it is easy to remember and keep at the forefront of the mind. Another aspect of visual control is that everyone is given the same visual cues and so is likely to have the same vantage point. (…) Visual signs and signals communicate information that is needed to make effective decisions. These decisions may be safety oriented or they may give reminders as to what steps should be taken to resolve a problem. (…) Visual controls are designed to make the control and management of a company as simple as possible. This entails making problems, abnormalities, or deviations from standards visible to everyone. When these deviations are visible and apparent to all, corrective action can be taken to immediately correct these problems" (http://en.wikipedia.org/wiki/Visual_control).

Summarising, if we talk about visualization in organisational terms, we are speaking about visual thinking or visual communication or visual control, because there is always the same base, which is about using more pictures than words. Pictures seem to be easier to understand; more universal than any language, simpler and more powerful than words.

Conclusion

The article presents problem of change management in multicultural organizations from the change leader's practical point of view. There are possibilities for external experts to act as effective change agents in culturally diversified environment. Being able to act as a change leader requires great communication skills as well, especially in a multi-language environment. In that case the non-verbal communication techniques can play a major role and we can all appreciate the meaning and the power of simple visualisation, visual communication or visual control, which can help to lead teams along the path of change.

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15. Investor relations as a company image component

Aleksandra Sobczak-Spasiuk*

Abstract

Purpose: The purpose of this article is to describe what organizational image means and identify Investor Relations (IR) as an important component that shapes organizational image.

Design/methodology/approach: Literature review of organizational science regarding image building and investor relations.

Findings: A company's ability to make a profit is crucial for investors, however, their decisions taken in the present, to buy, hold or sell company shares relate to the future and expected benefits associated with the investment. The share prices do not only reflect a company's financial situation. Thus, information itself is not sufficient – the obligation imposed on companies is to report their financial results. A broader context that gives the opportunity to evaluate the company is needed. Therefore,

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listed companies within IR need to provide information and take actions to shape the current picture of a company, due to which they are able to strive for the outstanding and strategically defined image to attract investors and other stakeholders. In other words, through transparent and planned activities create an image that influences appropriate investment decisions.

Research limitations/implications: The paper is limited to the review of the literature on investor relations and image creation from PR and management perspective and refers to companies listed on the Warsaw Stock Exchange.

Original value: The paper describes a strategic value of investor relations which due to planned communication impacts on how the company is perceived. Furthermore, the author argues that transparent and voluntary activities increase the competitiveness of company shares.

Introduction

The main purpose why companies enter the stock exchange is to obtain funding for development. Higher demand on shares means achieving a higher price and greater value for shareholders. With regard to this the companies take action in order to create demand on their shares and to promote their offer (Dziawgo, 2011, p. 95).

Although a separate function of Investor Relations and Public Relations is emphasized in the IR literature (Nielsen, 2006, p. 3), more and more attention in management study is given to intangible assets in the process of building relationships of listed companies with stakeholders (Roszkowska, 2011, p. 48), and how they affect a company's value. The downfall of Enron in 2001 turned researchers' attention on non-financial elements and additional, voluntary activities provided within IR as well as reliable and two-way communications with stakeholders (Allen, 2002, p. 206; Dziawgo, 2011, p. 74; Laskin, 2009, p. 241). However, a company's ability to make profit is crucial for investors, their decisions taken presently to invest, hold or sell a company shares relate to the future and expected profits associated with the investment. Therefore, the contemporary approach to IR is not limited to the financial reporting. Conducting additional activities – in a broader context – enables the presentation of a company in order to build a positive image in the minds of stakeholders and the assessment of a company's ability to develop current and future performance.

In order to Fombrun (1996, p. 6) intangible assets can become a sustainable source of competitive advantage more than technology or patents in the long term. Companies' strategies need to include a strong foundation for building the reputation or image.

Therefore the aim of this article is to determine what the image of an organization is and why it is important, likewise identification of IR as a key element in shaping the image of a listed company.

The article is divided into four parts. The first one concerns a review of the literature on image building and its various definitions. The second one explains the differences between image, identity and reputation. How to manage image is discussed in the third part. The fourth part is devoted to a review of literature concerning Investor Relations and their influence on the perception of company investors.

15.1. How the image is defined

A first reference about the image concept appeared in the fifties of the XX century (Abratt, 1989, p. 64). Then Boulding in 1956 (Abratt, 1989, p. 64) developed a concept of linking image with this how individuals behave. He argued that what an individual believes to be true, in fact it so. Similarly Martineau (1958) (in Abratt, 1989, p. 64) distinguished the functional meaning of the corporate image from emotional. For the first time in 1958 Harris (Abratt, 1989, p. 64) identified different company images: "the corporate image", "the institutional image", "the product image", "the brand image", "a diffused image", "the consumer demand image". Swanson (1957) (in Abratt, 1989, p. 64) distinguished the image depending on consumer point of view and named it "an ideal corporate image". Two years later Byayton (in Abratt, 1989, p. 64) conceptualized "actual" versus "ideal" image. The image is an impression appearing in stakeholder mind (Pang, 2012, p. 360) as a result of "experience and observation" (Bernstein, 1984) (in Abratt, 1989, p. 68) gained through direct or indirect contact with an organization. Cornellissen (2012, p. 98) adds that it is an association arising immediately upon a message communicated by an organization. Other authors describe the image as: "Thus the corporate image of an organization is the profile – or sum of impressions and expectations of that organization built up in the minds of individuals who comprise of its publics" (Topalian, 1984, in Abratt, 1989, p. 66). "The corporate image is composed of all planned and unplanned verbal and visual elements that emanate from the corporate body and leave an impression on an observer" (Selame and Selame, 1975, in Abratt, 1989, p. 66). A great number of authors agrees that image is an important company asset (Benoit, 2008, in Pang, 2012, p. 360) with a strategic meaning (Liew, 1997, p. 80). The image depicting a company is "net impression received by all the audience" (Bernstein, 1991, in Liew, 1997, p. 80). Following Bevis (1967) (quoted by Bernstein in Abratt, 1989, p. 67) "Corporate image is the net result of the interaction of all the experiences, beliefs, feelings, knowledge, and impressions that people have about the company".

Enterprises are able to manage their image (Kennedy, 1977, p. 120; Gray, 1986; Abratt, 1989, p. 63) and shape it (Christensen et al., 2008; Fombrun, 1996, in Pang, 2012, p. 360) to achieve „intended" (Brown et al., 2006, p. 103) or „interpreted" image (Bronn, 2010, in Pang, 2012, p. 360). The image management is focal to sustain trustworthiness (Gray, 1986, in Abratt, 1989, p. 63; Nielsen and Bukh, 2011). According to Elsbach (2008) (in Pang, 2012, p. 365) it is possible to manage the image on three levels: before, during or after a certain event. This event can be directly caused by a company or arise independently. A publication of financial report by a listed company is an example of such an event. Before its onset, companies can adopt a strategy of "wait and see", during the event, the strategy depends on whether the company perceives it as a threat or not, and after the event taken actions are going to serve to improve or strengthen the image of the organization (Pang, 2012, p. 365). Companies have ability to strive to achieve specified image and they need to decide a priori how they want to be seen in stakeholders' minds. It can be achieved through "intended associations" (Brown et al., 2006, p. 103), or symbolic associations (Cornelissen, 2012, p. 86). In fact, companies strive to promote and underline the expressive (Brown et al., 2006, p. 103) and positive attributes to cause an intentional association, in other words, the desired image. In contrast, Sander (2010) (in Pang, 2012, p. 372) claims that companies need to take into account an association of the company formed in stakeholders' minds when they think about the company and describes it as "enduring image". In addition, such image can be created on the basis of experience gained during the individual contact with the company or information obtained from other external stakeholders for example from the media (Pang, 2012, p. 370). Dutton and Dukerich (1991) (in Dutton, Dukerich and Harquail, 1994, p. 249) claim that the organization image applies to the organization members' beliefs what for external stakeholders is in the organization "distinctive, central and enduring". Three years later they added the "construed external image" notion, which explains and distinguish whose beliefs are in whose scope of interest. Image can be interpreter through the perception of internal and external stakeholders.

15.2. Identity, image and reputation

In the organization management the image is extensively described and it is difficult to obtain one, common definition (Abratt, 1989, p. 66; Dutton, Dukerich and Harquail, 1994, p. 249). Image is being described as synonymous with identity (Abratt, 1989, p. 66), or reputation (Dolphin, 2004, p. 81). It emerges from the fact that image is a multi-faceted concept (Dolphin, 2004, p. 81) thus it becomes dynamic and affected by continuous assessment which the organization is subject to (Gotsi, in Dolphin, 2004, p. 82). Therefore, in this article, the author presents the concepts and the relationships between these notions that occur in the management literature.

Abratt (1989, p. 67) quoting the image definition created by Bevis (quoted by Bernstaina, 1984), that image is "the net result of the interaction" between impressions, feelings or beliefs associated with organization adds "identity" ascribed by Bernstaina (in Abratt, 1989, p. 67), as "the sum of the visual cues by which the public recognizes the company and differentiates from others". Discussing the links between the image and identity Abratt broadens the notion and adds "corporate personality". According to him, it is the sum of all the characteristics of an organization, not just visual. Personality expressed by "visible artefacts" creates a corporate identity, and the overall impression created by the marks is the image (Abratt, 1989, p. 67–68).

The importance of the external company presentation resulted in creating an additional concept "corporate identity". While the Bernstain's definition of identity is one-dimensional, Birkigt and Stadler (1986) (in Cornelissen, 2012, p. 87–88) came to the conclusion that the team corporate identity is multi-dimensional. It combines all symbols of the corporate identity ranging from logo, through the colors characteristic for the organization, and ending with the font used in business correspondence. Attitudes, behaviours, formal language or the values presented by employees affect the identification of the organization. The corresponding attitude of those responsible for example for sales may affect the assessment of the quality of services, or purchasers' identification with company products. Forms of promotion, advertising and corporate events constitute another dimension identified with the organization. Identity consisting of symbolism, employees' behaviours and information policy conducted by the company arises from the organizational culture and the strategic assumptions formulated in the vision and mission. These dominants determine the appropriate image communicated to stakeholders. In addition, stakeholders build their perception about the organization through these dominants. According to Birkigt and Stadler it is a corporate image.

Corporate identity creates the company image which is outstanding in the minds of stakeholders. This concept is related to the external presentation and characteristics of the company (Cornelissen, 2012, p. 89). Albert and Whetten (1985) (in Hatch and Schultz, 1997, p. 357) conceived a definition of "the corporate identity" based on features that are focal, enduring and identifiable with the organization. The corporate identity is related to how employees perceive the organization, they feel when they think about the organization (Hatch and Schultz, 1997, p. 357) and whether they identify with the organization. In other words, this concept is employees' collective perceive of fundamental values of the company (Cornelissen, 2012, p. 89; Hatch and Schultz, 1997, p. 357).

A sum of opinions on the organization is its reputation. It relates to a stable picture of the organization, not just to the stakeholders' immediate reaction to a mention about the company (Dolphin, 2004, p. 81). Images created in stakeholders' minds affect the reputation. Stakeholders evaluate the organization on the basis of its past and present activities. They compare it to competitors, assess its position and future opportunities. By planned and deliberate actions, under communication strategy, organizations are able to obtain a positive reputation. Thus, image management affects the reputation of the organization. Companies do not conduct directly reputation management process, because it is a perception that arises in the minds of market players (Brown et al., 2006, p. 104). Compared to the image notion, reputation is a more stable state (Cornelissen, 2012, p. 98). Reputation affects consumers' behaviours. With a positive reputation, an organization is going to benefit from the right of "the first choice". Consumers are more willing to buy products, services and shares of such a company (Cornelissen, 2012, p. 90). Apart from an organization's performance, reputation is affected by certain factors independent from it including competitors, experience of stakeholders or opinion on the industry. Therefore, a good strategy is to monitor the market situation to be able to adjust communication activities in order to build a positive image and maintain a positive reputation in the long term. A positive reputation, built on a solid identity, combined with appropriate communication activities, will enable a company to survive crisis situations.

15.3. The management of image

Consumers favor organizations that demonstrate consistency in building and caring about the image. The constant monitoring of how a company is perceived by market participants (Ghosh, 1996, p. 13) and the strategic approach to creating a desired image is beneficial for companies. According to Cornelissen (2012, p. 86–87):

- Due to image shaping, companies may stand out from other organizations, and facilitate stakeholders to find the company on the market.
- By creating a positive image the organization is able to influence the decisions of stakeholders. Consumers put such company ahead of others and more frequently buy its products, services or shares.
- Obtaining stakeholders' favour and the formation of a homogenous image positively affects a company performance. There is an increased chance that customers who hold positively-shaped image about the company buy the same company shares in the future and it is probable that current investors simultaneously become customers of the company. The same applies to employees.

Companies can take activities to form their identity through which they affect their image (Abratt, 1989, p. 69). The strategic approach of managers to define the visual elements, values, and vision of a company gives direction to lead the business and to create characteristics with which the company wants to be identified. Thus, such an approach affects the formation of a certain image in stakeholders' minds. During the process of planning how to shape the image each company needs to answer the following questions (Abratt, 1989, p. 70):

- Who is our recipient?
- What is our objective?
- How do we want to achieve the objective?
- How is our company currently perceived?

The basis for answering the first three questions is comprised in the company mission – meaning the company existence – and vision – the leadership concept about the company in the future. The answer to the last question indicates whether due to taken actions, the company was successful in creating assumed image. This success is reflected in the extent to which market participants endorse and assimilate the image of the organization (Pang, 2012, p. 361).

The image management is a continuous process. Communication with stakeholders plays an important role in shaping sustainable and desired image (Christensen at al., 2008; Pang, 2012, p. 360). Hence, a strategic approach to communication programs and channels through which the companies want to deliver information is important. Lack of market monitoring and managing the image may cause that organization to lose oversight over the information flow. Such a situation allows a third-party to impact on others beliefs as to how to perceive the organization.

15.4. Investor Relations in image shaping

Accessing the stock exchange, companies want to obtain funding for their development. Due to this they superimposed on themselves an obligation to be transparent and reliable informing within appropriate timeframe, which is regulated inter alia, by the Act of 29 July 2005 (ACT of 29 July 2005 on Public Offering, Conditions of Introduction of Financial Instruments to Organised Trading, and on Listed Companies, "Journal of Laws" 2005, No. 184, item. 1539 par. 56). Thus, companies begin to court for the attention of investors in order to increase the demand for their shares. In this process, they are supported by Investor Relations. The definition reconciled by the National Investor Relations Institute (NIRI) in 2003, defines IR as:

[A] part of the strategic management that integrates finance, communications, marketing and compliance with the law on securities trading, in order to permit the most effective communications – bilateral in nature – between a listed company, the financial and investor community and other market players, contributing to reliable valuation of the company's shares[1].

The largest amount of financial data presenting an organization condition is disclosed in external financial reports. Until recently, they were the main source of information for investment decision making. However, after the downfall of Enron in 2001(Allen, 2002, p. 206; Dziawgo, 2011, p. 74; Laskin, 2009, p. 241) communication of a company in the context of IR became important which, in accordance with the cited definition needs to be bilateral. Not only companies provide information. Their disposition and openness to reactions and questions coming from the investor community. In addition, a great number of listed companies compared to the limited number of stock market analysts, an increase in the amount of individual investors for most of whom investing is an additional activity besides their occupation (Bęben, 2013, p. 177), causes that a great number of reports are too long, complicated and unclear. Information on action plans of the company, its strategy or non-financial elements impacts on the assessment and forecast of the results which are gradually recognized and disclosed (Roszkowska, 2011, p. 66) by large companies. Therefore, due to delivered information and action taken within IR, firms strive for a distinctive and strategically defined image, to attract investors and other stakeholders. Through the transparent and a planned actions they want to create a reliable picture of their business that makes an impact on appropriate investment decisions.

1 The author's translation.

Creating the image of listed companies within IR presents figure 15.1.

Investor Realtion → Transparency → Image
(obligatory information and activities)
(voluntary information and activities)
(elements and activities allowing to distinguish and achieve desired image)

Figure 15.1. Creating an image of listed companies within IR
Source: own.

Non-financial factors become increasingly important the investment decision making process. In 1997, Erns & Young conducted a study which demonstrated that 35% of investors' decisions were not only affected by financial results and the subsequent study of the Boston Consulting Group confirmed that 40% of investors (Drażba-Derda, 2008, p. 1).

Open communicating and translating the company's financial information, explaining where the company is going and what is its mission builds its image, which is the responsibility of "modern" IR.

Within IR there are tools that give companies ability to shape relations with communities. According to Dziawgo (2011, p. 102–103) these tools are "traditional" and "electronic". Such a division can be either made based on delivering only obligatory reports or providing supplementary, voluntary activities. Additionally, the tools are to be classified according to the company form of contact with investors – "direct" or "indirect".

Companies have at their disposal a great number of tools to communicate with investors. According to Koładkiewicz (2011, p. 269) and Dziawgo (2011, p. 103) these are:

- Meetings and presentations for investors and financial community,
- Building relationships with media,
- Providing company reports (periodic and current),
- Conducting a website with a part dedicated to Investor Relations,
- Loyalty programmes,
- Traditional and electronic mail.

Using selected tools, companies communicate with the market in order to build positive relationships with stakeholders, start a dialogue with them and receive their feedback. It is worth to emphasize that they combine the functions specific to marketing, public relations and finance (Dziawgo, 2011, p. 102). These tools help organizations to shape appropriate image in the minds of stakeholders. Therefore, companies design their composition in order to build trust and meet the information needs of their stakeholders. Diverse groups of IR recipients force the company to prepare communication due to the economic and financial knowledge of the groups. However, everyone has the right to obtain equal access to information. The information needs of individual investors may differ from the needs of the financial media and analysts. These two latter groups acting as a hub in the development of further messages and influencers on the perception of the organization (Dziawgo, 2011, p. 89).

Information provided by agents shapes the idea on the organization. Another question is whether the recipients are internally convinced of this (Żaba-Nieroda, 2011, p. 296). Nonetheless, the image formed in this way has an important meaning at first direct contact with the company. Investors often perceive the organization through capital market experts opinions quoted for example by media. Additionally, the competences of Investor Relations Officers (IROs) (Laskin, 2009, p. 243) and their professional abilities of building relationships with stakeholders are of a great importance. Their language, the way how they transmit messages to make sure that they are received as intended by the company (Dziawgo, 2011, p. 89). Frequently, market participants form their opinion on the company, assessing it on the basis of professionalism and reliability of IROs (Hoffmann and Fieseler, 2012, p. 149).

IROs professionalism is additionally reflected in their ability to cooperate with other departments. These skills allow them to acquire data from internal experts, for example the public relations, finance and sales department and formulate appropriate messages for external stakeholders (Krug, 2010, p. 40).

Considerable influence on shaping the image through IR has a document "Best Practice of Warsaw Stock Exchange Listed Companies" (Best Practice of WSE Listed Companies, the Annex to Resolution No. 19/1307/2012 Stock Exchange Council of 21 November 2012.). It provides "a set of corporate governance principles and rules governing the standards of relations between listed companies and their market environment". The aim of the practice is "to strengthen the transparency of listed companies, improve the quality of communication between companies and investors, strengthen the protection of the stakeholders rights also in the area not regulated by law, while not imposing a burden for listed companies, not balanced by the benefits resulting from the needs of the market (…)". Hence, among others, the document includes recommendations for the information policy of listed companies with the use of modern, electronic tools such as a website dedicated to IR. Regardless of the recommendations, companies increasingly post voluntary information on their websites to help investors determine the current and future "condition" of the company, assess investment risk, thus to make investment decisions.

Conclusions

A wide range of the literature referred to the article indicates a lack of clear definition of image and frequent alternating of the use of this term with the identity and reputation. Nevertheless, the author settles the subject scope of creating an image from which emerges a definition of the image as a picture formed in the minds of stakeholders (Pang, 2012, p. 360).

It is important to emphasize that image can be managed. An unmanaged image is like a "vacuum" that can be filled by the stakeholders relying on the external opinions (Pang, 2012, p. 373), instead of information from the company. Enterprises are equipped with necessary tools to take actions to prevent the creation of the "vacuum". On the capital market, an example of such tools are investor relations. Their task assignment is to build the company image based on trust.

A company's ability to generate profits is essential for investors. However, their decisions in the present to buy, hold or sell the shares related to the future and expected profits associated with the investment. Stock prices are not just a reflection of the financial situation. Thus, the mere information is not sufficient – the obligation for reporting of financial results. A wider context is required which gives an opportunity to evaluate the company. Neither organizational models affecting the value of the company, nor taken actions by a company do not translate how the company is perceived by investors if they are not communicated to the investor community in a thoughtful manner and with appropriate tools (Krug, 2008, p. 275). In other words, the company facilitates making appropriate investment decisions if its IR model is based on: transparency, reliability of information, consistency of messages and actions, fulfillment of reporting obligations on time, bilateral communication, compliance with regulations, and cooperation with other departments (Gajewska, 2005, in Krug, 2010, p. 37–39).

The article provides an overview of the literature on building and managing the image and investor relations. Additional, appropriate studies on how companies use IR to create an image, and whether the company image is important to make investment decisions are required.

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Social and ethical issues in management

16. Corporate social responsibility in the management of Norwegian government pension fund global

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Abstract

This article is an attempt to analysis socially responsible activities in the GPFG with reference to the specifics of the Norwegian economy. For this task was used the self-created tool dividing the dimensions of the concept of CSR and proposing suitable measurement methods for each of them. The phenomenal economic system in Norway (Scandinavian model, welfare state, egalitarianism, sustainable development) has a material impact on the quality and effectiveness of realisation responsible investment in the fund. The findings of the research can be used as a basis for more advanced analysing in other articles.

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Introduction

Corporate social responsibility is popular theme of discussion increasing amount of economics theorists and practitioners. The increase in interest in this subject is a response to the growing awareness of the role of balance in sustainable development, which is hard to achieve with a large share of the market mechanism in the economy. Disparities of the economic, environmental and social dimensions inhibit the growth and limit development. The concept of corporate social responsibility (CSR) tries to mitigate inadequate relations between these three basic dimensions of economic activity.

A specific example of an organization implementing the assumptions of CSR is Global Government Pension Fund in Norway. The analysis of the Fund in terms of responsible practices can be very useful in understanding the phenomenon of the Norwegian economic system. Management of the government fund is closely associated with the policy of the country. Norway is an example of a state, which consistently attracts the attention of researchers[1], arousing misunderstanding of ability to achieve economic success while respecting the environment and the needs of the individual.

16.1. The Government Pension Fund Global in Norway's and the world's economy

In the face of the limited natural resources and Dutch disease, creation GPFG is the manifestation of responsible distribution Norwegian wealth from the raw material sector distribution between generations, in a way that provides sense of security and prosperity for future generations guarantee.

A Government Pension Fund (consisting of the Global and the Norwegian Fund) was established in 2006 on the basis of the Government Petroleum Fund, which was founded in 1990 (NBIM, *History*). The first transfer of accumulated capital to the fund in 1996 was a reaction of the authorities to the situation deteriorating terms of trade, the specter of the Dutch disease and the loss of competitiveness in exports, as a result of capital inflows from the sale of raw materials. (Araszkiewicz, 2008, p. 124–125) the Fund has been accumulating capital for 25 years and also

1 For example R. Whitley (2000) and D. Soskice (1999, p. 100–134) who predicted the imminent defeat of the Norwegian system.

promotes balance between maximizing profit in the long term and investing in a socially responsible way only.

Great significance in the GPFG is primarily a consequence of the size of the Fund. The market value of fund has exceed the GDP of the country since 2005 year, constituting 220% of gross domestic product in 2013. (Government.no, *Market*…) Government Pension Fund Global in 2014 was the second largest government fund with respect to net assets in the world. (SWF, 2014). GPFG market value increased from 440 billion at its inception to 5478 billion NOK in the first half of 2014 years (Government. no, *Marke*t…). The largest share of market value of the fund is an inflow of capital from outside. In 2013, the transfer of capital from the budget to fund accounted for approximately 34% of revenues in the period (Norges Bank, 2014, p. 11).

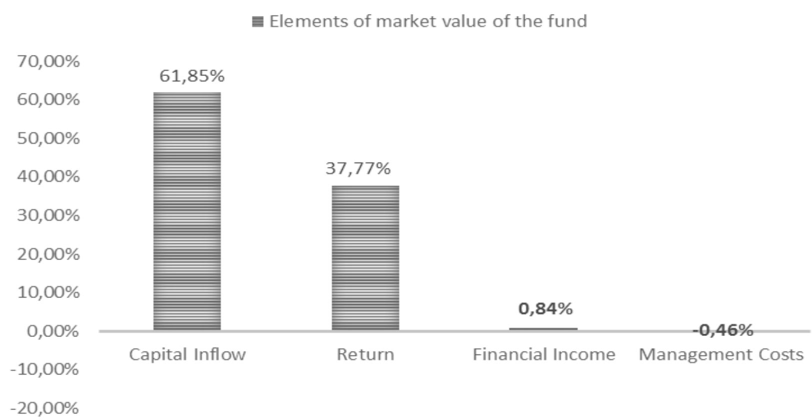

Figure 16. 1. The market value of the fund since its inception to the first half of 2014 (in %)
Source: own based on Government no., *Market value*, https://www.regjeringen.no/en/topics/the-economy/the-government-pension-fund/government-pension-fund-global-gpfg/market-value-and-capital-inflow/id696852/.

The Fund and Norwegian State has an impeccable reputation, resulting in a large trust investing. The investment strategy besides the logic of conduct clearly explained in the investment process, presents the simple rules of interaction with investors and the environment. Financial factors such as a high rate of return and a moderate level of risk contribute to the capital allocation in the fund (the average real rate of return from 2012.06 to 2013.06 was 13.26%) (Govermnent. no, *Fund*…). However, the added value is worthy of special attention, which is generated by active operation of Norges Bank Investement Menagement in all areas. Active mamangement has been getting more offensive, what was emphasised by General Director NBIM Yngve Slyngstad'a[2] in 2008, who in a fight with the crisis changed the strategy in a more plentiful of initiative. Under his leadership, the "Norwegian style" of fund management has become an one of the best international example of effective governance of sovereign wealth fund.

The Fund is an integral part of the Norwegian budget. In some situations, there are transfers of capital from the Fund to the budget. Despite the name, there is no formal fund pension obligations. No decision has yet been taken as to when funds will be used (Fiedorczuk, 2014, p. 71).

GPFG plays an important role in the national and global economy. By investing in selected companies abiding by ethical rules, the Fund sends signals to promote responsible behaviour among shareholders. The size and scope of the fund helps to effectively promote the validity of long-term implication of the concept of CSR in the world. Moreover, the global reach of the Fund's activities contribute to balancing the size of the business in order to provide the conditions for sustainable economic development.

16.2. Selected points of view of corporate social responsibility in the theory of economics

Corporate social responsibility is a relatively new concept. A proper sense of this term appeared in the mid-twentieth century. H.R Bowenis considered to be the founder of the concept, which tried to explain in Social Responsibilities of the Businessman. His proposal of definition was first explanation the most approximate to present understanding of SRC concept. (Rudnicka, 2012, p. 39). This does not mean that previously did not appear examples of socially responsible activities or attemptsof defining. However, they were fragmentary and without awareness of the meaning of the concept as a whole.

There is a large amount of definitions of CSR concept in the literature, due to the qualitative character of the responsibilities and wide interpretation possibilities. In some studies the concept is a trend in management in others it is treated as a supplement to a free market economy model of ethical and social elements, in others is a needed framework to introduce s-called "soft regulation" (Filek, 2013, p. 118). The wide range of meanings

2 In July 2013, Slyngstad was ranked number three on the Sovereign Wealth Fund Institute's Public Investor 100. Slyngstad has been listed as one of the top 100 most influential institutional investors worldwide.

for corporate social responsibility resulted in the appearance of more specific terms, for example: Social Responsible Investment, Corporate Social Rectitude, and Corporate Social Performance. Difficulty in defining the concept also cause problems with its measurement. A review of the literature and reports, analysis and publications of institutions dealing with this issue leads to the conclusion that there is no universal method to measure the implementation of the concept.

According to the definition adopted by Davis and Blomstrom the 1975 CRS is obligation to make such decisions and actions that will result in attention to self-interest and the public welfare (Davis and Blomstrom, 1975, p. 13). Also in this article it is assumed, that the activity is socially responsible, when benefits it the individual and society's interest. Due to the high degree of generality explanation of the adopted concept, it was divided into smaller parts to facilitate measurement.

According to the results of A. Dahlsrud's research (from the article *How corporate social responsibility is defined*) most synthetic definition adopted the European Commission in 2001. In this definition are included all five dimensions of the concept: economic, social, environmental, stakeholders and voluntariness (Dahlsrud, 2008, p. 7). According to the definition of the European Commission responsible social action must be applied on a voluntary basis, including the social and environmental aspects of commercial activities and contacts with stakeholders (Commission of the European Communities, 2001, p. 6).

Table 16.1. The dimension of Corporate Social Responsibility
Source: Dahlsrud (2008), p. 7–13.

According to a review of the empirical work by A. Wąsowska and M. Pawłowski operationalization methods of corporate social responsibility can be divided into four basic groups: (1) measurement charity activity – expenditure on charitable activities; (2) measurements based on existing databases and reputation index – base created by organizations and agencies; (3) surveys – surveys at the level of the organization and (4) monitoring of disclosure – financial statements and other reports (Wąsowska and Pawłowski, 2011, p. 15–16).

The combination of results of the work Dahlsrud's and Wąsowska, Pawłowski can create a scrupulous measurement tool, which is used in the next part of the article. To exhaustive and comprehensive analysis CSR proper methods were selected to each dimension of the concept.

Economic	Social	Environmental	Stakeholders	Volontariness
2.	2.	2.	2.	1.
4.	3.	3.	3.	
	4.	4.	4.	

Table 16.2. The proposal tool to analyse the level of CSR realisation
Source: own, based on Wąsowska and Pawłowski (2011, p. 15–18); Dahlsrud (2008, p. 7).

The proposed procedure allows for a more detailed evaluation. The use of one method to measure all dimensions of responsible action does not give rise to valuable conclusions. Therefore, it seems important to fragment the areas of CSR.

16.3. Corporate social responsibility in Government Pension Fund Global

The Fund is selected for the analysis and not accidentally. The idea of the creation and operation of the fund is proof of justice and accountability. The concept of CSR is a component of the operation ideology, which is exhibited in the investment strategy. The ethical principles are strictly adhered to. The guardian of responsible practices is an independent cell – the Council of Ethics. The Council decides to exclude from the investment portfolio entities whose activities go beyond the accepted area of freedom of taken decisions and makes publicly available a list of executed companies and governments (Council of Ethics, 2015).

The GPFG is particularly active in voluntary and an additional six areas: well-functioning and efficient markets, risk management, climate change, water management, respect for children's rights, equal treatment of stakeholders and stakeholder influence and responsibilities of the board (NBIM, 2015, *Responsible*…).

Norges Bank Investment Management, which manages the fund is a signatory to the Principles for Responsible Investment (PRI PRI, 2015). Ethical principles include the content of the precepts of the UN Global Compact (OECD, *Principles*…). NBIM manages the fund using the

OECD Guidelines on Corporate Governance and Multinational Enterprises (OECD, *Guidelines*…). NBIM applies reports under the initiative of the Global Reporting Initiative (GRI). Sustainability reporting is a vital step for managing change towards a sustainable global economy – the one that combines long term profitability with social justice and environmental care.

The GPFG is one of the most transparent fund in the world (SWFI, 2014; Behrendt, 2010, p. 6) and received one of the Truman Oil solvents resistance rating of SWF Scoreboard (Truman, 2007, p. 15). It publishes and complete lists of its holdings as well as its voting records in its quarterly and annual report. The GPFG publishes the benchmark portfolios used to measure its performance against.

Only four of the five dimensions were analysed, because available information was not found, moreover, a response from NBIM about the (Previous chapter). According to the fact that the GPFG is one of the most transparent fund in the world, using only two methods is not very risky and allows us to draw the right and rather true conclusions. The volontriness dimension was bypassed because available information were not found, moreover response from NBIM about adopted and implemented definition of CSR were not received. So there is no basis to confirm that charity activity is an element of it. Surveys were sent but response from NBIM was not received.

Dimension	Measurement charity activity (1.)
Volontariness	Measurement was not performed due to lack of the required data.
	Measurements based on existing databases and reputation index (2.)
Economic	CFA Institute (GIPS) Principles index from RI Transparency Report (PRI) Fund Management in 21st century (ISVA for WWF)
Social	
Enviromental	
Stakeholders	
	Surveys (3.)
Social	Method was used, but not replied feedback
Environmental	–
Stakeholders	Method was used, but not replied feedback
	Monitoring of disclosure (4.)
Economic	Performance Results (NBIM), Presentation of investment performance in compliance with Global Investment Performance Standards (NBIM), Verification Report (the Spauldnig Group), List of excluded and observed companies (NBIM)

Dimension	Monitoring of disclosure (4.)
Social	Expectations Document: Children Right, The list of excluded investors.
Enviromental	Annual Reports: Climate changes, Water Management
Stakeholders	Annual disclosure of voting record, Submissions to ministry, Stakeholder Advocacy, Negative screening

Table 16.3. The methods used to measure the implementation of the concept of CSR with the division of Dahlsrud dimensions
Source: own tool created on definitions and division Wąsowska and Pawłowski (2011, p. 15–18); Dahlsrud (2008, p. 7) (Previous chapter).

The results of the review of reports and disclosures prepared by itself allow for the conclusion that the responsible activities of GPFG is very mature. The concept of CSR occupies a strategic place in the mission of the fund, which organizes the organization and lines of action. The fund has a high degree of transparency in all six areas of responsible taken actions. However, there is lack of positive screening in Fund performance. Clarity and understanding of the practices and expectations of the stakeholders is in the form of simple messages in the form of, strategy, ethical principles, quarterly and annual reports, discussion notes, features. The Fund sends signals of respecting only social responsible behaviour among stakeholders by investing only in selected companies that abide by ethical rules. NBIM makes the decisions based on recommendations from the Council of Ethics. Council of Ethics appoints excluded company from the fund's investment universe or places company on an observation list.

The evaluation social responsible activity of GPFG based on existing databases and indexes reputation effects slightly worse results than by monitoring disclosures.Among sovereign wealth funds Government Pension Fund Global is recognized as a leader in the using and promotion of the CSR concept. However, in comparison with all types of entities involved in the assessment by international organizations, the Fund is listed relatively lower in the hierarchy. From the measurement results based on the analysis of existing data can also be noted that the Fund is the executor of the concept on a global scale. However, there are areas of activity, which should improve mainly environmental activities and introduce reporting positive[3]. In the international organizations reports also emphasize the particularly positive practice in the Fund. A report commissioned by WWF reveals the high standards of behaviour in inter-

3 This recommendation was supported by Robert Stand (professor of corporate responsibility and business ethics at university of Minnesota) in the letter to UK Financial Times in 2008.

actions with stakeholders. The Fund seeks to be an active manager, which performs effectively organizing meetings with investors and shareholders to dialogue and acknowledge expectations.

The ethical foundation is fundamental to the Government Pension Fund Global. The fund invests and exercises its ownership rights responsibly, because the fund's investments are about the future and belong to future generations. The main aim of management is the contribution to efficient and well-functioning markets and promoting work on international standards for responsible investment.Wide use of the concept of CSR in the Fund, as a rule also resulted in the development of reporting. The importance of corporate social responsibility reporting in today's financial markets is rising.

16.4. Considerations of responsible activities in Government Pension Fund Global

The maturity of the corporate social responsibility and naturalness of it application in the Fund is result of many of conditions. The ethical basis for the Norwegian CSR-policy derives from the inviolability of human dignity. Norway is one of the first countries to develop a coherent policy on Corporate Social Responsibility (CSR) in a global economy. Part of this policy is to base the investments of the Norwegian Government Pension Fund on an ethical foundation (Norwegian Embassy).

An analysis of the factors influencing the style of fund management should begin from Norwegian culture. Culture is a determining factor in the way of thinking, attitude and ability of a nation to develop, which is confirmed by the results of the research presented in the book *Culture is important* (Harrison and Huntington, 2003, p. 412). The word justice and equality are deeply rooted in the culture of social – democratic Norwegians. Religion and protestant ethics in harsh environmental conditions developed specific attitudes. On the one hand, society had to count only on themselves to fulfilling their duties by hard work of and the second, functioning without violating the standards of social conduct (Angel, 2013, p. 25–27). Thedifficulty in being self-sufficient and independent in such Norwegian hard conditions in the past resulted in acceptance of majority participation the state and institutions in the market. So a huge part of the responsibility for citizens and risk of satisfy all the needs of society were moved on the state duties. From the same reasoning society fully accepts the redistribution of income and participates in the welfare statecosts.

On the border between cultural factors and lifestyle is situated Norwegians concern for the environment. Both the state and society treat nature as a national heritage. The environmental aspect in Norway has gained strategic importance. In 1972, Norway was the first country in the world to create a ministerial unit dealing with issues of responsibility for the environment (Report No. 14, 2007). The need for the establishment of the unit due to the economic culture and traditions of Norway, whose main purpose is to manage, so that future generations can enjoy the unchanged nature (Harrison and Huntington, 2003, p. 70, 74).

The high standard of social responsible activities at organisation level in Norway is depended on state, which set an example responsible attitude[4]. Even in legislative process in Norway, the governments are carried out on the basis of democratic discussion with the public. This dialogue is called Nordic consensus. Thus, decisions by public authorities are a reflection of the views of citizens. "Happy democracy" in Norway is based on careful listening needs of the people at the level of individuals, groups (unions) and local communities. The Norwegian reality disputes are resolved parliamentary and very important decisions consult with citizens, eg. by referendum. The State has the support of the parties advisory bodies, which are intermediaries between the private sector (Nowiak, 2011, p. 130–134). Such consultations make public choices are relevant and acquire a more practical dimension. It is not surprising, Norway is the most democratic country in the world (Democracy Index, 2014)[5], with one of the highest levels of happiness of citizens[6], respect for gender equality (GDI in 2013)[7], the world's highest indicator of quality of life (HDI in 2014)[8] and the level of sustainable development of the country (HSDI in 2010)[9].

Social attitudes of the state and public institutions are worth describing. The relatively high proportion of intervention in the economy is social

4 The Labour Market Act, Social Welfare Act, The Pollution Control Act, The Product Control Act, The Greenhouse Gas Emission Trading Act, The National Insurance Act, The Norwegian General Civil Penal Code, The Norwegian Agency for Development Cooperation.

5 According the Global Democracy Ranking 2014, http://democracyranking.org/wordpress/?page_id=831.

6 II position in the world according J. Helliwell, R. Layard, J. Sachs, World Happiness Report 2013, http://unsdsn.org/wp-content/uploads/2014/02/WorldHappinessReport2013_online.pdf, p. 2.

7 According the Ranking of UNDP 2014, Gender-related development index (GDI), http://hdr.undp.org/en/content/table-5-gender-related-development-index-gdi.

8 According the UNDP, Human Development Report 2014, http://hdr.undp.org/en/countries/profiles/NOR.

9 According the Our World, 2010 Human Sustainable Development Index, http://ourworld.unu.edu/en/the-2010-human-sustainable-development-index.

manifest of absolute trust citizens. The market is a very effective mechanism for allocation in the short term, but in a long time horizon is not able to protect nature and human satisfaction.Only the state is able to effectively manage free goods and represent the interests of the whole community in the long run (Chmielak, 2002, p. 80–82).

The Norwegian welfare state model works in condition of high developed economy and well organized public sector. Norway has long experience in the functioning and management of the public sector. Important is social prestige and high consideration attributable to the state officials fulfilling a social mission (Nowiak, 2011, p. 136–137). Social responsibility is not just a dead note, but also style of work even at the lowest level of its implementation. It leads to higher quality of work and reduces the possibility of acting to the detriment of the state.

Being a responsible country is required meeting expenses for the implementation of responsible initiatives. A highly developed economy is not a prerequisite for the exercise of CSR principles. Norway is one of the richest economies in the world (2nd place in the world in 2013 in terms of GDP per capita (current US $)) (World Bank, 2014, GDP…). The financial situation of the country is as a consequence not onlyproduction of crude oil and gas, but responsible management of state wealth.

Natural phenomenon responsible activities in Norway originates in culture and tradition. The Scandinavian model is the extraordinary variety of social market economy. This uniqueness stems from the social acceptance for the use of tools (the tax system, social programs, income redistribution) in reducing disparities. Congenital egalitarianism constitutes the basic principle of a fair system by which individuals and groups should be the same as any other background. Egalitarian attitudes of Norwegian society are reinforced high availability of education and learning at all levels. Knowledge in addition to being an economic value, which enables the use of development opportunities[10], affects the understanding and universal acceptance of responsible activities.

According to the results of K. Bachnik's digressions on culturally in the management process at micro scale, a nation's cultural characteristics are transferred in the professional sphere and influence the type of model order (Bachnik, 2012, p. 80–94). The author draws special attention to Scandinavian egalitarianism, the desire to adhere to the principles, the use of dialogue in decision-making, respect for privacy, the importance of collectivism in cooperation, neutrality and consensus in resolving

10 According the Ranking of World Bank Knowledge Economy Index (KEI) 2012 Rankings, Norway takes fifth position in the world as a Knowledge – based economy, http://siteresources.worldbank.org/INTUNIKAM/Resources/2012.pdf.

conflicts, building lasting relationships with stakeholders as distinctive cultural components of other nations.

The Fund is managed on behalf of the Norwegian people by a special unit of the Norwegian Central Bank, which is a state institution. Implemented tools and fund management style reflect the expectations of society and the state. The fund is a specific international version of the Scandinavian global economic model.

16.5. Concept of Corporate Social Responsibility and sustainable development in Government Pension Fund Global

The concept of sustainable development at the level of the organization is poorly defined and represents a new approach in the management sciences (Adamczyk, 2001, p. 32). The transformation the sustainable development concept from macro and micro level is defined as a sustainable business in English literature (Paliwoda-Matiolańska, 2014, p. 246). The organisation functioning in accordance with assumptions of sustainable development are called sustainable corporation. According to Banerjee's definition sustainable corporation isan organization that strives to increase the economic long-term value for shareholders, through the integration of economic, environmental and social opportunities to increase the value of corporate strategy (Banerjee, 2002, p. 107). In this sense, sustainable organizations can easily discern the four dimensions of a socially responsible organization, proposed by Dahlsrud (without the exposed dimension ofvolontariness). This causes difficulty in making a clear distinction between the activities falling under the implementation of the concept of corporate social responsibility and sustainable development at the level of the organization, which is the Fund.

The concept of sustainable development and CSR have more common characteristics than differences. The clearest ideological differences are: the level of implementation of the concept (CSR – scale micro SD – the whole globe, the country), the origin of the creation (Jonker, Reichel and Rudnicka, 2011, p. 41–42) and the expected time horizon (usually a long period of planning and implementation occurs in the case of sustainable development). Due to the international nature of the organization scale implementation of the concept CSR is comparable to sustainable development policy. In 2009, was developed by the Ministry of Foreign Affairs document "Corporate Social Responsibility in a Global Economy", which highlights the increased expectations of states to use the concept on a larger scale in order to emerge from the crisis. The publication of this document highlights two issues. The first highlights the strategic treatment of CSR by Norway as a way to mitigate the effects of the crisis and achieve competitive advantage. It extends the coverage by the adopted micro to macro minimum in Norway. The second point concerns the manner of introducing changes begins with the establishment of regulations, documents and regulations. A. Carroll locates "the legal regulations" in second place after the economic conditions.

The analysis of the degree of similarity, differences and relationships between two concepts should emphasize the specificity of the subject of analysis. The Fund is an independent organization, but operating within the state structures. As a rule, management style and operation shall be in accordance with the directions of its policies, including sustainable development. Louche and Lydenberg (2008) confirm that the attitude of the government to determine the sustainability of policy interpretation and approach to the concept of socially responsible (Bengtsson, 2008, p. ?). And Norway plays pivotal role in driving sustainability disclosure at a national and global level. High rank sustainability enforces a similar level of realization of the concept of CSR. The high efficiency of the fund is not limited to the success of the organization, but to the entire state.

Other characteristics of the two concepts are the same[11]. Corporate social responsibility is a tool for implementing the concept of sustainable development of the country at the level of enterprises/organizations. As noted by A. Rudnicka implementation of the concept of CSR may lead to more effective pursuit of the organization to implement the country's sustainable development policy (Rudnicka, 2012, p. 47–48).

The compared concepts mutually stimulate themselves. The first interaction expresses as the influence of corporate social responsibility on Sustainable development. In this direction of the action, CSR support the implementation of sustainable development through the use and promotion of internationally socially responsible behaviour. The second portion of influence refers to the need to respect the principles of sustainable development through the state public institution, which in this respect is the world leader. These feedbacks cause the maturity of responsibility, because they are carried out simultaneouslyat the national level and micro scale. High investor trustto GPFG is on the border of the trust the governments of Norway. In the future, the experience acquired by the Norwegian authorities is a combination of the active use of these two concepts and reputation (The Reputation Institute, 2005, p. 7–8), Norway could fulfill a niche by offer for other country the effective and responsible management of public assets.

11 Annex 1.

The results of the WWF Report from 2008 onwards, indicate that there are many reasons for acknowledging Norwegian government as a world leader of responsible and effective way of investing and management. Oslo is indicated as potentially the world's capital of socially responsible investing, due to the current consistency and naturalness responsible activities (Innovest Strategic Value Advisors for the WWF in 2008, p. 70–71). Government Pension Fund becoming the best managed fund in the worldand Oslo – the SRI capital of the world would place Norway at the forefront of invest innovation in the future economy. It would also cause to recognize Norwegian fund as the most important tool for realising the state aims of promoting global sustainable development and tackling climate change.

Conclusions

In summary, the main purpose of the article and the detailed plans have been achieved. The Government Global Pension Fund of Norway is a resilient executor and promoter of CSR. Socially responsible activities are very mature in the fund. Conditions that maturity underlie Norwegian tradition and culture of the nation, which also determine the specificity of the economic model of Norway. When evaluating CSR, it is necessary to establish the Norwegian model because it creates the possibility to implement this concept in a very natural way. The common and popular applying of the CSR could improve competitiveness in the long-term in Norwayandmakes reducing the small differences in relation to the concept of sustainable development. In this country the concept of CSR could be included to the permanent element of the style of Norwegian management.

Governmental Pension Fund Global is an excellent example of proper relation between the priorities of socio-economic and environmental development. It is a balance between and a sense of justice. This relationship is the essence of the model of the Norwegian economy – the market mechanism and state intervention. The Norwegian approach shows that for sustainability responsibility is shared between business and the state.

The implementation of the assumptions of the CSR concept is the one correct way to sustainable development of an organisation, and then the state and the world. Functioning in accordance with the objectives of this concept increases stakeholders confidence, resulting in formation of a competitive advantage.

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http://dx.doi.org/10.18778/8088-012-2.17

17. Social engineering in the company management

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Abstract

Purpose: The aim of this article is to indicate opportunities for the practical use of social engineering in the company management.

Design/methodology/approach: The method of analysis and idiographic method were used as research methods. The latter enables the acquisition of information which reveals unusual, distinct, unique and distinguishing features of a phenomenon of social engineering operations.

Findings: The first part of the article is a presentation of social engineering as science with specification of its origin and scientific interpretation disputes. The methodological bases of social engineering were specified. The rules and methods as well as basic social engineering models were indicated. Subsequently, having conducted an analysis of opportunities for the use of social engineering, features of social engineering

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which qualify it to the group of practical sciences were indicated. The second part of the article constitutes the transmission of scientific considerations into the practical use of social engineering in business entities management. The use of social engineering in relation to an individual and groups of employees in order to form adequate attitudes in a company and the opportunities of its practical exploitation to solve problems are indicated.

Research limitations/implications: The use of social engineering which is presented in the article does not exhaust the problem and does not constitute any remedy. It is only an attempt of indication of opportunities of the use of this science and an impulse to further studies regarding its effective implementation in company management.

Original value: The connection between a theory of science on social engineering and its practical use in the management of a company through the formation of adequate attitudes of both an individual and groups of employees in a company.

Keywords: models, management, social engineering

Introduction

All people are born with an inner need to learn more about their nature and surroundings. The process of creation of a social order requires a conscious emphasis on adopting an adequate model, the creation of values, acceptance of agreed norms or making changes. Social engineering in relation to social groups or the whole society refers to rational action aimed at attaching reality to specific way of understanding. The issue of evaluation and subjective stimulation of appropriate attitudes, targets worth of implementating and ideas which should be addressed is a very important aspect of social engineering, especially in management.

Sociotechnical aspects in management became the leitmotif of this article whose main purpose is an attempt to indicate opportunities of the practical use of social engineering in management of an enterprise. The idiographic method and the method of analysis which was used as the research method were used to pursue the adopted aim.

Managers who manage business entities and are successful, consciously or unconsciously influence their workers to pursue adopted targets. Therefore, in management it is very important to effectively use work and capital as well as the information and knowledge, including social engineering in order to change the behaviour of people, influence and form them depending on the needs of the organisation. The knowledge of rules which function in science, methods of impacting on people as well as basic sociotechnical models on the highly competitive market is nowadays necessary for managers.

Except from the indication of the above-mentioned principles, methods and models, this study considers also scientific aspects regarding social engineering making an attempt to transfer scientific considerations to its practical use in managing business entities. The indication of opportunities of the use of social engineering in relation to the individual and employee groups to form adequate attitudes within the company as well as the practical use of sociotechnical operations to deal with the problems within the organisation is the effect of the analyses conducted in the article.

The use of social engineering presented in the article does not cover the problem and is not the remedy but only an attempt to indicate opportunities of the use of this science and an impulse to further works on its effective use in the management of an enterprise.

17.1. Social engineering, genesis and scientific interpretations

Modernisation processes of the 19th and 20th centuries were the impulse to generate social context of creation of social engineering. Industrialisation, urbanisation, democratisation gave rise to the demand for social knowledge which enabled us to manipulate people and symbols like objects (Amsterdamski, 1999, p. 299). The creation of social engineering as a science is, first and foremost, the occurrence of a theoretical approach of the creation of a new scientific discipline which was formulated, described and published in the Principles of social engineering. The study of recommendations for solving detailed problems (presented in the following volumes of Social engineering) was the second stage. The institutionalisation of social engineering, i.e. the creation of the Social Engineering Section within the Polish Sociological Association as well as the creation of the Institute of Social Prevention and Resocialisation was the conclusion of operations related to the creation of the new scientific discipline. L. Petrażycki in policy of law, T. Kotarbiński in praxeology and S. Ossowski in techniques of social operations were precursors of social engineering (Ozierański, 2014). Theassumptions of L. Pietrażycki were developed in America by R. Pound (law as a tool for social change). W. Lenin tackled the social engineering of revolution providing guidelines for transformations within great social structures. G. Myrdal dealt with the problem of solving social conflicts with the use of sociological knowledge. He also, and then K. Popper (partial social engineering) disseminated sociotechnical directives and contributed to the conduction of analysis and reflections concerning social engineering as science.

The notion of social engineering is determined in the scientific literature ambiguously (Trejderowski, 2009, p. 15). This author states that the notion of social engineering refers to the sum of methods and operations aimed at achieving appropriate behaviour of individuals and groups of people as well as the science on methods and results of conscious impact on surroundings through law, education, exercise of public authority, etc. T. Trejderowski argues that social engineering in its fundamental meaning is the impact on people which causes that people behave subconsciously in such a way that is completely different than the way of behaviour compatible with their own will. Therefore, social engineering is called influence, manipulation and the control of people. Desired behaviours or decisions are obtained also through an inappropriate presentation of the reality beginning from changing facts and choosing them in such a way that they support a particular thesis to a bold-faced lie (Trejderowski, 2009, p. 15).

Podgórecki distinguishes three ways of understanding the notion of social engineering. Firstly, when he mentions social engineering in a broad sense he is thinking about the technical capabilities of the social sciences thus their role in inspiring effective strategy and procedures with the use of techniques and methods of planning social changes. Secondly, social engineering may be perceived as a separate practical science with the subject matter relying on evolving the purposive procedure in which an individual or collective maker has control of a social group and pursues adopted goals influencing a social system. In the third and the narrowest meaning, social engineering is equated with purposive procedure alone, considered as the way of reaching adopted targets based on an adopted system of values and accepted theoretical statements (Czapów and Podgórecki, 1972, p. 9–10).

Whereas T. Koćkowski divides the notion of social engineering into social engineering of the first stage which relies on the creation of a set of incentives which induce people to specific behaviours with a direct use of the system of punishments and prizes as well as social engineering of the second stage which is specified as the way of the creation of specific motivation among people or forming particular features of personality. A similar influence in both described cases with the difference that social engineering of the second stage relies on the indirect influence of legal standards because of their internationalisation in the consciousness of the individual is the effect of the notion interpreted in such a way (Zajęcka, 2014).

While compiling presented definitions for the needs of this article it was adopted that social engineering is a practical science which is based on the techniques offered by science (sociology, praxeology, juridical studies, psychology, logic, political science, management) and methods aimed at influencing reality, relying on acquiring the desired behaviour of individuals or social groups to pursue adopted aims.

To sum up, in accordance with the presented definitions, social engineering does not include all changes resulting from individual or collective human activity, but only the ones which are the result of aware activity and influence on these entities. Sociotechnical processes are the most interesting from a scientific point of view. Purposive stimulating operations contributed to their creation or described phenomena were caused by intended changes in the conduct of behaviour of individuals or groups.

17.2. Rules, methods and basic sociotechnical models

The knowledge of basic functional elements of social engineering, such as rules, methods of influencing as well as sociological models is a very important aspect of the use of social engineering in the management of an enterprise.

The rules which may be specified in a formal way as actions, which may be applied in a specific field have also been used in social engineering. Sociotechnical rules present specific aspects of human life (they refer also to professional life), which are used as grounds of possible actions. Sociotechnical rules refer to our features of character, our way of behaviour or thinking. Due to these features each of them may be ordered and named (Trejderowski, 2009, p. 58–60):

– The rule of authority is mainly power, knowledge, experience, i.e. all forms and symptoms of superiority over others. It is a very important rule in management,
– The rule of consequence involves all issues, events, forms as well as ways of using sociology which are based on consistent activity, following concrete stimulus or impulse,
– The rule of maximisation of own profit. This rule refers to issues and tools of influence and manipulation techniques which are connected with value. Measurable, quantifiable as well as unquantifiable values, the most important for every man in a psychological and personal sense, such as reverence, dignity, safety and the future,
– The rule of mutuality or showing gratitude for favours done for us. Many ways of using social engineering include mainly influencing the behaviour of colleagues from work and subordinates may be built based on such feelings,

– The rule of liking refers to everything which is recognised by us as nice, friendly, good, and pleasant. The features of liking are considered by the staff of an enterprise as very positive,
– The rule of non-availability is the most extensive among all the rules. Depending on the aspect and the way of its action we connect it with controversy or temporality, curiosity, mystery or prohibition. Everything which is unavailable, controversial, temporary, transient, prohibited, mysterious or interesting for us stimulates our unconscious desire to own or learn it,
– The rule of social proof which is the pressure of surroundings. We have this rule each time we take into account the opinion of society or our closest environment instead of our own convictions.

The rules presented above constitute basic pillars of social engineering in management. The issue of influence could not be complete without description of the basic methods of influence which supplement and strengthen the operation of sociotechnical rules.

K. Mlicki (1986, p. 21–25) indicates the following triggering sociotechnical methods: persuasion, manipulation and control, creation of situations of deprivation. The encyclopaedia of management describes three classical forms of a sociotechnical message: persuasive and manipulative actions as well as facilitative actions.

Four methods of influence of social engineering on the management of business entities were adopted for the needs of this article:
– The method of persuasion which relies on convincing staff with clearance of indicators of persuasion to accept presented views due to the obtaining interest of staff, understanding and approval for these intentions,
– The method of authority is involved to soft sociotechnical methods which are based on acquired or created authority influencing an individual or a group of employees,
– The method of manipulation basing on the use of psychological power in order to change opinions, behaviours and attitudes of an individual or group of employees against their will or without their knowledge,
– The method of coercion based on the opportunities and privileges of the authority forcing to accept the proposed solutions.

The models of social engineering described in the literature on the subject are supplement of the basic functional elements of sociology. We may distinguish three main models (Podgórecki, 1966b, p. 30, 44–52).

The first is the “Classical” model which relies on systematisation and selection of various general regularities from the field of sociology as well as other social sciences. This model transfers these regularities into appropriate practical directives. The presented recommendations in the form of the set of directives are some kind of transmission of descriptive, general and detailed statements into the simple language of recommendations referring to pure action. The classical concept of social engineering is not interested in the fact that if a given set is used in practice or not.

The second is the "Clinical" model. It specifies not only the prepared set of practical directives. It mainly aims at the need for cooperation with those to whom these directives are directed. To accept and implement directives on the way of persuasion.

The "Intervention-expert" model is the last presented model. Its purpose is not only the creation of a recipe for practical operation as well as a specified influence on the person who ordered the research but it also stands for inherent intervention against various social groups, institutions, organisations, etc. At the same time it indicates the necessity of sociotechnical action together with the calculation of losses and profits which would appear as its result and the value which will be engaged in this action.

17.3. Social engineering as practical science

Definitions quoted in this study indicate unambiguously that social engineering is a practical science. It is also proved by A. Podgórecki (1966b) in scientific considerations between sociology as a theoretical science and social engineering as a practical science. He claims that sociology tackles formulating and verifying statements concerning relations between different elements of social life whilst social engineering manages how to pursue adopted targets on the basis of these statements. Sociology endeavours to find out social reality and social engineering endeavours to learn a rational change of this reality.

According to A. Podgórecki (1970a, p. 14) the issue of practical sciences, which is presented by social engineering, relies on the course of purposive procedure, the course of special action which may not be brought down to anything else.

From a methodological point of view, in social engineering as a practical science connected with the rules of effective action the course of purposive procedure consists of four stages:

- The first refers to the determination of values crucial for planned social change, i.e. their revealing and ordering,
- Social diagnosis is the second stage which is focused on catching the coexistence of various phenomena or causative relationships which connect them,

- The third is the use of theoretical statements to formulate sociotechnical directives. This stage of the purposive procedure expresses a scientific plan in the fullest way which aims at the creation of a practical science on the certain foundation of the verified statements with an agreed period in force,
- The last and fourth stage is a measurable assessment of the effects of action which is made both ex-post and ex-ante and based on the analysis of costs and benefits (Ozierański, 2014).

Social engineering is included to the practical sciences mainly because of forming social awareness through giving people rational tools for the description of reality as well as participating in giving predictions which influence leading social processes. However, the most important aspect which qualifies it as a practical science is the creation of directives resulting from the cause and effect relationships which provide a foundation for effective action.

Thus, social engineering as a practical science gives knowledge whose use having appropriate instruments and means allows its users to persuade individuals or groups of people to behaviours expected by makers of impacts (Podgórecki, 1966b, p. 23).

17.4. The attempt to indicate opportunities of practical use of social engineering in the management of business entities

The management of an enterprise is a difficult and complex action whose main processual aim is to generate decisions in four of the most important spheres of management, i.e.: planning, organising, motivating and controlling (Gajda, 2014, p. 133).

The skill of managing teams of workers through influencing them towards forming desired attitudes and behaviours is one of the priorities in all fields. The attitudes of staff influence directly the operation of all resources and a part of the organisation. Managers must use a modern variety of methods and realisational tools created by social engineering.

Persuasion is the first sociotechnical method used successfully in management. The principle of use of this method relies on influencing the mental sphere of a worker or a group of workers in order to accept formulated targets, expectations, requirements and decisions as the result of convincing workers to presented reasons due to acquiring their interest, understanding and approval. Persuasion is a means for changing not only the personality of a worker but also his situation through interference in the rational or emotional sphere. It creates a situation where a person impacting on staff determines behaviours and behaves in a way desired by both sides. There is mutual consent and there is no punishment or prize.

Skilful persuasion results in the effect of the equation of aims of a worker with the aims of an enterprise, participation in management, influencing the fate of a plant and dedication to a place of work. In general, low-skilled workers are more prone to emotional persuasion made by a person with great authority. As regards highly skilled workforce, partner persuasion is more effective. Persuasion means take the form of negotiations, consultations, suggestions, appeal or propaganda.

The role of persuasion, especially the one which is based on convincing, consulting, suggesting and informing increases along with an increase of qualifications and an awareness of workers, their needs of participation in the process of making decisions, independence, authority and competence. Persuasion substitutes order and stimulates impact on behaviours and attitudes of people towards work, strengthening inner motivation. There is no absolute advantage of emotional persuasion of convincing and partner persuasion or of individual to group persuasion. The range of use of emotional persuasion is decreasing not only because of the growing level of qualifications but also due to the nature of aims in the process of work as well as a scarcity of managers who have the gift of carrying people away who would induce among them boundless faith in the sense of particular actions. In conditions of autocratic style of management there is a danger of transferring persuasion into orders. Even though its form is kept, i.e. desired behaviour is not directly connected with sanction, in reality such sanctions appear with delay. In the case of misunderstanding of a suggested direction of behaviours or not accepting them, the workers fall into disfavour and suffer the consequences (Penc, 2000, p. 205–207).

Persons holding managerial positions in an enterprise have to do well in being a manager and also a leader. Therefore, they have to develop their communication competences – improving themselves in impacting on people successfully. Here, there is temptation of using simple rules of social engineering instead of becoming a leader of subordinates. The leader who will cause that the workers will follow his visions of operation of an entity, style of management and implemented and planned changes in the company. The authority and the use of this method of social engineering gives an opportunity to impact on the staff. This method of authority relies on impacting on people through referring to knowledge, skills, experience or opinion of a person considered as an authority. Paradoxically, this method of authority works also when the authority expresses his opinion on the subject in which he is not an expert. The communicators of authority are assessed on the basis of the positive qualification of the source – "recognised authority". The workers agree and accept the influence of the authority because the person with authority knows more and can do more than them, they see the difference in experience and want to use this experience. Moreover, in case of adequate communication relationships, between the authority and a subordinate, the subordinate wants to accompany the authority because it gives him the feeling of safety and acceptance. We are yielded to this method almost automatically. The impact of this method is more effective in situations when workers of enterprise do not have appropriate knowledge or experience in order to assess the situation without any help. It is a very effective form of impact and management of a modern enterprise which allows it to pursue strategic as well as tactical aims, implement changes in the production and organisation system or to manage staff.

Manipulation is different than the methods presented above. It is not so important to implant ones own thinking process in workers of the enterprise and to cause that they would feel well but to extort from them doing what we want and without their awareness and without giving intention of our action. Manipulation relies on using psychical power to change convictions, attitudes and behaviours of employees. The point of the use of this method is to implement it step by step that a person towards whom the method is used cannot see it (Hadnagy, 2012, p. 297). It is "a short cut", in cases when the manager cannot or does not want to agree with a worker, he uses tools which act beyond his awareness in order to achieve his target without cooperation or without an attempt to meet the requirements of a worker as the other party of the cooperation. The basic tools of this method of impact include: lie, fraud, uncertainty, doubts, lack of knowledge, needs, fears, associations programmed on purpose, putting vigilance to sleep or its purposive evoking, modulation, fitting. The person who manages an entity should take into consideration that the use of the above-mentioned tools of manipulation without being aware of the consequences of their use is a short-sighed action. Manipulation is a short cut action which makes the way and effort of the manager easier, however, without any guarantee that it will be successful (it may be discovered) and with a guarantee of uncertainty. When the worker or the group discovers that it is manipulated, then the reactions are usually drastic and in the majority of cases the cooperation is finished. Therefore, manipulation in the management of an entity may be used as a last resort and with huge limitations. It is not possible to cooperate and manipulate, because manipulation closes the way to constructive cooperation and cooperation will disclose manipulation sooner or later.

The order of presentations of sociotechnical methods gives an opportunity to gradual moving to the following forms of impacting on the staff of an enterprise when previous forms are not effective. When persuasive influence is ineffective, a manager may try to control workers through his authority or manipulation and when these forms fail, the workers may be forced to do something or their resistance may be broken through the use of coercion. Coercive measures in modern entities have the form of orders, bans, instructions, recommendations and advice of a manager as well as own commitments and duties undertaken voluntarily which force the worker to a specific behaviour. The method of coercion assumes subordination of behaviours of workers to aims and will of the manager (business of the enterprise), there is no space for individual needs or expectations of the workers. In the practice of private business because of economisation of expenses the managers very often use the method of coercion at the beginning predicting resistance and ineffectiveness of the soft forms of influence. Such action is justified only in situations which require quick reaction or in situations of danger. At the same time, almost all are ineffective when creative ideas and the integration of workers with the targets of the company are desired. The means of coercion impose on the staff a specific way of behaviour. First of all, they regulate the range of competences and responsibility of a worker for work discipline, the way of making tasks and perception of health and safety requirements. They aim at total elimination or limitation to minimum undesired behaviours of workers who bring losses to the enterprise. The tools of coercion impact in one way and force the employee to a particular type of behaviour, subordinate to the manager or act in a particular way towards the plant (Zieleniewski, 1981, p. 509). Part of them such as orders or recommendations are of obligatory character and have deadline. The fact that they are obligatory causes that any failure is subject to penalty. However, recommendations and advice are optional and lets the worker freedom to decide on the way of execution. Nevertheless, in practice the persons who use the means of coercion think that only they may offer right advice and that subordinates should abide to them and if they fail to do this they may be exposed to the allegation of neglecting the authority, disapproval and discourtesy from the managers (Penc, 2000, p. 205–207).

The use of all of the sociotechnical methods presented above aims at the improvement and increase of skills and effectiveness of making changes of attitudes and behaviours of individual and working teams. The attitudes of staff influence directly the operation of all other resources and parts of organisations but they are also the causes of conflicts in the organisation. These conflicts may be connected with functional and technical relations, i.e. with the division of tasks, actions, duties in an enterprise. They may also occur in connection with the order of relationship of authority, the way of division of benefits and privileges, level of following standards and rules binding in the company, type of organisation of individuals and groups as well as the level of their subordination to moral principles which provide social order in the enterprise. Conflicts may appear also as the result of cultural and social differences in the community which constitutes the human substrate of the enterprise (Karwińska et al., 2002, p. 87).

The subject of dispute, engaged parties and ways of existence of the conflict should be diagnosed and identified to solve a problem. The right diagnosis should be the basis of selection of an adequate strategy of action. That science of management indicates three main strategies for solving problems in enterprises (Ivancevich et al., 1977, p. 258):

1. The strategy of waiting – its issue is to create conditions which enable to wane conflict emotions, make aware of factual reasons of dispute, agree to the terms and conditions in which effective actions which lead to compromise or the "creation of community" may be taken.
2. The strategy of avoiding – which relies on minimizing contacts between parties to conflicts through purposive negligence of dysfunctional situations, ignoring actions and separation of parties of the conflict, limitation of interaction only to formal relations.
3. The strategy of confrontation – in which direct actions are taken aimed at solving the conflict through the exchange of staff between the parties of the conflict, putting emphasis on priority goals, confrontational meetings or discussions on solving the problem.

If a manager wants to use all three strategies successfully, the strategies have to use the methods of impact from persuasion and authority through manipulation to coercion worked out by social engineering.

Conclusion

The management of an entity on the modern highly competitive market is an art of using all chances and avoiding or limiting to minimum occurring threats. Therefore, management should use and uses all possible fields of science which offer the opportunity of endeavour to described state.

In order to use the chances which occur and limit threats, very often the behaviour of an individual or all workers in an enterprise is controlled and social engineering is exploited to impact on them towards desired attitudes and behaviours.

Nevertheless, social engineering is not only a set of methods and actions endeavouring to achieve appropriate behaviour of individuals and working groups. It is a new way of internal and external impact on the whole entity and surrounding legal, social and economic environment. Social engineering constitutes a modern, aware approach to needs, systems of behaviour of individuals as well as entire enterprise and its surrounding. Social engineering which influences the operation of an enterprise is a new style of life for a company. This is the path which should be followed to be successful on the competitive market. To succeed managers must use a modern arsenal of methods and the realisationaltools worked out by social engineering, which are presented in this article.

Global market which is openis the result of a well-managed enterprise which knows sociotechnical methods and is able to use them for increasing its functionality and competitiveness. Subsequently, the lifetime of such an enterprise will be generational.

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http://dx.doi.org/10.18778/8088-012-2.18

18. Cultural Values and Their Importance for Ethical Codes in Banking Sector

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Abstract

This article is one of the results of an interdisciplinary research project between the Department of Civic Education, University of Ostrava and Department of Economics, VŠB – Technical University of Ostrava. The main goal of this research project is the description of relations between society and ethical codes in companies. The initial phase of the project is focused on the banking sector, because we assume that in this sector is the code of ethics mostly used. The aim of this article is analyzing the banking sector in the Czech Republic, its history and present, ownership structure and identifying bank leaders in the Czech Republic, its ethical codes and consistency with cultural values. The final analysis focusses on economic efficiency and the ethical content analysis of selected entities.

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Introduction

The banking sector is one of the most important sectors in the economy of acountry. Banks are the engine of the economy because banks decide on the amount of credits, loans, interest rates for savings or investment. Bank clerks are faced with households or companies which are the most important for the economy. That's why most banks in the Czech Republic are focused just on corporate clients. Therefore, there is a presumption that the code of ethics, which should be used by bank clerks, is a very important part of the banks culture. For a better understanding of relationships in the banking sector and the creation of codes of ethics it is necessary to know the background of this sector. The history of the banking sector and its development can give some answers. Also, disentanglement of current links in ownership can help to understand the cultural and ethical values in the ethical codes, which banks use.

18.1. History of Czech banking system

The first banks founded in Czech lands (which were part of the Austro-Hungarian Empire) in the early 19th century. On the initiative of the Czech aristocracy was founded in 1824 in Prague, the Czech Savings Bank (Českáspořitelna). In 1847 began to operate in Prague a branch of the Austrian National Bank. In the future, were founded a lot of banks and banking houses. One of the important banks, especially for small savers, was the State Postal Savings Bank. But, some banks soon suffered from imprudent behavior. The banking sector was particularly affected by the stock market crash in Vienna Stock Exchange in 1873. For example during period 1873–1883 were founded 6 new banks, but 99 banks went bankrupt.

Another important milestone of the Czech banking sector was formed in Czechoslovakia in 1918, respectively the emergence of Czechoslovak National Bank in 1926. Czechoslovak National Bank was a limited company with the nature of a public institution, received a 15-year exclusive right to issue banknotes (which were fully covered by gold) in Czechoslovakia (Polouček, 2006, p. 39).

The Czech banks (including the central bank) had to submit to German requirements in the Protectorate of Bohemia and Moravia. In 1939 Slovak banking became independent and the Slovak National Bank and the National Bank of Bohemia and Moravia were founded After World War II, these banks were again integrated. Based on the Benes Decrees 102/1945 were nationalized all stock banks in Czechoslovakia.

Another milestone of the Czech banking system took place in 1948. There were major political changes during February of that year, which significantly influenced all areas of human life. The Communist Party of Bohemia and Moravia came to power and wanted to adapt the Czech banking system to the Soviet model. It began a period of centralizing the state of the economy, when thebanking sector was subject to the fulfillment of financial plans. The Czechoslovak National Bank was merged with the Tatrabanka, Postal Savings Bank and Živnostenská Bank and renamed to the Czechoslovak State Bank. It was the monopoly of thecentral and commercial banking for a long period. All private banks were nationalized and almost all non-bank financial institutions in the country were closed. The whole banking market became subordinate to the Ministry of Finance.

The year 1989 was an important for the whole of Central and Eastern Europe. There were, besides political and social changes, also a few very important changes in the banking sector. Firstly, till 1989 there was strict specialization of individual banks. The new banking act was adopted in 1992. This act had the typical character of the world banking system, which led to the universalization of banks and other financial institutions. This year also started a conversion of state financial institutions into joint stock companies and their entry into the coupon privatization. Secondly, two years earlier, was adopted another law on the State Bank of Czechoslovakia, which laid the foundations for a two-stage banking system – on the one hand there was a central bank with the right of printing money, supervision and regulation of commercial banks and on the other hand there were several commercial banks. Very soon after the Velvet Revolution in 1989 also showed the first problems with old bad loans, which were provided by the State Bank of Czechoslovakia to state-owned enterprises. Therefore, was founded the Consolidation Bank (state-owned), which took all these bad loans – it was almost 80 billion Czech crowns (CZK), which was about 7% of GDP in 1992.

In 1993 there was a split of the Czechoslovak Federal Republic into two separate states: Czech Republic and Slovak Republic. In this year was also adopted the law on building savings and state support for building savings, leading to the formation of new actors – building societies. This law was motivated by the experience of Germany and Austria. The act on banks was amended in 1995 and has been supplemented by the law on deposit insurance. From this year on all deposits wereinsured up to 80% of the value of the deposit, maximum was 100 000 CZK for one person in one bank. Over the years there have been several amendments to this Act – the latest legal version is from 2010, when deposits were insured up to 100% of the value, maximum is 100 000 EUR for one person in one bank.

In 1995 was founded another state-owned bank – the Czech Export Bank, which was established to support the foreign business activities of domestic firms. The last important milestone of the Czech banking sector, was the privatization of large banks, which had been gradually prepared since 1990. Finally, the largest banking houses of the Czech Republic (Komerčníbanka, Českáspořitelna and Československáobchodníbanka) were privatized between the years 1999 and 2001. In the following years there were only minor changes in the individual laws, harmonizing them with some European laws and in 2006 unification of supervision of all financial institutions under one authority, namely the Czech National Bank.

During the whole described period came and went many financial institutions – from small credit unions to mid-sized banks. As mentioned earlier, till 1990 banks were strictly divided according to their purpose and de facto existed only 5 banks. After 1990 the number of banks sharply increased, because the conditions for obtaining a banking license was not too complicated, and therefore came various foreign entities to the Czech banking market. The numbers of banks in selected years summarized table 18.1. These banks are divided to group: large banks, medium-sized banks, small banks, foreign bank branches and building societies. The definition of the size of banks has changed over the years, that's why there is described last "valid" version from 2012. Large banks are those with total assets of more than CZK 250 billion, medium–sized banks have total assets of between CZK 50 billion and 250 billion and small banks have total assets of less than CZK 50 billion (CNB, 2015).

Year	1990	1993	1995	2000	2005	2010	2014
Banks total	5	52	55	40	36	41	45
Large banks	5	5	5	4	4	4	4
Medium-sized banks	0	2	10	11	10	8	8
Small banks	0	32	24	8	5	6	6
Foreign bank branches	0	7	10	10	11	21	22
Building societies	0	5	6	6	6	5	5
Banks under conservatorship	0	1	0	1	0	0	0

Table 18.1. Number of banks and their classification by size in selected years
Source: Bank statistics ARAD, Czech National Bank, 2015.

The table 18.1 shows that the early years of the modern history of the Czechoslovak Federative Republic were specific by big increase in the number of small banks. Banking standards are still not fully adjusted, therefore a lot of different companies got a banking license easily. When began the first problems with the liquidity of these banks, the Czech National Bank tightened the conditions for issuing banking licenses, and the banking sector in the Czech Republic has stabilized. The last 10 years of the Czech banking sector is characterized by an increase in foreign bank branches.

Figure 18.1 shows an overview of entities that are currently operating in the banking market in the Czech Republic. Banks are divided in to groups which use the Czech National Bank, it means there are four large banks, eight medium-sized banks, six small banks, twenty two foreign bank branches and five building societies.

Large bank
Česká spořitelna,
Československá obchodní banka
Komerční banka
UniCredit Bank Czech Republic and Slovakia

Medium-sized banks
Česká exportní banka
Českomoravská záruční a rozvojová banka
GE Money Bank
Hypoteční banka
J&T BANKA
PPF banka
Raiffeisenbank
Sberbank CZ

Small banks
Air Bank
Equa bank
Evropsko-ruská banka
Expobank
Fio Banka
Wüstenrot hypoteční banka

Foreign bank branches
Bank Gutmann
Bank of Tokyo-Mitsubishi UFJ (Holland)
BNP Paribas Fortis
BRE Bank
Citibank Europe
COMMERZBANK
Deutsche Bank
HSBC Bank
ING Bank
Meinl Bank
Oberbank
Poštová banka
PRIVAT BANK
Raiffeisenbank im Stifland
Saxo Bank
Sumitomo Mitsui Banking Corp. Europe
The Royal Bank of Scotland
Volksbank Löbau-Zittau
Všeobecná úverová banka
Waldviertler Sparkasse Bank
Western Union International Bank

Building Societies
Českomoravská stavební spořitelna
Modrá pyramida stavební spořitelna
Raiffeisen stavební spořitelna
Stavební spořitelna České spořitelny
Wüstenrot – stavební spořitelna

Figure 18.1. Entities operating in the banking market in the Czech Republic
Source: Financial market supervision report 2013, CNB.

18.2. The ownership structure of banks

When the Czech banking sector was opened for foreign subjects (after 1989), market competition increased and banks owned by the state and municipalities were unable compete with these “modern” banks. For that reason, the government decided to privatize Czech banks. Till 1997, state and municipalities owned almost 75% capital of banks, foreign investors only 25%. As mentioned above, the biggest privatization wave was between the years 1999 and 2001, which were sold to foreign subjects the biggest Czech banks on the market. After this wave, the share of foreign capital increased in the banking sector to almost 83%. The last five years is characterized by increaseof Czech (private) capital in the banking sector. That’s why the share of foreign capital slightly decreased to 74%, it means, that the share of Czech capital is about 26% (the percentage for year 2013). Despite this slightly decreased we can say that the Czech banking sector has a stable ownership structure. Foreign capital with a direct share (i.e. direct foreign shareholders holding shares directly) has long dominated the domestic banking sector’s capital. Ten banks are wholly owned by foreign capital, and foreign capital predominates in five banks. Two banks are majority owned by Czech shareholders. Seven banks are wholly Czech-owned (Financial market supervision report, ČNB, 2014). Figure 18.2 shows how Bank ownership structure changed in the 2011–2013 period.

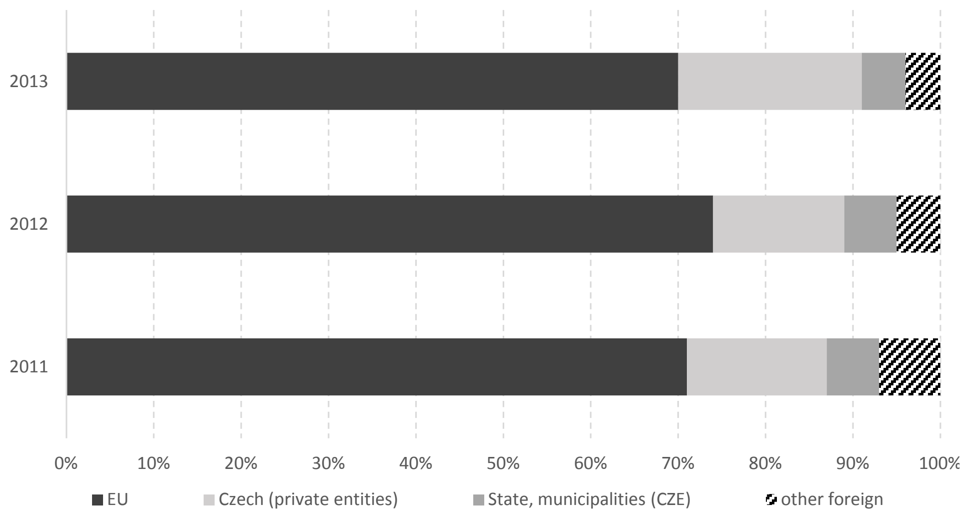

Figure 18.2. Bank ownership structure (in %) between 2011–2013
Source: Financial market supervision report 2013, CNB, 2015.

Figure 18.2 shows what has been managed above the share of foreign capital in the bank slightly decreases while domestic capital slightly increases. The graph also shows the dominant ownership of European capital, currently non-European ownership is approx. 4% (this capital comes mainly from Russian Federation).

Because of the differences in cultural values of individual nations,authors make an analysis of the ownership structure.Therefore, figure 18.3 shows the nationality of parent banks, including foreign bank branches.

The map shows that the majority of banks operating in the Czech Republic have established theirparent bank in Austria or Germany. We can almost say that every second foreign banking institutions operating in the Czech Republic has established his parent in Germany or Austria.

Figure 18.3. Map of nationality of parent bank
Source: Own processing of Lists of regulated and registered financial market entities, CNB, 2015.

Other countries in the imaginary "nationality" ranking are Great Britain with four entities and Russia with three entities. As mentioned in figure 18.2, non-European entities operating in the Czech's banking sector are only four (three from Russia and one is from the United States of America).

"Tracking down" the real majority shareholders is problematic, because most entities are joint stock companies, therefore ownership of these entities is variable. An example might be a GE Money Bank, which is own by the largest multinational company in the world, General Electrics, which was founded in the United States of America, but the real owners may be entities outside the US market. Other "ownership problematic" bank is PPF bank, which is owned by the PPF Group (the richest Czech man Petr Kellner) but the bank headquarters is in the Netherlands, because of lower taxes. And thirdly "troubled bank" may be mBank, respectively BRE Bank, which is based in Poland, but the bank is part of the largest financial groups in Europe – German Commerzbank.

From the perspective of our analysis, it is not important to find the real owners, but rather explore the environment, behavior, standards, values, which is used in the parent company, or is used in the country from which the parent comes from. And if (and how much) this foreign corporate culture affects domestic entities and if these standards and behavior are transferred to the domestic corporate culture (for example to the ethical codes).

The Czech National Bank also monitors the origin of capital for each group of banks (it means for large, medium-sized, small banks and for building societies). We have already mentioned above that in 2013 was the share of foreign capital in Czech banking sector about 74% and the share of domestic capital about 26%. Figure 18.4 shows that foreign and domestic capital arevery unequally represented in different groups of banks.

In the large banks, which currently include Českáspořitelna ("the Czech Savings Bank"), Komerčníbanka ("the Commercial Bank"), CSOB (Československáobchodníbanka – "the Czechoslovakia Commercial Bank") and the Unicredit bank, shared foreign capital in 2013 was more than 98%. This is a predictable result, because these banks were privatized at the turn of the millennium by foreign entities.

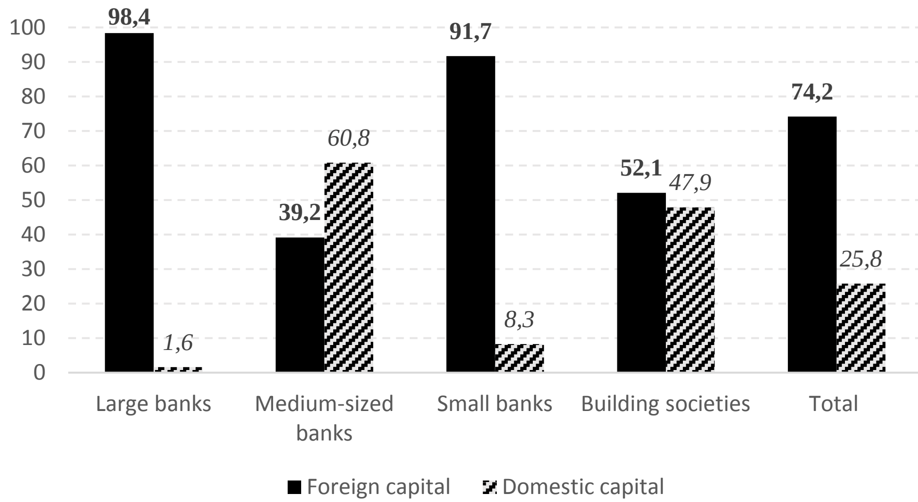

Figure 18.4. Capital origin (in % for banks with licenses as of 31st December 2013)
Source: Financial market supervision report 2013, CNB, 2015.

In the large banks, which currently include Českáspořitelna ("the Czech Savings Bank"), Komerčníbanka ("the Commercial Bank"), CSOB (Československáobchodníbanka – "the Czechoslovakia Commercial Bank") and the Unicredit bank, the shared foreign capital in 2013 was more than 98%. This is a predictable result, because these banks were privatized at the turn of the millennium by foreign entities. Czech capital (ownership) dominates in a medium-sized banks. This fact is mainly due to the fact that there are two large state banks, founded to support business and export. These banks are Českáexportníbanka ("the Czech Export Bank") and Českomoravskázáruční a rozvojovábanka ("the Czech-Moravian Guarantee and Development Bank"). This category includes also two relatively new banks in the hands of private Czech entities. These banks are the J&T BANKA and the Hypotečníbanka ("Mortgage Bank"). In the category of small banks dominated again foreign capital, amounting to nearly 92%. In figure 18.4 does not show foreign bank branches, because there is a 100% proportion of foreign capital. A relatively balanced situation is in the category of building societies, where the ratio of foreign capital and domestic capital is almost equal. Foreign capital is higher than domestic capital by about 4%.

18.3. The Czech banking sector and Codes of Ethics

Before the analysis of ethical codes of selected domestic and foreign banks, it was necessary to analyse the occurrence of ethical codes of the Czech banking sector. During these analyses, it was found that 17 of 45 banks are focused on corporate clients. The remaining 28 banks have corporate and private clients. After a website analysis of individual banks, it was found that only 15 banks have their own ethical codes published on their websites. Eight banks declared affiliation to the Ethical Code of the Czech Bank Association. Some of the banks declared both. Banks, which have been found at least some mention about ethical codes on their website, are summarized in figure 18.5.

Figure 18.5 shows that the number of banks in the Czech Republic has not published a code of ethics on their website. The possibilities for subsequent analysis, therefore is "dramatically" reduced. Based on previous analyses (ownership in the banking sector and published codes of ethics on websites), it was necessary to select entities for the analysis of ethical values contained in their codes.

The key for selecting a relevant bank was:

- Has been selected bank, which is important for the Czech banking market – it means a bank which has a big market share.
- The bank has on its website a copy of a Code of Ethics or any mention of ethical behaviour.
- After selecting the Czech banks was also included to the analysis foreign banks which are the parent bank for the relevant Czech banks.

There were finally included inthe analysis of codes of ethics thefollowing banks (the list is given, including justification for this selection).

Českáspořitelna, Komerčníbanka, ČSOB – because these banks are the largest banks in the Czech banking market. Unicredit Bank Czech Republic and Slovakia was not included to the analysis, because there was not found any code of ethics on their website.

As representatives of foreign banks were selected parent banks of chosen Czech banks, ie. Sparkasse Erste Group Bank (from Austria), Société Générale (from France) and KBC Bank (from Belgium).

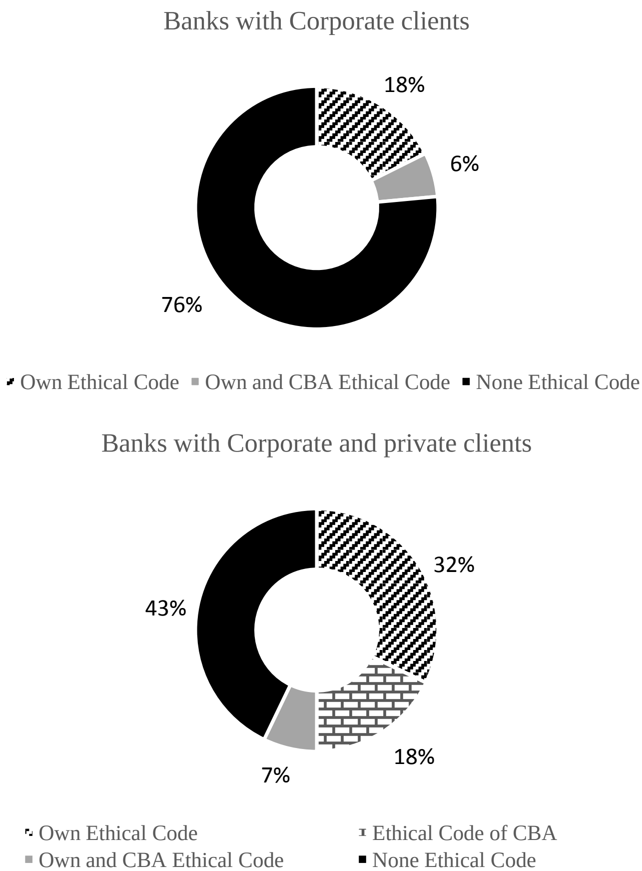

Figure 18.5. Banks with a published Code of Ethics on the website
Source: own data based on banks web pages, 2014.

To complete the selection, it was chosen one more bank on both sides (Czech and foreign). It has been selected one of the "youngest" banks in the Czech Republic – Air bank, which is fully owned by Czech capital. As a representative of a foreign bank a branch has been selected bank from Germany – Deutsche Bank, because Germany has (after Austria) the most branches in the Czech Republic.

18.4. Ethics content analysis and economic analysis of selected banks

In these selected banks were made a basic analysis (Ethics content analysis and economic analysis), which aimed to measure the efficiency of the selected banks based on the ethical values which these banks declare.

The main indicator for economic analysis was chosen ROAE (Return On Average Equity), because this indicator must be published by all banks and it is one of the best indicator of profitability of bank. This indicator refers to a company's performance over a fiscal year, so the average-equity denominator is usually computed as the sum of the equity value at the beginning and end of the year, divided by two. Higher value of this indicator means a better efficiency of the bank.

A certain distortion results may occur that ROAE at foreign (parent) banks, is usually the average value of all foreign branches; for example. Sparkasse (Erste Group) not includes only the results of Austrian bank branches, but also Slovak, Hungarian and last but not least Czech branches. There was a hypothesis, that parent banks will have smaller ROAE's than subsidiary banks, but the differences are too high (see Figure 18.6).

The methodology and process of the Ethics content analysis is part of the article *Cultural Values and Their Importance for Ethical Codes in Banking Sector from Ethical Perspective* from the same authors. That's why the following text, will mention only the results of this analysis.

The results of these analyses is summarized in figure 18.6, wherein the x-axis presents the Values indicator and the y-axis presents the ROAE of individual banks. The Values indicator was constructed as the social values minus the individual values. If the number of result is negative, the bank (code of ethics) preferred individual values. If the result is a positive number, the bank (code of ethics) preferred social values. Then the actual number of results will show how much is dominating individual or social values. For certain "anonymity" were encoded individual banks, where the parent bank and subsidiary banks have the same code (i.e. A and AA). When two letters are marked for parent banks and one letter for subsidiary banks. The pair of banks were created from the Czech bank (Air bank) and foreign bank branch (Deutsche Bank). Although these banks have nothing in common, they were also called with the same letters, not to be easily identifiable.

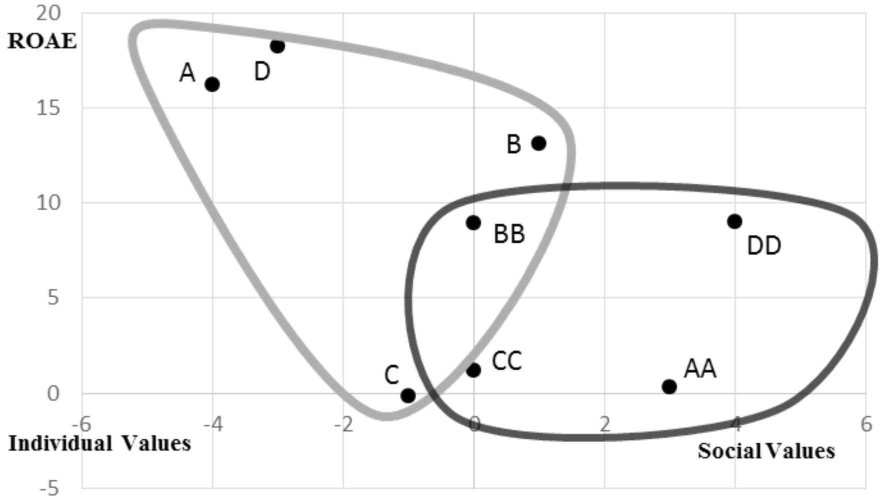

Figure 18.6. Values indicator and economic efficiency of selected banks
Source: own calculation, 2015.

Figure 18.6 shows that Czech subsidiary banks are more efficient, respectively have bigger profits than their parent banks. From the perspective of values indicator, the subsidiary banks preferred individual values, on the contrary parent banks are rather balanced values or social values predominate. From this analysis should be a simple conclusion: that ethical behaviour (code of ethics) of Czech subsidiary banks is focused more individual and got bigger profit than their parent. One of the reasons why the Czech banks are profitable than their parent is the fact that a large part of the profit is fees for banking services. This was one of the reasons why large Czech banks were profitable even in the financial crisis (in 2008–2010) when most parent banks were unprofitable.

Two pairs of banks (B-BB and C-CC)arerelative consistent. It means, that codes of ethics are equally balanced and the profitability of these banks is not too different. In contrast, an absolutely different outcome for the remaining couples – where is the balance between individual and social values totally different, what also reflects on the profitability of banks. For example the difference in profitability between pair A-AA is 15 percentage points and between pair D-DD is nearly 9 percentage points. It can be deducted from this analysis that the focus of these banks is significantly different and this is also reflected on the "success" – profitability of the banks.

Conclusion

The aim of this article was to evaluate the influence of cultural values on codes of selected entities in the banking sector. Historically, when the Czech Republic was part of the Austro-Hungarian Empire, Austrian and German banks played an important role in the Czech banking sector. Other countries were in the minority. Another important fact is that the banking system of the Czech Republic was affected by government intervention after the 2nd World War. In this time free competition on the market was distorted. A few years after the Velvet Revolution, loose monetary policy has enabled the establishmentof many entities. Within a few years many of these entities went bankrupt, which was a good thing for the entry of foreign bank branches, which brought to the domestic banking sector a different culture. The results of the analysis showed that domestic banks tend to focus on the person and client (codes of ethics contains more individual values). One of the reasons, why a code of ethics contains more individual values, is a bigger bank struggle of the customer. This "battle" might not be so strong abroad, that's why banks are trying to attract their clients through the preferring of social values. The results of the analysis also confirmed that domestic banks are more profitability than their parent in abroad. Therefore is a possible to say that, if a code of ethics contains more individual values than social values, it means that it is more focused on the customer, the company (bank) is more profitable.

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http://dx.doi.org/10.18778/8088-012-2.19

19. The global economic crisis from a sociological perspective: civilisational roots, individual and social repercussions

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Abstract

This article is an attempt of a sociological reflection on economics and the latest global economic crisis. The authors focus on the social and individual impacts of the economic crisis, because global economic processes directly influence and severely touch individual human beings. Its repercussions can be observed not only at the economic level, but also analysed in a sociological and psychological sense.

The purpose of this article is to explore the implications of the economic crisis at the social level. The economic crisis is synonymous with the crisis of capitalism, which is only an aspect of a much wider and more

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serious civilisational crisis of our time. The economy should be understood in the context of the social order – being only one of its five aspects or dimensions – it is influenced by and in turn influences the remaining aspects of the social order. This article is based on statistical analysis, comparative research on chosen European countries, as well as a critical reflection on international sociological literature in this domain.

It provides a comparative sociological analysis of two ideal types (in a Weberian sense), two different orientations clearly emerging in the contemporary economy- unconditioned, ruthless capitalism on one side, and a more pro-social capitalism on the other. These trends are the subject of analysis and debate in sociological literature. Each orientation has very different implications at the social level, creating societies with different social values and diverse levels of cultural and social capital.

Keywords: capitalism, civilizational crisis, economy, social order

Introduction

The current economic situation of the Western world or more specifically of the European Union Member States leaves a lot to be desired. The Old Continent has not yet managed to get back on its feet after the striking blow it received as a consequence of the global economic crisis that is said to have begun on the other side of the Atlantic Ocean in 2008 with the bankruptcy of Lehman Brothers. This event is rather a symbolic date, and the actual roots of the crisis should be searched for in much more distant times. The word 'crisis', which was traditionally a rather neutral term, meaning a turning point or a moment of change, not necessarily for the worse, but maybe for the better, has now been deprived of any glimpse of positive significance. This word conveys everything but positive emotions- from fear to anger, and even complete despair. Although the economic crisis is analysed primarily from an economic perspective, which would seem logical at first sight, we will argue that this perspective – even if not completely erroneous – is extremely restricted, for it does not allow us to see the whole picture, but only its fragment. In our opinion, the economic crisis is only part of a much wider and more severe crisis of our time- the civilisational one. This being said, the economic crisis needs to be understood in terms of the social order. For we are convinced that a sociological reflection on the economic situation may shed light on its deeply rooted causes, at the same time proving to be of great use when it comes to predicting such crises in the future and attenuating their negative consequences.

19.1. The civilizational roots of the global economic crisis

As we have already mentioned the global economic crisis requires a sociological reflection on economics and its doctrines. Why do economics encounter serious trouble when it comes to predicting, diagnosing and understanding such a great crisis? Perhaps those who point to some economists' involvement in the interests of financial companies are not completely mistaken. Another reason, one might suppose, could be the conformity on the part of many of them as well as their belief in the neo-liberal ideology which stigmatised those who criticised 'the real capitalism'. Perhaps some economists are short-sighted because they seem to have a methodological problem. This refers in particular to the representatives of the so called 'hard economics', which claims to be a science. In Knut Borchardt's words, "This discipline has no specific methods at its disposal with which to consider and analyse crises" (Borchardt, 2010, p. 220).

What is more, many economists assert that the very concept of crises does not make sense from the point of view of the business cycle theory. In their opinion, what is commonly referred to as a 'crisis' should be understood as a natural process of self-regulation of the economy. The best thing to do about it, as they claim, is to do nothing! The concept of crisis, though, due to its ideological and psychological character, calls for an energetic intervention (Borchardt, 2010, p. 222).

However, it is our intention to point out a more fundamental problem when it comes to the sociological point of view, namely that of understanding the economy in the context of the social order (Wielecki, 2012). When referring to the social order, we mean a constantly created, recreated and transformed result of a changeable, internally heterogeneous, complex and dynamic process of structuration. This is a process which constitutes the relatively continuous and unbroken basis for the organization of the social practice of life, in other words it crystallizes, reproduces, disintegrates and transforms the relatively steady fundaments of a relatively defined large community. The social order understood in this way determines a more or less durable framework for the common practice of life.

Within the social order, we can distinguish five dimensions: the social structure (groups, strata and classes, as well as the system of relations between them), culture, the institutional order, the economic order, and the demographic order. These five dimensions are all interrelated: a major occurrence in one of them produces effects in all the remaining ones. Due to this interdependence, analysing the economy as a separate system does not provide us with a view of the entire picture, making it often impossible to notice and understand phenomena and processes which are quite basic in character. This is exactly the case when it comes to dealing with the current economic crisis. Its actual causes are of a civilisational nature, not an economic one. Great civilisational changes disturb the foundations of the social order, and consequently those of the economic one. Phenomena which are often interpreted as economic causes of an economic crisis are rather the results of completely different processes that cannot be prevented or cured by implementing purely economic measures, especially with one's horizons narrowed in a doctrinaire sort of way.

Today's reality is characterized by the break-up of industrialism, brought about by scientific and technical achievements of the post-World War II period which have been causing important technological changes in the most advanced societies since the 1970s. These, in turn, have resulted in profound civilisational, demographic, cultural and social changes, which also happen to be fast-paced.

Furthermore, this is a time of transition between two civilisational formations and, as a result, between two types of social orders in all of their possible dimensions. Changes in culture give rise to a crisis in the way that people understand the world, the aim and sense of living, morality, obligations and solidarity. Thus ours is also the time of a mental crisis, a crisis of traditional horizons of reference and frameworks of action and also a very severe crisis of fundamental institutions as well as – in the case of many people – a crisis of personal identity (Wielecki, 2003).

Evidently, we cannot deny that the current economic collapse has its origins in 'creative accounting', in other words – in the freedom to run up debts and offer airy-fairy loans, in the enormous speculative bubble in the real estate market and in the modern so called 'financial instruments' serving to take in states and millions of citizens, a practice unheard of on such a scale before. All this is well known, however this time, we are faced with global-scale pathology which is only possible in a globalised world, where large financial entities are independent of state control, quite often thanks to the enormous capital and wealth at their disposal. This in turn not only equips them with an unprecedented range of freedom and independence, but what is more, enables them to make the states (or their elites) dependent upon them.

It should therefore be emphasized that the current crisis differs from the earlier ones, typical of the industrial civilisation (which is being replaced by the post-industrial one). The crises of the industrial era brought about a number of tragic results, especially in the 20th century, in the form of two world wars, communist revolutions, economic collapses, the Holocaust, and totalitarian rule in its various forms. The end of their bloody history was marked by the creation of an entirely new type of social order within the industrial civilisation, which we will call the phase of 'mature capitalism'. It is made up of a liberal-democratic order, with a socially-oriented economy and the historic compromise of the welfare-state policy, with the civil law-observing state, which played the role of the mediator and guarantor of the compromise between the main social forces of that time, i.e. the employees and the employers. New communications technologies contributed to the rekindling of the industrial crisis, which seemed to have been solved once and for all, but this time on a global scale and in the reality of the post-industrial civilization (Wielecki, 2010).

19.2. The crisis of capitalism

It is quite evident that the civilisational crisis also affects capitalism. It is a crisis of the foundations of the post-war version of the capitalist economy corresponding to a specific type of social order. No patching could be of any use here, with no money at the disposal of the states and governments, apparently so disliked by the neo-liberal economists. Embezzlement is not the cause of the crisis, so no amount returned to the system will make it function properly again. Neither is it enough to reprimand the offenders and create new controlling mechanisms. This post-war order also had its faults and faced harsh criticism. However, in spite of the many tensions in the post-war years, it had been proving fairly functional up until the 1970s.

There is no doubt that the crisis of capitalism lies at the very basis of today's economic order. If the banking system, stock exchange and financial balance are the basis of the market economy, then what else has to go wrong for us to become convinced that a certain version of capitalism typical of the industrial social order is coming to an end? It is undergoing so many changes that its existence in this form is no longer possible. As Immanuel Wallerstein points out, traditional sources of capital accumulation, thought of by many to be the foundation of capitalism, are drying up (Wallerstein, 2001). The reserves of relatively low-cost labour force from rural areas, freely available resources of the natural environment, the traditional tasks of the nation state and further possibilities of externalizing costs are all disappearing.

As a result, dramatic social conflicts, inherent in capitalism, have revived; the welfare state – which we deem a historic compromise that was of service to the main social classes, capitalism and especially to democracy – is made void. In a time of global networking, things are no longer that simple. By transferring today's society, culture, politics and economy to the virtual and global network, all of these aspects escape the control of traditional institutions or citizens. This makes global, unrestricted accumulation possible and renders democracy difficult, if not impossible to practice. When a compromise is reached on the market between the main social forces and the state is its guarantor, as it is the case in countries pursuing the welfare-state policy, then such a market is declared by some (e.g. the neo-liberals) as lacking freedom. The hypocrisy of their using the 'free market' slogan consists in the fact that they oppose this compromise because they see it as unfavourable for themselves- this however, they are unwilling to admit. They prefer to deliberate at great length about a lack of freedom of the market, in reality, wanting more of it for themselves. This is of course possible, but always at somebody else's cost. The said compromise put an end to a tragic thread in an almost 200-year history of capitalism. By the time it was achieved, the world, and especially Europe, had experienced waves of revolutions, wars and economic catastrophes. The compromise was not a present, but wisdom paid dearly for with blood and misery of millions of people.

In terms of social structure we find that, as a result of civilisational processes the position of employees is getting weaker. This instability can prove to be dangerous in so far as these two groups are often considered to be a stabilizing factor in democracy. Modern technologies are now encroaching upon traditional areas of the so-called white-collar work. Yet it is the growing crowd of people who are unemployed and who are not going to have jobs that deserves special attention. Their unemployment will probably be hereditary for the most part. It is important to note that unemployment not only doesn't allow those concerned to fulfil their material needs, but in the long term takes its toll on the stability of the family at the micro level and at the macro level touches the social structure, by intensifying inequalities, injustice, a lack of solidarity, hence becoming the source of social tensions and divisions.

Furthermore, an unsettling phenomenon of today's capitalistic societies is social exclusion, which excludes individuals and groups from the social mainstream. Anthony Giddens writes about two types of social exclusion that threaten the stability of the social order. One is the underclass; it encompasses the segment of the population that occupies the lowest possible position in the social structure, its main characteristic being poverty, experienced in a variety of ways. This is the youngest segment of the population, a side-effect of modern and mature capitalism. On the other hand, social exclusion affects the rich, those occupying positions at the very top of the social ladder; they withdraw from society in gated communities or by accessing private health care and education. The supporters of the Third Way promote a redistribution of possibilities rather than of resources. Equality of opportunity is of greater importance than equality of outcome. Hence, an inclusive society is one in which all citizens receive the opportunity to be involved in the public sphere, having access to education and work. Social exclusion must be tackled in the interest of social cohesion (Giddens, 1998, p. 101–103).

Nowadays great multinational capital has gained a chance to free the market, or, rather to get full freedom for itself – from the state, from all the institutions and organizations that have been guarding the social compromise on the state level (e.g. trade unions). As long as there are no mechanisms in place to enforce the compromise at the global level, we will be in danger of a great global conflict between the desperate excluded ones and a part of the employees with the overly empowered global employers. The disproportionately weaker excluded ones and employees may resort to radical methods of fighting. This will not be easy, as modern technologies have also made their way into the institutions of control. However, as we now know, no police or prisons can stop terrorist attacks, including cyber terrorism. What is more, the above mentioned social exclusion also produces a number of well known effects, such as demoralization, crime, disintegration of social structures, nervous and mental diseases, family pathologies etc.

This is, of course, a pessimistic scenario. Perhaps, as some promise, new jobs will be created thanks to the technology sector; maybe a new, global civil society will emerge as a serious counterpart for the global capital. Or yet another scenario will become true. One cannot fail to notice that the new times offer people new possibilities to live more comfortable, safer, more individualized and freer lives. Obviously, one can also worry that this will even further encourage consumption and materialism, which already deprive people's lives of sense and aim, bonding and responsibility. What is more, we cannot fail to observe that a new axis is being formed distinctly differentiating communities on the home front and worldwide – one of access to consumption. The freedom to consume is strictly limited by means of social and cultural factors. Inequalities in this area are growing dramatically. Nowadays, about 10% of the world's richest people have at their disposal 90% of its wealth.

19.1. Globalization and social movements

The crisis of capitalism briefly described above goes hand in hand with the process of globalization. Globalization means a new beginning not only in capitalism, but also in world politics. States as the subjects in the game are becoming weaker and less important, although it is them who are expected to 'rescue' their economies from collapsing. They are supposed to be responsible for a lot of things within their respective jurisdictions, but as a result of the processes of globalization and the neo-liberal ideologies of the great economic entities they are left with ever diminishing possibilities to take on this role. The current economic and political crisis is largely the result of these processes being uncontrollable. The forming of supranational political entities is an attempt at taking part in this global game, and the European Union can serve as an example. At the moment, we are witnessing two parallel processes that are taking place: the global 'free market' is being formed and the structure of global institutions is emerging. The future will show whether the 'free market' will truly remain free or will it rather find itself to be under the influence of the global structures of power. Today we still do not know if the opposite will not occur, i.e. the global structures will become dependent or taken over by the entities of the global free market. Was this to happen, there is every indication that the global order would not be democratic, at least not at the beginning.

Manuel Castells predicted that 'the net', which absorbs and transforms all the aspects of people's lives, including the struggle for power, has to become the scene of a struggle for the dominant culture code and for power in general (Castells, 2004). Let us observe, though, that now we are talking about a global power, gaining control over the global space. These processes cause the aspirations of many to grow, especially in the richer parts of the world, but they also create the beginnings of the global network society. The movement of 'The Outraged', which overflowed in many areas of the world, was initiated for the most part in the global virtual world of the Internet. It is there that frustrations and aspirations are articulated, mobilization takes place and the awareness of interests crystallizes. Secondly, the movement finds its expression in the streets of various cities and towns, in many countries with different political, economic and cultural systems. The actions primarily take place on the Internet itself, taking the form of manifestations of views and showing unity. We can see the great strength of the people who forge bonds using modern technical means, as in the example of the said network communities, or the so-called new social movements.

The development of the so-called new social movements is another way of reacting to the current situation. In a way, these movements are an alternative to the formally institutionalized world. Social movements are often treated like institutions of the civil society acting on the inspirations directed against the state which apparently limits people's freedoms by nature. However, it is also possible to imagine movements limiting different freedoms or striving to introduce such limitations, e.g. movements with fascist tendencies, racist movements.

Social movements may also play a significant role in the mechanisms of democracy. In the more and more complex and crisis-inducing processes of indirect democracy, they form niches of direct democracy, thereby giving citizens a sense of influence and importance. It is probably an emergency mechanism to shield the institutional order from social discontent and social apathy. It is worthwhile, though, to recognize social movements as a new form for people to get organized. Many theoreticians, like already mentioned Castells (2004) or Alain Touraine (1995), have high hopes for these movements and welcome them as manifestations of new tendencies of the post-industrial society. Touraine treats social movements as social forms which may become an important factor in modern democracy due to their aspiration to 'shape history'. Castells, in turn, thinks that movements go beyond the identity of resistance and can be the factor of change.

Claus Offe (1999, p. 248) holds a view that new social movements are gaining in importance due to democratic governments backing off from interventionist policies. Nonetheless, this creates considerable issues, at the same time making people believe that it is only them on their own, and not the state, who can solve these problems. Alberto Melucci identifies new social movements as 'new social actors' whose ambition is to be able to influence the main codes of symbolic culture by opposing traditional ways of understanding the world and striving for the new. Social movements are seen in juxtaposition with political parties (Melucci, 1990, p. 9).

19.4. 19.4. The two orientations of contemporary capitalism

As we have already signalised, we are not saying that the current civilisational processes have to result in a catastrophe. These are dynamically developing processes, which implies that they can progress in numerous directions. Along with the crisis of capitalism, we are already witnessing two orientations emerging in today's economy. These are ideal types in a Weberian sense, meaning they do not appear in a pure form in reality, however they are important theoretical models that are of great use when analysing the economic order of specific countries.

The first orientation is one which can be called 'ruthless capitalism', geared solely towards capital accumulation and proclaiming self-regulating abilities of the market. It makes use of the network, steering clear of any obligations towards man, culture, values or the natural environment etc. It is mainly based on anonymous shareholding, depersonalized flow of virtual money whose owners are usually ignorant about where, what for and on what terms it is invested and who are much less inclined to identify or sympathize with anything or anyone. Capitalism of this kind unceremoniously destroys people, the environment and culture. Its adherents, using the ideology of freedom in the neo-liberal understanding, monopolize the market, and behind a full-of-hypocrisy cover of the slogan of the free market, they destroy the competition and appropriate the market. What is more, this type of capitalism is founded upon an individualistic model of the human being, that of the *homo economicus*. This is a model of the human being that according to Margaret Archer contributes "nothing to the common good unless by accident and is unmoved by his social relations" (Archer, 2011, p. 120). This model "leaves out those social bonds that are humanly most important to us" (Archer, 2011, p. 121), which reinforces the lack of obligations or solidarity towards others and the society, since there are no bonds to restrain the pursuit of monetary gain.

The other orientation is the more corporative-oriented, 'pro-social capitalism' (probably the most advanced in Sweden) which, among others, takes the form of social movements or communities. Profit, although very important, is not the only value in this model; the decision-making process and profit redistribution are often geared to a social or even an environmental objective. Nevertheless in the contemporary Western social order, it seems that civilisational changes, especially the process of globalization favour the first type of capitalism. The world-wide financial crisis, the effects of which we are still dealing with today, testifies to its fateful success. Ironically, with the modern civilisation being based for the most part on social and cultural capital, it is the second model that should seem to be more economically and socially effective, hence should be the one more commonly opted for.

In most cases, we can observe the following dependence: the more pro-social an economic system and the more 'protective' a state, the better the economic situation. This is most likely also related to other mechanisms that make the social and cultural capital rise as a result of the welfare expenditure, which, in turn, combined with increased outlays on new technologies and development, increases labour productivity and allows the Gross Domestic Product to grow. Let us illustrate these conjectures with European Union Member States' economic statistics at the time of the latest economic crisis (countries which are very atypical – for example Luxembourg – and would make this analysis more difficult are omitted in the following table).

Country	Per capita GDP as percentage of EU average (100%)	Welfare state expenditure (% of GDP)	Labour productivity (EU-27 = 100%)	Per capita expenditure on new technologies (2008): position in EU-27
Holland	130	28.4	110.0	10
Austria	123	28.0	112.4	4
Sweden	117	29.7	111.3	1
Denmark	117	28.9	101.2	3
Germany	116	27.7	104.9	5
UK	116	25.3	110.2	8
Belgium	115	29.5	123.8	7
Finland	110	25.4	106.9	2
France	107	30.5	120.3	6
Spain	104	21.0	110.6	15
Italy	102	26.7	109.5	17
Greece	95	24.4	101.8	22/23
Czech Republic	80	18.6	71.7	13
Portugal	78	24.8	83.7	12
Slovakia	72	16.0	78.8	25
Hungary	63	22.3	70.1	18
Estonia	62	12.5	63.7	16
Poland	56	18.1	65.1	20/21
Lithuania	53	14.3	55.6	19
Latvia	49	11.0	49.9	20/21
Romania	42	12.8	47.0	22/23
Bułgaria	41	15.1	37.2	25

Table 19.1. Expenditure on 'welfare state', new technologies and development, labour productivity per person and per capita GDP in selected EU Member States
Source: Eurostat, 2010.

Does this data confirm our hypothesis? One could of course reverse the reasoning and say that rich societies can spend more on and invest in social capital (including cultural capital), or that high social capital is an important factor in societies' wealth. We suppose otherwise. Who is right seems to be of key importance to the world. It is a fact, however, that Finland – twenty years ago a poor country on the brink of an economic collapse – started its rescue therapy by building its social capital. It created a 'virtuous cycle' out of the information society and the welfare state. The success of the information society allows for the continued financing of the welfare state. In turn, the welfare state generates well-educated people who consequently develop the information society (Castells and Himanen, 2002). This was also the case with Sweden, which treated itself to a strategy of pro-social market economy based on the welfare-state policy long before the Swedish economic boom started.

Apart from economic statistics, there are several indicators, 'softer', social ones that testify to the existence of the two models of capitalism presented above. The social well-being is not only made up of economic prosperity, but also of the subjective well-being of citizens, the level of their optimism, social trust, satisfaction with public institutions etc. According to the Central Statistical Office in Poland, in 2011, among 30 European countries taken into consideration, the citizens of pro-social countries were among those with the best statistics concerning the state of their health, i.e. in Sweden only 20% of citizens claimed that their health is not well, whereas in Poland this value amounted to 42%. These statistics are of course linked to the level of expenditure on health care, which is often higher in pro-social systems, than in those of 'ruthless capitalism', i.e. according to OECD, in 2011, health care expenditure amounted to 9.5% of GDP and 6.9% of GDP in Sweden and Poland respectively.

Table 19.2 presents statistics regarding the level of trust within those European countries, which are implementing the two different models of capitalism. In this survey, respondents were asked to answer the following question: "Do you think that most people would try to take advantage of you if they got the chance, or would they try to be fair?". Their answer was to be given on a scale of 0–10, where 0 signifies: "most people try to take advantage of me", as opposed to 10: "most people try to be fair". According to this data, we can conclude that countries, which are realizing the 'pro-social model' have the highest level of social trust, i.e. Scandinavian countries, as opposed to those fulfilling the 'ruthless capitalism model', and have the lowest level of social trust, i.e. Great Britain or Poland. Citizens living in pro-social economic models generally have greater trust in their fellow citizens, as well as in public institutions.

Country	Scale 0–10
Denmark	7.3
Finland	6.9
Sweden	6.7
Holland	6.1
Germany	5.8
Belgium	5.7
France	5.7
Great Britain	5.7
Portugal	5.2
Spain	5.2
Czech Republic	5.1
Poland	4.5
Greece	3.7

Table 19.2. Social trust in chosen European countries: most people try to take advantage of you or try to be fair?
Source: European Social Survey, 2002.

Conclusion

In conclusion, the latest global economic crisis proved that a sociological reflection on economics is crucial in order to understand the origins and possible outcomes of such crises, which are of a civilisational nature, not an economic one. The economy should be understood in terms of the social order, being only one of its dimensions. The two models of capitalism presented in this article exemplify various ways of dealing with the crisis of capitalism. Their implementation has very different consequences for the construction of the social order, as well as the lives of individual citizens.

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