

megatrend

review

**The international
review
for applied
economics**

Content

Foreword to the first number	3
Global economics	7-65
Regional economics	67-101
Financial markets	103-120
Business operations, analysis and planning	121-131
Economic policy and development	133-169
Management and marketing	171-185
New technologies	187-239
Book reviews	241-251



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FOREWORD TO THE FIRST NUMBER OF MEGATREND REVIEW

On the occasion of fifteen years of work, the period in the course of which it has become the largest private university in the Balkans, Megatrend University of Applied Sciences starts the international scientific review for applied economics – Megatrend Review.

Megatrend Review would be another point of vivid gathering and connecting of teachers, assistants and students of the Megatrend University. In order to reflect the inter-disciplinary studies of our University, the Review would thematically cover various contemporary fields of social and natural sciences applied in economics. In the field of social sciences, the pages of the Review would be open to various views of and opinions on the issues of global and regional economics, economic policy and development, work of financial markets and companies, as well as the issues of management and marketing. In the field of natural sciences, we would welcome the papers dealing with the application of new technologies to economic research and practice, as well as papers in the field of econometrics. The Review would also monitor the events in the economic science, publish the translations of scientific and expert papers and present the reviews of new books by both domestic and foreign authors. Finally, extra space would be given to news related to the work of Megatrend University, announcements of the international scientific conferences organized by the University and information on cooperation with other universities both in the country and abroad.

Professor Mića Jovanović, PhD
Head of Megatrend University of Applied Sciences
President of Editorial Board of Megatrend Review

CONTENT

FOREWORD TO THE FIRST NUMBER 3

ARTICLES

GLOBAL ECONOMICS

ACADEMICIAN ANDREJ MITROVIĆ
 Serbian Academy of Arts and Sciences, Belgrade
ORIGIN OF EUROPEAN BANKS ACTING IN THE BALKANS
– one link to the first integration of the Balkan peninsula into the modern Europe – 7

PROFESSOR BLAGOJE S. BABIĆ, PhD
 Institute for International Politics and Economics, Belgrade
MANAGING CURRENT DEVELOPMENT IN ECONOMIES IN CRISIS 35

PHIL EYRE, ASSOCIATE PROFESSOR
 Grenoble Graduate Business School, France
THE INTERNATIONALISATION OF SMALL & MEDIUM SIZE ENTERPRISES AND EXTERNAL SUPPORT: A FRENCH REGIONAL EXAMPLE 55

REGIONAL ECONOMICS

PROFESSOR LAURA RUIS JIMENEZ, PhD
 University Institute Hose Ortega y Gasset, Complutense University of Madrid
THE IBEROAMERICAN COMMUNITY OF NATIONS – THE UNUSED POTENTIAL OF A STAGNANT SYSTEM 67

PROFESSOR SLOBODAN S. PAJOVIĆ, PhD
 Geoeconomics Faculty, Megatrend University of Applied Sciences, Belgrade
ESTABLISHING INTERREGIONAL DIALOGUE BETWEEN SERBIA AND MONTENEGRO AND THE COUNTRIES OF LATIN AMERICA 77

FINANCIAL MARKETS

PROFESSOR VEROLJUB DUGALIĆ, PhD
 Faculty of Economics, University in Kragujevac
FUNDAMENTAL AND TECHNICAL ANALYSES OF SHARE PRICES 103

BUSINESS OPERATIONS, ANALYSIS AND PLANNING

- PROFESSOR VLADIMIR PRVULOVIĆ, PHD
 Geoeconomic Faculty, Megatrend University of Applied Sciences, Belgrade
COMPETITIVE INTELLIGENCE 121

ECONOMIC POLICY AND DEVELOPMENT

- PROFESSOR BYONG SEOB KIM, PHD
 Graduate School of Public Administration, Seoul National University
REFORM OF QUANGOS IN KOREA 133

- PROFESSOR DRAGAN KOSTIĆ, PHD
 Geoeconomic Faculty, Megatrend University of Applied Sciences, Belgrade
**ECONOMIC AND LEGAL ASPECTS OF PROPRIETARY
 TRANSFORMATION OF PUBLIC ENTERPRISES IN SERBIA** 151

MANAGEMENT AND MARKETING

- VESNA MILANOVIĆ-GOLUBOVIĆ, ASSISTANT PROFESSOR
 Faculty of Business Studies, Megatrend University of Applied Sciences, Belgrade
GLOBAL BRANDS IN DEMAND MANAGEMENT 171

NEW TECHNOLOGIES

- DUŠAN JOKSIMOVIĆ, ASSISTANT PROFESSOR, PROFESSOR VERKA JOVANOVIĆ, PHD,
 LJILJANA STANOJEVIĆ
 Megatrend University of Applied Sciences, Belgrade
NEURAL NETWORKS AND GEOGRAPHIC INFORMATION SYSTEMS 187

- JASMINA NOVAKOVIĆ, ASSISTANT PROFESSOR
 Faculty of Business Studies, Megatrend University of Applied Sciences, Belgrade
INFORMATION SYSTEM OF REVENUE AUTHORITIES IN SERBIA 197

- ANGELINA NJEGUŠ, ASSISTANT PROFESSOR
 Faculty for Business Studies, Megatrend University of Applied Sciences, Belgrade
**RESEARCHING THE CONCEPT AND DEVELOPMENT
 OF VIRTUAL UNIVERSITY ARCHITECTURE** 219

BOOK REVIEWS

- SMILJKA ISAKOVIĆ, M.A.
 International Biographical Association Cambridge
NEW AGE MANIFEST 241
 Essay on the book "Intercultural management" by Professor Mića Jovanović

- PROFESSOR ZORAN JEVIĆ, PHD
 Academy of Liberal Arts, Belgrade
**CULTURE OF COMMUNICATIONAL
 SEDUCTION OF PUBLIC** 247
 Essay on the book "Public Relations" by Professor Milivoje Pavlović

ACADEMICIAN ANDREJ MITROVIĆ
Serbian Academy of Arts and Sciences, Belgrade

ORIGIN OF EUROPEAN BANKS ACTING IN THE BALKANS

– *One link to the first integration of
the Balkan Peninsula into the modern Europe* –

Abstract: *In the time period between the Berlin Congress and World War I, financial capital from the developed European countries played double and in many ways contradictory role in the independent but developing countries of the Balkan Peninsula. It had an important part supporting modern development of the Balkan states, but yet it primarily served its own business interests as well as the interests of the countries it belonged to. The Europeanization of societies and lives of the new independent small states in the Balkans required transformation of the economy. This required not only models, but also money, loans and investments by the developed European states. In accordance with their business efficiency that could be reduced to the saying that there were not small business deals, big modern European joint-stock banks made a step at the Balkan ground on their way to penetrate the Near East. The interests of the most reputable, primarily Austro-Hungarian, German and French financiers, in the Balkan Peninsula based on view of the Balkan-Near East region as a unique geopolitical and economic field.*

Key words: *financial capital, joint-stock bank, the Balkans, international bank consortiums.*

1. Introduction

The second half of 19th and the beginning of 20th century was the period of international business activities by the developed European economies, the period when global interests of big states originated and the first age of nationalism, as basic political phenomenon with the role to destroy *ancien regime* finally, was completed; it was the period when the banks, although originating from

centuries far gone, transformed into one of the leading economic, i.e. financial institutions important for the development; they became contemporary factor of the new growing world and became considerably important in foreign policy of the great powers they belonged to. Considering the essence of this process shows that 'final solution to the Eastern issue' was open by the origination of vassal Serbia after long armed and patient policy conducted from 1804 to 1830 and independent Greece after heavy battles and with great help of the Great Britain, France and Russia from 1821 to 1830; it was completed by the process of origination of the independent Balkans by the international recognition of Serbia, Montenegro and Romania in 1878, Bulgaria in 1908, when the 1912 war actions by the Balkan states reduced Turkey to territories north from the Channel, and by the international recognition of the independent Albania in 1913.

In this relatively short period of time lasting about three and a half decades, from 1878 to 1914, the Balkan countries, based their development on European models and became interested in the support of European capital, which at the same time became interested and had interest in the business operations with the Balkan countries.

These were very reputable companies, mining concerns, industrial firms and banks of the business world of that period. This double-sided phenomenon played an important role in strengthening of the Balkan states development which had already started, but while the implicit cooperation was of the key historical importance for the Balkan side it was the additional, more or less profitable business for the European side. In principle the banks followed only their business interests, adjusting as required to the politics of the countries they belonged to. The international role of money and universal intention to earn profit were, however, in the shadow of the request to respect the national state interests that were determined by the political factors.

Geographical and political reasons were those that made Serbia, which was assumed to be geographically close, interesting for the Middle European banks but Serbia also had its own interests so that it accepted this situation as useful. However, French financial capital played an important role from the very beginning, and geographical distance, according to its state policy, was less important for its power. These interests had the most important role, but they can be fully understood only within the framework of the interests that the most important European banks of that time had in the Balkans; these banks were then the only relevant factors since the activity of the USA economic centers could be barely felt and only in the Western border parts of the Ottoman Empire.

2. Creation of modern banking in Europe

Financial capital from the developed European countries played double and in many ways contradictory role in the independent but developing countries on the Balkan Peninsula in the course of four decades – from 1878 to 1918. It took an important place in support of contemporary development of the Balkan states, but yet primarily served its own business interests and also the interests of the countries it belonged to. In order to study this issue, it is necessary to consider the real positions that the Austro-Hungarian and German capital acquired through the network of banks; this also requires considering the place and role of capital from other rival countries. The assumption needed to make the outline of acquired positions is to get acquainted, first of all, with those banks from European countries that brought the financial capital and represented it in the Balkans. Both the proponents and the opponents of the establishing of the new overseas empires called this epoch an imperialistic one – the former praising it, the latter rejecting it. Still, yields of new civilization improved the living conditions. After the wartime year of 1870, there were not any international armed conflicts in Europe for three and a half decades. There were people who were bored because of this, that period was remembered by pleasant life in Vienna and Paris, and nice and wordy name *Bel époque* remained from that time.

This time the attention is paid to the banks because of their extremely important place in the economy of the modern time. Under the conditions of ever increasingly complex commodity-monetary relations, the banks were active and transforming along with the transformation of financial activities during the economic flourish of 1930s; led by their profit, they multiplied and improved the ways of collecting, keeping and placing money in their own as well as in the foreign countries, taking part in and in their own way being the part of the international life. According to their rather widespread geographical engagement, business efficiency that could be reduced to the saying that there were not small businesses, activities that could provide nice profit even in the developing parts of the world, the big banks were those that were ready to take a step on the Balkan Peninsula.¹

The complete turn of events in banking happened first of all in Great Britain (in England actually), where more than 2,000 joint-stock banks were founded

Previous note – The author quoted the materials from German archives according to call numbers while they were in the places as noted, i.e. before the archives were transferred to Belin. A.M.

¹ See: P. Delfaud, Cl. Gerard, P. Guillaume, J. A. Lesourd, *Nouvelle histoire économique*, Tome 1, Paris, 1976; K. E. Born, *Geld und Banken im 19. und 20. Jahrhundert*, Stuttgart, 1977; A. Dauphin-Meunier, *Histoire de la Banque*, Paris, 1959. See also: *Longman Atlas of Modern British History. A Visual Guide to British Society and Politics 1700-1970*, by Ch. Cook and J. Stevenson, London, 1978, p. 80-83; *Lexikon für das Geld-, Bank- und Vösenwesen*, Frankfurt a. M., 1958.

from 1826 and 1844. Some private banks were still among the leading ones, primarily N. M. *Rothschild and Sons*, established in 1804, as well as some old and new banks such as *Parr's Bank Ltd.* (1782), *Morgan Grenfell and Co* (1838) or *Frühling and Goschen* (1853). Nevertheless, a group called 'the big five', consisting of both some of the oldest but thoroughly transformed and some recently established banks, had a lead: *Barclay and Co*, established in London as long ago as 1729, *Lloyds Bank*, established in Birmingham in 1765 and transformed into joint-stock company in 1865, *National Provincial Bank of England*, established in Birmingham in 1833 as one of the first modern banks, *London and Westminster Bank*, established in London in 1834 and *London City and Midland Bank*, established also in Birmingham in 1836.² *Bank of England* had the role of the central and regulative bank. It was established as long ago as 1694 and it became central issuing bank in 19th century. These banks made the Great Britain the strongest banking power of the world; because of that only and not for some other special interest of its own, it was important for the Balkan region. It is written in the literature that in the summer of 1914 the investments of the British financial capital at the Balkans amounted to 17 million pounds, which made only 0.86% of the total British foreign investments.³

In Austria-Hungary modern banks were established between 1853 and 1890 under the influence of the model offered by European banking and with the support of the French and German capital.⁴ Earlier established private banks had and kept their important role here as well, primarily S.M. *Rothschild* bank, which started to work in Vienna as early as 1816. The state performed its regulative role in the field of finances through the agency of *Österreichisch-ungarisch Bank (Osztrak-magyar bank)*, as was the name of the earlier *Nationalbank* (established in Vienna in 1816) since 1867, i.e. after the formation of dual Monarchy. Radical change happened with the establishing of

² *Barclay and Co.* was named *Barclay Bevan Triton and Co.* (until 1896), and from 1918 until today its name is *Barclays Bank Ltd.*; *Lloyds Bank* was named *Taylor and Lloyds Bank* until 1889, and in 1912 it moved its headquarters to London; *National Provincial Bank of England* and *London and Westminster Bank* merged into *National Westminster Bank* in 1968; *London City and Midland Bank* was named *Birmingham and Midland Bank* since it was established until 1891, then *London and Midland Bank* until 1898, while it had the name mentioned in our study from 1898 to 1918, when it became *London Joint City and Midland Bank*, and in 1923 it got the name *Midland Bank*; *Parr's Bank Ltd.* Had the name of *Parry Lyon and Co.* since it was established until 1865; *Morgan Grenfell and Co* was established under the name of *George Peabody and Co*, and from 1864 to 1910 it had the name of *J. S. Morgan and Co.* (See: K. E. Born, quoted work, *Bankenregister*, p. 646-662).

³ R. J. Crampton, *The Hollow Detant. Anglo-German Relations in the Balkans 1911-1914*, London s.d., p. 19

⁴ See Note no. 1. H. Benedikt, *Die wirtschaftliche Entwicklung in der Franz-Joseph-Zeit*, Wien, 1958; *Die österreichischen Banken im Jahre 1908*, in: *Mitteilungen des k. Finanzministeriums*, Jg. 17 (1911), p. 31-44; B. Michel, *Banquest et Banquiers en Autriche au debut du 20' siecle*, Paris 1976; *Compass 1918*, Band 1, Wien, 1917.

Niederösterreichische Escompte Gesellschaft in 1853 (established under the influence of the example set by *Comptoir d'Escompte de Paris* and *Discontogesellschaft*), *Oesterreichische Creditanstalt für Handel und Gewerbe* in 1855 (under the influence of the example of *Société Générale du Crédit Mobilier*) and *Österreichische Bodencredit-Anstalt* in 1856 (under the influence of the example of *Crédit Foncier de France*). *Anglo-Österreichische Bank* (*Anglo-Austrian Bank*) was established in 1863 with the money of London banks, *Wiener Bankverein* was established in 1869 with the money of Viennese bank *Österreichische Bodencredit-Anstalt*, and the association of four small banks resulted in the establishing of *Unionbank* in 1869. The establishing of private 'Mercur'-Bank followed in 1870 and *Allgemeine Depositen-Bank* in 1871. Parisian bank *Société de l'Union Générale* founded *Österreichische Länderbank* in 1880, which appeared to be longer-lasting than its founder. The establishing of *Österreichische Sparkassa* in 1833 completed the network of Viennese banks. On the last day of 1903, there were 75 banks in Austria (including Bohemia), 56 of them joint-stock banks, and 18 of them in Vienna (without *Österreichische-Ungarische Bank*).

A little bit slower and depending considerably on Viennese financiers, a modern, although not a strong banking center emerged in Budapest at that time. The first important bank was established in 1841, and it was *Pester Ungarische Commerzialbank* (*Pestimagyar kereskeldemi bank*), while the first credit bank in Hungary, *Ungarische Allgemeine Creditbank* (*Magyar altalanos hitelbank*) was established in 1867 by the Viennese bank *Österreichische Creditanstalt für Handel und Gewerbe*. The establishing of *Ungarische Escompte und Wechsler Bank* (*Magyar leszamitolo es penzvalto-bank*) followed in 1869, then *Ungarische Handels AG* in 1890, which was named *Ungarische Bank und Handelsgesellschaft* (*Magyar bank es kereskeldemi reszvenytarsasag*) in 1910.⁵ There was a simultaneous financial rise of Prague, where it should be noted that *Zivnostenska banka* was established in 1869 (*Handelsbank*, shortly named *Zivnobanka* in Bohemia) and in 1870 *Prazska uverni banka* (*Prager Creditbank*, or shortly named *Pragobanka* in Bohemia).⁶

The great change and expansion of German banking happened between the beginning of 1850s and 1870s, especially in Prussia, and the new flourish followed after the union and the creation of German Reich (January, 1871).⁷

⁵ Ibid.

⁶ C. Nečas, *Na prahu české kapitálové expanze*, Brne, 1987.

⁷ See: P. Delfaud, Cl. Gérard, P. Guillaume, J. A. Lesourd, *Nouvelle histoire économique*, vol. 1, Paris, 1976; K. E. Born, quoted work; A. Dauphin-Meunier, *Histoire de la Banque*, Paris, 1959. See also: *Enzklopedisches Lexikon für das Geld, Bank und Borsenwesen*, hr. von Palyi und P. Quittner, Frankfurt a. M., 1958; *Longman Atlas of Modern British History. A Visual Guide to British Society and Politics 1700-1970*, by Ch. Cook and J. Stevenson, London, 1978, p. 80-83; *Lexicon für das Geld, Bank und Börsenwesen*, Frankfurt a. M., 1958; G. Dioritch, *L'Expansion des Banques allemandes à l'étranger*, Paris, 1909; J. Riesser, *Die deutschen Grossbanken und ihre Konzentration*, Jena, 1910; H. Nussbaum, *Unternehmer gegen Monopole*, Berlin, 1966; W. Gutsche, *Monopole, Staat und Expansion vor 1914*, Berlin, 1986.

The transformation model here was also offered by private banks that had been established earlier and that adjusted to the requirements of the new time since the middle of 19th century: *Gebrüder Bethmann*, established in Frankfurt on the Maine in 1748, *Sal. Oppenheim jr. und Co* (Bonn, 1789, Cologne since 1801), *Abraham Schaaffhausenscher Bankverein* (Cologne, 1790), *M. M. Warburg und Co* (Hamburg, 1798), *Samuel Bleichröder und Co* (Berlin, 1803), *Mendelssohn und Co* (1805), *M. A. Rothschild und Söhne* (Frankfurt am Maine, 1810), *B. H. Goldschmidt und Co* (Frankfurt am Maine, 1821), *Gebrüder Schröder und Co* (Hamburg, 1846), *Robert Warschauer und Co* (Berlin, 1849), *Erlanger und Söhne* (Frankfurt am Maine), etc. They all held very strong and influential positions during 19th century, but were still pushed aside after the establishing of joint-stock banks. This turn started at the end of 1840s in the Rhine Valley and in Berlin. Due to the need for restoration to financial soundness imposed by the economic crisis at that time, *Abraham Schaaffhausenischer Bankverein* was reorganized into the first German joint-stock bank in Cologne in 1848; however, strong business banks were conceived in Berlin in 1851 by the establishing of credit cooperative society under the name of *Discontogesellschaft*, which was reorganized into joint-stock company in 1856. It soon became the strongest financial institution in Prussia and second bank in power in German Customs Association, dominated then by *Darmstädter Bank für Handel und Industrie*, which was established in 1852 after the model of Parisian *Société Général de Crédit Mobilier*. In 1856 *Berliner Handelsgesellschaft* was established in Berlin, and *Norddeutsche Bank* in Homburg. After a decade and a half there were new important banks founded: *Deutsche Bank* in Berlin in 1870 and *Dresdner Bank* in Dresden in 1872. The state influenced the financial policy of united Reich through *Deutsche Reichbank*, established in 1875 (the foundation was offered by *Preussische Bank*, established in 1765). Establishing of *Nationalbank für Deutschland* in Berlin completed the “period of bank development” – all important German banks were established.

After German union in 1871, Berlin as a capital developed as the most important German and very important European, soon also world money center.⁸ Not only new banks were established in Berlin, but strong banks from other German cities moved their headquarters into it. At the beginning of 20th century *Deutsche Bank*, *Discontogesellschaft*, *Dresdner Bank* and *Darmstädter Bank für Handel und Industrie* represented real giants worldwide and were called “die vier grosse D”. They concentrated bank capital strongly, integrating or subordinating to them many small and big banks. For instance, *Dresdner Bank* “swallowed” *Erlanger und Söhne* in 1904 among other banks, and *Darmstädter Bank für Handel und Industrie* “swallowed” *Robert Warschauer und Co* in 1905, but the most spectacular success was achieved by *Discontogesellschaft*, which integrated

⁸ A. Lange, *Das Wilheminsche Berlin*, Berlin, 1984. Also: K.E. Born, *Wirtschafts und Sozialgeschichte des Deutschen Kaiserreiches 1867/71-1914*, Stuttgart, 1985; H. U. Wehler, *Das Deutsche Kaiserreich 1871-1918*, Göttingen, 1975; F. Stern, *Gold and Iron*, New York, 1977.

with *Norddeutsche Bank* in 1896, *M. A. Rothschild und Söhne* in 1901 and until recently giant *Abraham Schaaffhausenscher Bankverein* in the spring of 1914.⁹

By the middle of 19th century France grew into the second important world financial center and Paris soon became the most important money market for the Balkan business operations. The basic bank was *Banque de France*, established in 1800, which grew closely together with the state as time went by. Although French monetary power could not be imagined without private banks such as *Heine et Cie* (1795), *Louis Dreyfus et Cie.* (1810), or the most important among them *Rothschild Freres* (1812-1815), new business and joint-stock banks were those who brought powerful financial expansion. First of them, *Comptoir d'Escompte de Paris*, was established in 1848 after the British model and with state guarantees, and reorganized as private joint-stock company in 1854. When it was wound up forty years later, it continued to exist in 1889 as a successor bank – *Comptoir National d'Escompte de Paris*. Radical change took place by the establishing of *Société Général de Crédit Mobilier* in November of 1852, with which a universal-type bank was created in accordance with modern needs of economy for long-term loans to industry, traffic and commerce, soon even agriculture (this instigated establishing of the first agricultural bank in 1852 – *Crédit Foncier de France* – which started to work in 1854). Although this was undoubtedly a creation that “created an epoch” and that internationally-wise “served as an example”, as of 1867 it could only vegetate exhausted by the struggle in competition with the powerful Parisian Rothschilds and disappeared quietly in 1902, when it was altered into a smaller and less powerful bank – *Crédit Mobilier de France*.

In the second half of 19th century many other modern banks were founded in France: *Société Général de Crédit Industriel et Commercial* in 1859, then *Crédit Lyonnais* in 1863, with its headquarters in Lyonne (private joint-stock company since 1872), then *Société Général pour favoriser la développement du Commerce et de l'Industrie en France* in 1864, created by the Rothschilds as a counter-balance and competence to *Société Général de Crédit Mobilier*. In 1872 joining of the old *Amsterdam Banque de Crédit et Dépôts des Pays Bas* and new *Banque de Paris* (created by several Parisian banks in 1870) resulted in the foundation of a powerful *Banque de Paris et de Pays Bas (Pariba)*.⁴ *Société de l'Union Général* existed from 1878 to 1882 only, but it still got a place in the history of banking by the manner it conducted its business, the role it played outside France and the big affair in which it collapsed. At the beginning of 20th century *Banque français pour le Commerce et l'Industrie* (better known as *Rouvier Banque* in 1902) was established as well as powerful *Banque de l'Union Parisienne* (1904), which developed during take-over of *Banque Parisienne* (1879) by *Mallet Freres et Cie* (1722), *Hottinger et*

⁹ A. Fandler, *Zur Kapitalkonzentration der Berliner Grossbanken von 1914-1923*, Berlin, 1926; J. Hermann, *Konzentrationbestrebungen im deutschen Bankwesen*, in: *Die Konzentration in der deutschen Wirtschaft seit dem 19. Jahrhundert*, hg. Von H. Pohl und W. Treue, Wiesbaden, 1978, p. 45-83.

Cie (1785), *De Neuflize et Cie* (1800), *Vernes et Cie* (1811) and *Mirabaud et Cie* (1822).¹⁰ In 1894, *Banque Swiss et Français* was established with Swiss capital in Paris and it soon became predominantly French bank (*Crédit Commercial de France*, 1917).

At least seven Swiss banks joined the group of the biggest financial institutions by the beginning of World War I; the following banks were important for the Balkan operations: *Schweizerische Kreditanstalt AG* from Zurich (1856)¹¹ and *Schweizerischer Bankverein* from Basel (1872).¹² In 1898, *Banque Internationale de Bruxelles* was established with the international capital; *Crédit anversois* should also be mentioned among other Belgian banks. As for Russian banks, *Russian-Asian bank (Banque russo-asiatique)* from Petrograd was established in 1910, by joining of the *North Bank (Banque de Nord)* and *Russian-Chinese bank (Banque russo-chinois)*; it participated prominently in the business activities regarding state loans to Bulgaria, and within its business operations with Turkish Empire it stepped on the Balkans engaging in the most important Turkish and Balkan port of Thessalonica; 65% of its capital was kept by Parisian banks – *Société Général de Crédit Industriel et Commercial*, *Pariba* and *Banque de l'Union Parisienne*.¹³

3. “Passion for the Near East”

Institutional structure of European banks formed at the end of 19th and the beginning of 20th century, especially the names of the stated banks, speaks a lot about how much financial capital of Europe was interested in the Balkan business operations. It is not just that at least 80 banks differing in purpose, character, scope of business and power of capital were interested, but that the majority of them made the elite of European and world banking.

A German historian wrote that in the developed countries of 19th-century Europe the race to gain economic and political positions in the Asian and North-African territories of Turkey acquired the proportion and characteristics of real “passion for the Near East”.¹⁴ This observation refers especially to Austro-Hungary and Germany, while the Near East represented objectively the farthest range for the Monarchy and for the German Reich was for long only one of the

¹⁰ E. Bussiere, „La Banque de l'Union Parisienne et l'existence d'un courant national dans les milieux pétroliers français dans l'entre-deux-guerres”, in: *Relations internationales*, no. 43 (automne 1985), p. 305-322.

¹¹ *125 Jahre Schweizerische Kreditanstalt*, Zürich, 1981.

¹² H. Bauer, *Schweizerische Bankverein 1872-1972*, Basel, 1972.

¹³ D. Geyer, *Der russische Imperialismus*, Göttingen, 1977, p. 203-204; G. W. F. Hallgarten, *Imperialismus vor 1914*, Band 2, München, 1953, p. 470 (Author's researches have not confirmed that Russian-Chinese Bank „was one of the biggest financial institutions for the Balkans“, as claimed by Halgarten.)

¹⁴ K. Hammer, *Weltmission und Kolonialismus*, München, 1978.

areas of expansion (together with Oceania, China, parts of central and South-West Africa, Magreb, South America).¹⁵ However, since about 1910, it was the area that Germany started to defend ferociously since in other parts of the world its positions were either lost or considerably shattered. The outburst of World War I in the summer of 1914 brought further flare-up of the “passion for the Near East” in both Empires; the big financiers and representatives of imperialism among influential publicists and rarely among top state bureaucracy instigated these even under the war circumstances. These plans regularly included the creation of institutions, therefore opening business in the Balkans.

Austro-Hungarian capital had shown vivid interest for the Near-East business dealings even before German capital, and focused on it even earlier than on the Balkans. In the Monarchy itself, Austrian capital far exceed Hungarian chronologically as well as with its ambition and efficiency. Business circles of Austria in the late 1860s suggested and in the first half of 1870s tried to gather and organize for their joint and more powerful appearance in the Near East. *Österreichisches Handelsmuseum* was then established in Vienna, and its publication “Austrian Monthly for the Orient” published in its first issue (on January 15, 1875) a long editorial, which was actually an ideologically and militantly intonated program.

“Commerce and traffic have recently been directed towards the East with double fervour (...) We state this fact today only to point to the consequences resulting from its natural influence to our circumstances. By the Adriatic Sea and the Danube, as well as by the railway that should soon connect us to the countries of the Orient directly or indirectly, we are in fact referred to traffic along eastern roads and Levant. The Suez Canal and the Black Sea offer the shortest ways under the most favourable conditions, which open markets to our industrial and agricultural products and also meet our requirements in imported goods. We have thus had an opportunity to join the great oriental traffic of the world with the chances of success (...) Our situation today forces us also to take part in it as much as possible, since the direction to the Orient remained postulate by fate for our foreign trade (...) Awareness of reality directs us to that path relentlessly and puts us before the destined request of the obligation to survive, namely to remove all barriers preventing us from accomplishing our task (...) The mission of Austria, ambassador of European culture and morality in the neighbouring areas of the East, hovers before our eyes.”¹⁶

This proclamation was preceded by the adequate practical moves by the bankers. In 1869, *Anglo-Österreichische Bank* undoubtedly used its English founders and co-owners and in cooperation with *Creditanstalt für Handel und*

¹⁵ L.Rathmann, *Stossrichtung Nahost 1914-1918*, Berlin, 1963; A. Kössler, *Aktionsfeld Osmanisches Reich*, New York, 1981; G. Schöllgen, *Imperialismus und Gleichgewicht*, München, 1984.

¹⁶ *Österreichische Monatsschrift für den Orient*, Nr. 1 (January 15, 1875), p. 1-2

Gewerbe established *Austro-Ägyptische Bank*¹⁷ in Alexandria, the first Austro-Hungarian-dependent bank abroad, which coincided with the possibilities for great business operations when the Suez Canal was open. Two years later (in 1871), *Weiner Bankverein* in cooperation with *Anglo-Österreichische Bank* and a certain assistance by the German *Dramstädter Bank für Handel und Industrie* founded *Austro-Ottomanische Bank* in Constantinople.¹⁸ Both cases provide evidence of Austro-Hungarian attempts to join the era of Imperialism actively and relatively early.¹⁹ However, the Viennese bankers proved to be too weak to persevere in rigorous international competence, so *Austro-Ägyptische Bank* ceased its operations as early as 1873, while *Austro-Ottomanische Bank* merged with *Banque Imperiale Ottomane* in 1875.²⁰

The bankers of the Monarchy directed their full attention to their neighbours, the Balkans, from that time on, where they accepted to take part in the international consortiums as weaker partners under the leadership of powerful banks from the developed countries, while in Turkey they were satisfied with more modest representation – they did not make efforts any more to create big independent banks there. However, this is the reason why the ideas brought out in the middle of 1870s had to be renewed in the course of the next forty years, while they were realized gradually and in smaller proportion. *Wiener Bankverein*, which opened its branch office in Constantinople in 1906, and branch office in Smyrna in 1911, achieved the greatest success²¹ but in all this it must have been decisive that this bank was in close connection with Berlin *Deutsche Bank*. By the beginning of World War I another two banks had their branch offices opened in Constantinople – Viennese *Unionbank*²² and *Ungarische Bank und Handels AG*²³, as the representative of Hungarian capital. In accordance with the ideas of 1875, trading, industrial and banking capital created *Austro-Orientalische Handelsgesellschaft* in 1905, for the purpose of placing Austro-Hungarian goods in the Near-East markets. Since 1913, this trading company opened its ten subsidiaries: from Skadar, Ruscuk, Varna and Plovdiv, via Constantinople, Trapezunt

¹⁷ H. Benedikt, quote work, p. 46; J. Joham, *Entwicklung und Aufgabenstellung der Creditanstalt Bankverein 1855-1955*, in: *Beiträge zur Geschichte des Bankwesens*, Wien, 1955, p. 9 (*Osterreichische Creditanstalt für Handel und Gewerbe* and *Wiener Bankverein* joined into *Creditanstalt Bankverein* in 1934).

¹⁸ *Ein Jahrhundert Creditanstalt Bankverein*, Wien, 1957, p. 44

¹⁹ F. Klein, *Weltpolitische Abitionen Österreich-Ungarns vor 1914*, in: *Jahrbuch für Geschichte*, Bd. 29 (1984), p. 263-289; F. J. Kos, *Die politischen und wirtschaftlichen Interessen Österreich-Ungarns und Deutschlands in Südosteuropa 1912/1913*, Wien, 1996; E. Kolm *Die Ambitionen Österreich-Ungarn im Zeitalter des Hochimperialismus*, Frankfurt a. M., 2001.

²⁰ H. Benedikt, quoted work, p. 46.

²¹ *Compass* 1918, Bd. 1, p. 494

²² Orientalicus, *Die Organisation der österreichischen und ungarischen Banken im Orient*, in: *Balkan Revue*, Jg. 4 (1916), p. 509-511

²³ *Compass* 1918, Bd. 1, p. 683

and Smyrna, all the way to Tehran and Tybis in the East and Cairo in the South. *Creditanstalt für Handel und Gewerbe* was primarily behind this company.²⁴

World War I was understood as an irregular opportunity offered to Austrian and Hungarian banks to achieve their aspirations, since the war alliance with Bulgaria and Turkey opened the doors for them. The circumstances were then favourable to push back far more powerful competition of the British and French capital, primarily because both weaker allies depended very much on the support by the two central powers, materially and militarily. After Serbia was occupied in 1915, which set the direct continental link with the Turkish Empire, more favourable circumstances were made and in the last months of 1915, the Monarchy capital made new efforts to regroup its power. First the “Orientgruppe” was established, consisting of *Wiener Bankverein*, *Creditanstalt für Handel und Gewerbe*, *Allgemeine Ungarische Kreditbank* and *Pester Ungarische Commerzialbank*²⁵, and soon after that “Orientalisches Syndikat”, consisting of *Österreichische Länderbank*, *Niederösterreichische Escopmpte Gesellschaft*, *Allgemeine Depositenbank*, *Pester Erster Vaterländische Spaarkassa Verein*, *Ungarische Bank und Handels AG*, *Vaterländische Bank* and *Ignaz Deutsch und Söhne*.²⁶ By the end of the War in November 1918, neither of the two attempts gave any results. However, both because of the failure and rare half-successes in the Near East, the Balkan Peninsula became important for the Monarchy; Austro-Hungarian statesmen and bankers, but also the industrials and traders, took the Balkans as their sphere of interest important both as itself and as the bridge to the Near-East.²⁷

German capital²⁸ appeared in the Near East not earlier than 19th century, but it soon acquired strong position. It manifested the greatest ambitions and proved to be the serious rival to the British and French competition.²⁹ It was led by *Deutsche Bank*, which spread the network of its interests worldwide.³⁰ However, two German dependent banks were established apart from *Deutsche Bank*: *Deutsche Palästinaabank* in Berlin on January 01, 1899 (the foundation consortium included big Prussian landowners gathered around *Heydt und Co* from Berlin) and *Deutsche Orientbank*, established also in Berlin on January

²⁴ Haus-, Hof- und Staatsarchiv in Wien, Administrative Registratur (further referred to as: HHStA-Wien, AR), F. 34, K. 51, several documents

²⁵ E. März, *Österreichische Bankpolitik in der Zeit der grossen Wende 1913-1923*, Wien, 1981, p. 236

²⁶ *Compass* 1918, Bd. 1, p. 367

²⁷ See: A. Mitrovic, *Berliner Handelsgesellschaft i Srbija*; the same, *Pester Ungarische Commerzialbank in the Balkans*

²⁸ J. Nagel, *Zwischen Kapitalarmut und Kapitaleexport. Zum Problem der Auslandsinvestitionen deutscher Grossbanken*, Frankfurt a. M., 1996.

²⁹ A. Kössler, *quoted work*.

³⁰ G. Schölgen, *quoted work*.

03, 1906,³¹ and the founding consortium included such banks as: *Abraham Schaaffhausenscher Bankverein*, *Nationalbank für Deutschland* and the leading *Dresdner Bank*. The stated banks pulled the important German trading capital and the largest overseas transporters *Levant Linie* and *Hamburg-America-Linie* in this business.³² *Deutsche Palästina-Bank* operated in the narrower Levant, which started as a relatively small and remained such with the capital of about 6 million francs. It opened its branch offices in Jaffa (1899), Haifa (1904) and Beirut (1907).

Deutsche Orientbank was far more powerful, it had the capital amounting to 20 million francs and spread the network of thirteen branch offices from Hamburg and Constantinople (1899) via Brusa, Alexandria and Cairo (1906) to the western part of North African Atlantic coast, in the ports of Tangier and Casablanca until 1913, when it had to leave them over to the French capital. It was far and away the most powerful German banking institution in the eastern Mediterranean and it resisted the British and French competition successfully; it also struggled with *Deutsche Bank*, not only in the Asian Turkey inland, but also in Iran (Persia).³³ Its intentions were to cover the countries in various regions (the Mediterranean, the Near East, and the Balkans). The founding act provided for the development of “all banking business transactions in Turkey, Egypt, Greece, Bulgaria, Romania, Serbia, on the Malta, in Morocco and Persia”, and the Reich Chancellor expected it to be “the counterbalance to English-French *Banque Imperiale Ottomane*” in the whole Near-Eastern and Balkan region.³⁴ In the middle of November 1912, German Consul in Constantinople said that “*Deutsche Orientbank* established relations with all important places in Macedonia and Albania, especially with Thessalonica, Cavalla, Karaferia, Holly Mountain, Bitolj, Janina, Drach, Skopje, i.e. with all places interesting for trading”.³⁵ It still did not penetrate into the northern Balkan areas, although there are some data that at least after the Balkan Wars it was interested in exploitation of natural resources of Serbia.³⁶ Its footholds were first in Thessalonica, and then in Delegacy, from where it supported German traders who bought tobacco in

³¹ W. Schweinitz, Gold, *Bankiers und Diplomaten. Zur Geschichte der Deutschen Orientbank 1906-1946*, Berlin, 2002.

³² W. Steinmetz, *Die deutsche Grossbanken im Dienste des Kapitaleports*, Luxembourg, 1913, p. 124-136; A. Kössler, quoted work, p. 379-383

³³ Ibid.; J. Mendel, *Die deutsche Auslandsbanken am Balkan*, in: *Balkan Revue*, Jg. 1 (1914-1915), p. 28-29; G. Schölgen, quoted work, p. 226-330

³⁴ A. Kössler, quoted work, p. 382

³⁵ Politisches Archiv des Auswärtigen Amtes in Bonn (further in the text: AA-Bonn), Oxford registry p. 725, Politische Abteilung (PA), series *Orientalia Generalia* 13, Bd. 3, Report No. 465 from Constantinople dated November 15, 1912.

³⁶ Zentrales Staatsarchiv in Potsdam (ZStA-Potsdam), Auswärtiges Amt Nr. 6513, Beograd, January 09, 1914.

Xantia and Djevdjelija regions.³⁷ In October 1916, *Deutsche Bank* and *Dresdner Bank* settled an agreement regarding *Deutsche Orientbank*, and obviously on the account of rivaling *Discontogesellschaft*. Namely, *Dresdner Bank* took over 10,000 shares that *Abracham Schaaffhausenscher Bankverein* had in *Deutsche Orientbank* and at the same time *Deutshce Bank*, *Wiener Bankverein* and *Ungarische Allgemeine Creditbank* joined the consortium of the owners. In all likelihood *Deutsche Bank* dashed the efforts of Austrian and Hungarian bankers to gather into groups to compete the very German capital in the Near East.

4. Origin of regionally important dependent banks

In the beginning of 1880s, after the failure in the Near East, Austrian and Hungarian capital directed to the Balkan neighbours and started to create dependent banks that sustained for a long time. Due to the lack of money and cautiousness, which forced them to share the risk, they started their operations in this region also in cooperation with financiers from the developed countries, primarily France. They first started their operations in Serbia, which remained permanently important for the Austro-Hungarian bankers, but first of all because they could never gain their superiority in it during peacetime. A little bit later and in the same way the expansion to Romania and Bulgaria followed, to a certain extent to Greece, and much later to Albania. The overall result everywhere was similar to that in Serbia, although Austrian and Hungarian capital became best established in Bulgaria.

The first step was made by *Österreichische Länderbank*, which was established as a monetary institute of aristocratic circles of the Monarchy and this is why it fell to its share to settle up economically political predominance of Austro-Hungary in the neighbourhood over the Sava and the Danube. It was suitable to it since as a new bank it had to acquire clients and areas for business operations, therefore it had to accept risky moves as well and use political opportunities. The decision to open the dependent bank in Serbia and the required preparations were made in the course of 1882, so that *Srpska kreditna banka* (*Serbian Credit Bank*), the first modern bank in Serbia, started to work in Belgrade in 1883.³⁸ Although it was primarily devoted to financing import from Austria-Hungary, it never depended only on *Österreichische Länderbank* or the capital of the Monarchy, since the other member of founding consortium was powerful *Comptoire d'Escompte de Paris* and since the main Viennese bank was closely con-

³⁷ AA-Bonn, Ox. 725, PA, *Orientalia Generalia* 13, Bd. 3, Nr. 465, Constantinople, November 15, 1912.

³⁸ A. Piperger, *100 Jahre Österreichische Länderbank*, Wien, 1880, p. 43-44; B. Michel, *quoted work*, p. 263; N. Vučo, *Privredna istorija Srbije do prvog svetskog rata*, Beograd, 1955, p. 246

nected in business with Parisian *Société générale pour favoriser le développement du Commerce et de l'Industrie en France*.³⁹

By the autumn of 1915, French capital remained in possession of the owners although Parisian partner-banks changed, so, for instance, in the middle of 1910s the co-owner was C.h. Monshicourt.⁴⁰ Since 1911, *Živnostenska banka* from Prague also became one of the owners. Austro-Hungarian Consulate in Belgrade estimated in the summer of 1911, that *Srpska kreditna banka* “operates with about 5.5 million Franks, 3 million Francs being ours.”⁴¹

In 1883, *Pester Ungarische Commerzialbank* also started to work in Serbia; in 1888, it created the associate bank *Banka Andrejevic i Ko.*⁴² (*Andrejevic and Co. Bank*), which was the most powerful foothold of the Monarchy capital in Serbia⁴³ in the second half of the first decade of 20th century and for several years the strongest bank in this country.⁴⁴ However, the Budapest headquarters estimated that due to the lack of money and competence that was stronger and stronger, the dependent bank in Belgrade should be strengthened by association with some bigger financier and it seems that German intelligence information were true that the efforts were made to connect with French capital and to make consortium either with *Pariba* or *Banque Imperial Ottomane*.⁴⁵ Since foreign policy reasons took prevalence, the agreement was reached with *Berliner Handelsgesellschaft* on April 09, 1903, and since then until the summer of 1913, the Berlin Bank, at least by name only, participated at parity in capital of *Banka Anrejevic i Ko.*, which was organized as joint-stock company in 1910, and opened a branch office in Niš.⁴⁶ It is interesting that in international communication it always wrote its name in French – *Banque Andreevitch et Cie*.

In 1888, *Österreichische Länderbank* appeared on the Aegean coast opening *Banque de Salonique* in the most important Balkan port, keeping eight fifteenths of the capital for itself and leaving four-fifteenths to *Comptoire d'Escompte de Paris*, while three fifteenths were left to private bank *Fratelli Allatini* from Thessalonica.⁴⁷ This branch office in Thessalonica was achieving good results for a decade and a half, supporting import from the Monarchy by railway through

³⁹ B. Michel, *quoted work*, p. 263.

⁴⁰ AA-Bonn, Ox. 575,PA, Serbien 7, Bd. 19, Annex to the unnumbered letter, Beograd, January 02, 1908.

⁴¹ HHStA-Wien, AR, F. 23, K. 70, streng vertraulich Nr. 64 h.p., Beograd, July 12, 1911.

⁴² R. von Hegedüs, *Geschichte der Entstehung und des Bestandes der Pester Ungarischen Commerzialbank*, Bd. 2, Budapest, 1917, p. 282-283.

⁴³ A. Mitrović, *PesterUngarische Commerzialbank na Balkanu*

⁴⁴ B. Michel, *quoted work*, p. 263

⁴⁵ AA-Bonn, Ox. 575, Serbien 7, Bd. 19, Letter by *Berliner Handelsgesellschaft* bank, Berlin, April 06, 1908.

⁴⁶ A. Mitrović, *Pester Ungarische Commerzialbank na Balkanu*, p. 51-52; *ibid.* *Berliner Handelsgesellschaft I Srbija*, p. 180-186

⁴⁷ A. Peperger, *quoted work*, p. 47

the Morava and Vardar valleys, and also gathering the considerable number of traders of the south Balkans. However, in 1904, *Österreichische Länderbank* had to apart from the majority of its stocks and the dependent bank in Thessalonica went to the French and Greek owners. To tell the truth, the main bank in Vienna tried in 1909 to penetrate the Near East under the guise of this Thessalonica office, which it did not succeed although it joined the consortium with *Société general pour favoriser le development du Commerce et l'Industrie* and *Österreichische Bank*; it is interesting that even in 1918, it had its own reasons to count still on some of its rights in *Banque de Salonique*.⁴⁸

Viennese and Budapest banks appeared in Romania relatively early as well as ambitiously and successfully, but this was also the soil where for the first time they had to face the fact that they had to accept partnership of the German financial capital due to business and political reasons. *Österreichische Länderbank* participated with 75% capital in the earlier established bank *Jeschek e Co.*, which became its own small dependent bank with the capital amounting to only 400,000 Leis (equal to French Franc); but it developed successfully and in 1904, it was turned into joint-stock *Banca romana di credit* with the capital amounting to 1,000,000 Francs and with its participation of 60%. By joining of *Dickin e Co* and entering the main consortium *Niederösterreichische Escomtegesellschaft*, one of the largest Romanian banks was established in 1908, which started with the capital amounting to 6 million Leis and increased it in 1914, to 10 million Leis.⁴⁹ The influence of *Pester Ungarische Commerzialbank* was felt in Romania more in 1883, and in 1889, it entered the partnership with private *Banca Marmorosch, Blank e Co*, which was joined by the German *Darmstädter Bank für Handel und Industri* in 1890 already, by *Berliner Handelsgesellschaft* in 1904, (when there was a reorganization on the joint-stock basis and the capital increased to 8 million) and by *Pariba* in 1905 (bringing another 2 million Leis), so that Hungarian, German and French members of the consortium had equal parts of 20% each. This dependent bank opened branch offices in trading and river-traffic center of Galac on the Danube, the center of oil production in Ploesti, and in Kraiowa and Jashi.⁵⁰

In 1897, an outstanding representative of German capital expansiveness in Bucharest, *Discontogesellschaft* bank, in cooperation with *Samuel Bleichröder und Co* from Berlin, established the strongest Romanian bank *Banca generala romana*, the capital of which amounted to extremely high 10 million Leis for that time, and in 1914, it increased to 15 million Leis. This dependent bank had branch offices in Braila, Constance, Kraiowa, Djurdj, Ploesti and Turn-Magurele, in

⁴⁸ Ibid., p. 47; B. Michel, *quoted work*, p. 265; *Compass* 1918, Bd. 1, p. 1884-1885

⁴⁹ A. Piperger, *quoted work*, p. 47, 62, 65; A. J. Gutzulescu, *Die Geld und Kreditinstitute in Rumänien*, s. 1, 1914, p. 73

⁵⁰ *Bank Marmorosch, Blank und Co, Bukurest*, 1924; R. v. Hegedüs, *quoted work*, p. 287; J. Mandel, *quoted work*, p. 18; B. Michel, *quoted work*, p. 264

other words in seaports and oil industrial centers.⁵¹ Finally, at the end of 1906, *Wiener Bankverein* and *Anglo-Österreichische Bank* closely cooperated with *Banque de l'Union Parisienne* and founded *Banca commerciale* in the Romanian capital, which ranked among the top biggest Romanian banks.⁵²

In 1905, Hungarian-German-French consortium founded *Banque de Commerce et de Depots* in Thessalonica, as 'daughter-bank' of Bucharest *Banca Marmorosch*, with a million-franc capital.⁵³ The purpose of this venture was to ensure the place in the important business town and port of Thessalonica and to set the starting point for the breakthrough to the Near East. In 1904, *Nationalbank für Deutschland* from Berlin established *Banque d'Orient* in Athens in cooperation with Greek *National Bank* with the capital amounting to 10 million Francs; it immediately opened branch offices in Thessalonica and Smyrna. In 1906, *Nationalbank für Deutschland* planned to increase the capital to 15 million Francs connected with *Deutsche Levant-Linie* and opened the branch office in Homburg and new branch offices in Constantinople and Alexandria and took steps to settle down in Cairo. However, due to the refusal of Greek government to accept domination of the Berlin bank, *Nationalbank für Deutschland* withdrew from this in December 1905, and at the beginning of 1906, it joined the consortium that was founded by *Deutsche Orientbank*.⁵⁴

Pester Ungarische Commerzialbank established its first connections with Bulgarian economy in 1884, and in 1898, it founded dependent *Trading bank* in Sofia with the capital amounting to only 250 thousand Leva (equal to French francs), but which quadrupled this capital until 1902.⁵⁵ By the half of the first decade of 20th century there was a wave of opening of dependent banks in Bulgaria. The first step was made by *Discontogesellschaft* from Berlin, which in consortium with *Norddeutsche Bank* (which was then actually its property) and *Samuel Bleichröder und Co*, founded *Credit bank* (parallel names: internationally *Banque de Credit*, in German speaking regions *Kreditbank*) in Sofia in the beginning of October, 1905, with the capital of 3 million Leva; in 1906, it opened its branch office in the port of Varna.⁵⁶ Responding obviously to this German move, the capital of Monarchy soon founded its dependent banks in Sofia, leaning again on the French money. In December 1905, *Wiener Bankverein* founded the *Balkan Bank* (*Bank Balcanique*) with the capital of 3 million Leva and under the name that spoke of intention to spread business operations outside Bulgarian borders. French money had to be included to make sure the project

⁵¹ J. Mendel, *quoted work*, p. 16-23; A. Mitrović, *Discontogessellschaft i Balkan*

⁵² B. Michel, *quoted work*, p. 264

⁵³ R. v. Hegedüs, *quoted work*, p. 286-292

⁵⁴ G. Diouritch, *quoted work*, p. 704-708; J. Riesser, *quoted work*, p. 342; A. Kössler, *quoted work*, p. 381

⁵⁵ R. v. Hegedüs, *quoted work*, p. 286-292

⁵⁶ G. Diouritch, *quoted work*, p. 704-708; J. Riesser, *quoted work*, p.342; A. Kössler, *quoted work*, p. 381

would succeed: *Banque de l'Union Parisienne* joined the consortium in 1908, and *Société general pour favoriser le development du Commerce et l'Industrie* in 1910. This dependent bank doubled its capital by 1911, and opened branch offices in Plovdiv, Bourgas, Varna, Plevna, Vidin and Ruschouk.⁵⁷ In January 1906, *Pester Ungarische Commerzialbank* in association with *Pariba* founded its own independent bank also under the name of *General Bulgarian Bank (Banque Général de Bulgarie)* with the capital of 4 million Leva, which increased to 5 million Leva until 1911, and it opened its branch offices in Plovdiv, Bourgas, Varna and Ruschouk.⁵⁸

Five or six years later there was a new wave of establishing of dependent banks. The consortium that controlled *Balkan Bank*, established *Credit Agrarian Bank of Bulgaria (Crédit Fonciere de Bulgarie)* in Sofia in 1911, with the capital of 5 million Leva.⁵⁹ Then, at the end of 1911, consortium of *General Bulgarian Bank* in association with *Berliner Handelsgesellschaft* and with Belgian-international group gathered around *Banque Internationale de Brussels*, founded *General Mortgage Bank of Bulgarian Kingdom (Banque Hypothecaire du Royaume de Bulgarie)* with the capital of 10 million Leva.⁶⁰ The group gathered around the *Balkan bank*, now under the leadership of powerful *Société general pour favoriser le development du Commerce et l'Industrie* and drawing in *Banque d'Outrier* from Brussels, guided by the desire to make great competition, prepared at the end of 1911, and carried out the reorganization of *Credit Agrarian Bank of Bulgaria* in the beginning of 1912, turning it into the institution under the name of *Bulgarian Land Credit*, with the capital of 20 million leva.⁶¹ In this way the agrarian sector of Bulgarian economy became the field of rivalry of the two strong international financial groups, one Hungarian-French-German-Belgian and the other French-Austrian-Belgian. But the Russians interfered also, so in the end of February 1912, the consortium led by the new Parisian bank *Crédit Française* was founded (established from Lhoste et Cie) with 50% participation and with *International Commercial Bank (Banque International de Commerce)* and *Discount Bank (Banque d'Escompte)* as members, both from Petrograd and with 15% participation respectively. This group established *Commercial and Land Bank for the Balkans (Banque Commerciale et de Fonciere des Balcans)* with the capital of 10 million leva, with its headquarters in Paris and business operations primarily

⁵⁷ J. Mendel, *quoted work*, p. 23-24; Ž. Natan I L. Berov, *Monopolisti; eskii kapitalizm v Blgarie*, Sofia, 1958, p. 294-295

⁵⁸ R. V. Hegedüs, *quoted work*, p. 294-295

⁵⁹ HHStA-Wien, AR, F. 23, K. 64, Nr. 63 h.p., Sofia December 22, 1910; Ž. Natan I L. Berov, *quoted work*, p. 47

⁶⁰ *Ibid.*, Reports from Sofia Nr. 45 dated December 01, 1911 and Nr. 97F dated December 15, 1911, as well as the report of *Pester Ungarische Commerzialbank* Nr. 15.501 from Budapest dated December 14, 1911; R. V. Hegedüs, *quoted work*, p. 297

⁶¹ HHStA-Wien, AR, F. 23, K. 64, Report Nr. 41 from Sofia, dated December 01, 1911; Ž. Natan I L. Berov, *quoted work*, p. 47

in Bulgaria and to some extent wider in the Balkans.⁶² It became noticeable in those years that Russia made efforts to provide its financial place in the area of its important political interest with the support of French capital. In 1912, *Bulgarian Banking and commercial joint-stock company* was established in Sofia (*Société anonyme de Banque et Commerce de Bulgarie*) with the capital of one million Leva, the founder of which was *Ungarische Bank und Handels AG*.⁶³

Along with the proclamation of the independent Albania, Viennese bankers appeared there also. In the end of May 1913, the representative of Viennese *Unionbank* in Drach was interested in the opening of branch office.⁶⁴ *Wiener Bankverein* was far more ambitious, but it confronted with the Italian interest, so that the solution was in the compromise; there was an attempt to establish the *National Bank of Albania* as the dependent bank of a concern consisting of Austrian group led by *Wiener Bankverein* and Italian group led by *Banca commerciale italiana* from Milan with *Österreichische Länderbank*, *Pester Ungarische Commerzialbank* and *Ungarische Allgemeine Credibank*, as well as *Credito italiano*, *Societa bankaria italiana* and *Societa de credito popolare*, as the members. This project yielded fruit – conclusion of preliminary contract on June 25, 1913, but was not successful because the banks from other developed countries, as well as those from Germany⁶⁵ opposed very strongly.

5. Bank important for the Balkans

In 1889, a consortium headed by *Deutsche Bank* and with *Wiener Bankverein* and *Schweizerische Kreditanstalt* as members bought 88% shares of the earlier established society *Compagnie Générale pour l'exploitation des Chemins de Fer de la Turquie d'Europe* and in 1890, founded *Bank für Orientalische Eisenbahnen* in Zurich. This group was joined by *Dresdner Bank* in 1895, but with small share and not a big investment.⁶⁶ The founding consortium left over to its newly-established bank 51% of the bought mass of shares, i.e. 45% of shares of earlier the Society for exploitation of railways in European Turkey.⁶⁷ The main capital of this bank amounted to 50 million francs.⁶⁸ It later bought probably the whole remaining

⁶² HHStA-Wien, AR, F. 23, K. 64, Reports from Sofia Nr. 5 h.p. dated February 06, 1912 and Nr. 2 dated March 04, 1012.

⁶³ Ibid, Report Nr. 21, h.p., Sofia, April 16, 1912.

⁶⁴ Ibid, K. 65, Report Nr. 8 h.p. from Drach dated May 27, 1913

⁶⁵ Ibid, several reports and letters from Vienna and Drach; B. Michel, *quoted work*, p. 265-266

⁶⁶ F. Seidenzahl, *Bank für Orientalische Eisenbahnen. Eine Finanzholding und ihre Portefeuille*, in: *Beiträge zu Wirtschafts und Währungsfragen und zur Bankgeschichte*, Mainz, 1984, p. 15-23. Also: G. Diouritch, *quoted work*, p. 456; J. Riesser, *quoted work*, p. 336 (it says that *Dresdner Bank* joined as early as 1891); W. Steinmetz, *quoted work*, p. 68

⁶⁷ HHAtA-Wien, AR, F. 23, K. 65, *Zur Frage der Orientbahnen-Transaktionen*

⁶⁸ E. Achterberg, Georg von Siemens und die Banken, in: *Beiträge zu Wirtschafts und Währungsfragen und zur Bankgeschichte*, p. 325-337

part of 12% of shares, and in 1910, it released these shares to stock exchanges in Zurich, Geneva and Basel and started to issue bonds in Switzerland and Germany. In 1896, it took over the majority of shares from *Société du Chemin de Fer Ottoman Salonique Monastir* established in 1891, and later participated with a small share in the so-called Anatolian railways.⁶⁹ It existed until 1934.

Bank für Orientalische Eisengahnen was registered as Swiss bank since it had its headquarters in Switzerland and its organization and mode of operation was coordinated with the laws of this country, and *Schweizerische Kreditanstalt* stated it as its dependent bank. It was international as far as business operations and participation of capital were concerned; this was first of all because of its engagements on the Near East railways, one multinational project with intertwined interests of the biggest financial and political powers in the world at that time. However, it was primarily devoted to the railways in the Balkan provinces of the Turkish Empire; considering the basic capital, it was actually a subsidiary of German-Austro-Hungarian-Swiss consortium that had established it in the first place and superficially it was the first middle European bank.⁷⁰ The relationship between the members of consortium is not possible to decipher fully because of the business secrecy of banking operations (banks hide many things from each other, from their governments and from the governments of the allied countries) and because the shares were constantly sold in various quantities. It is still quite clear that *Deutsche Bank* was always predominant and it remained predominant.

In 1890, the members of the consortium kept 49% of the bought shares for themselves (or 43% of total shares of Society for eastern railways), but *Wiener Bankverein* soon lost its share and competent financial institutions of Austro-Hungary estimated at the beginning of 1914 that “in the last 22 years...probably three quarters and most certainly more than two thirds of the Oriental shares came into German-Swiss possession”.⁷¹ The fact that Austro-Hungarian part acknowledged the leadership to *Deutsche Bank* proves also that this bank held the biggest part of shares.⁷² At the end of September 1908, the representative of Secretary of State in charge of the Reich foreign affairs stated that even “the half of business capital belonged to Germany”,⁷³ meaning primarily of *Deutsche Bank* considering a very small share of *Dresdner Bank*. Certain change took place in the spring of 1913, when the consortium consisting of Austrian banks (*Wiener Bankverein*, *Anglo-Österreichische Bank* and *Österreichischer Bodencredit Anstalt*) and Hungarian banks (*Pester Ungarische Commerzialbank*, *Ungarische Allgemeine Creditbank* and *Erste Vaterländische Spaarkasse*) concluded contract

⁶⁹ Ibid., p. 335-336; F. Seidenzahl, quoted work, p. 15-18

⁷⁰ E. Achterberg, quoted work, p. 335-336; F. Seidenzahl, quoted work, p. 20-28

⁷¹ HHStA-Wien, AR, F. 23, K. 65, *Zur Frage der Orientbahnen Transaktionen*

⁷² Ibid., Die Bedeutung der Orientbahnen für uns, February 23, (1913?)

⁷³ *Die grosse Politik der Europäischen Kabinette*, Bd. 26-1, Berlin, 1925, Nr. 8951, p. 72

on April 16, and bought 45% shares from *Bank für Orientalische Eisenbahnen* and 6% from *Deutsche Bank* and thus provided majority for Austro-Hungarian capital, or 51% and leadership.⁷⁴ In Germany still they considered that *Deutsche Bank* had “decisive importance” in this company.⁷⁵ At the end of 1913, it already presented a problem to Austro-Hungarian consortium to sell back the shares bought in April, and also firmly denied the right to some German construction companies to ask for the concessions from Serbian and Greek governments for the construction of railways on the territories that were Turkish until recently after the first Balkan war.⁷⁶ The essence of *Deutsche Bank*’s influence should probably be seen in that it had the largest share of stocks of all banks, according to Austro-Hungarian estimate even 25% or 30%, while the members of Austro-Hungarian consortium had only 8.5% respectively.⁷⁷ If we do not neglect the fact that *Schweizerischer Kreditanstalt* and *Wiener Bankverein* belonged to the same business group gathered around *Deutsche Bank*, which had its considerable part in both banks, then it is clear that this big German bank actually controlled *Bank für Orientalische Eisenbahnen*. In order to fully consider the special role of this Zurich banking institute, it is necessary to observe that it was not really a bank but just “financial holding”,⁷⁸ “holding-society”⁷⁹ or “housing bank”,⁸⁰ i.e. financial office of the company devoted to the construction and exploitation of Eastern railways, which was on a neutral and stable Swiss soil, and under the guise of Swiss bank it carried out business operations in favour of the Reich and the Monarchy, but primarily, however, in favour of the biggest German capital gathered in *Deutsche Bank*.

⁷⁴ HHStA-Wien, AR, F. 23, K.65, *Zur Frage der Orientbahnen Transaktionen*

⁷⁵ *Die grosse Politik*, Bd. 37-2, Berlin, 1926, Nr. 15.132, p. 728

⁷⁶ Bundesarchiv in Koblenz, R 85, Nr. 88, several reports.

⁷⁷ HHStA-Wien, AR, F. 23, K.67, *Zur Frage der Orientbahnen-Transaktionen und Ankauf der Majorität der Aktien der Orientbahnen*. It was actually the effort to ensure “influence on the Balkan railway system” (ibid., *Die Bedeutung der Orientbahnen für uns*), but also that “traffic value should not be overrated”, since it was “political and financial issue” (ibid. F. 19, K. 47, opinions of Austrian Ministers for railway traffic and commerce). German party saw the interest of the Reich to preserve connection to the railways that were constructed in the Near East as the most ambitious German investments (*Die grosse Politik*, Bd. 37-2, Nr. 15.132, p. 727-731), but also the aspiration of the Monarchy to gain “the valuable trump for the forthcoming negotiations with Serbia” by ensuring the control over the Eastern railways (AA-Bonn, Ox. 668, PA, Türkei 144, Bd. 33, Belgrade report, April 01, 1913). Also, the Reich leaders understood the efforts made about the French-Austro-Hungarian cooperation as “the sword pointed at us only” (*Die grosse Politik*, Br. 37-2, Nr. 15.137, p. 736-737, as well as Nr. 15.139, p. 739-740). See: Lj. Aleksić-Pejković, *Odnosi Srbije sa Francuskom i Engleskom 1903-1914*, Beograd, 1965, p. 737-803

⁷⁸ F. Seidenzahl, *quoted work*, p. 15

⁷⁹ E. Achtenberg, *quoted work*, p. 333

⁸⁰ K. E. Born, *Geld und Banken*, p. 274

6. Competitive bank

In the Balkans-Near East regions, the capital from middle European Empires came across the more powerful capital – French, in the fore-Asia with British capital, and especially fiercely confronted them in two countries that were then the regions of the greatest tensions and the most important conflicts – in Turkey and Serbia. The bank that was the most serious competitor to middle European banks – the *Ottoman Bank* – was established in 1856, with the British capital. The purpose of the establishing of the *Ottoman Bank* was to set economic footholds to British and French financiers in the Turkish soil, in accordance with the alliance of the Great Britain, France and Turkish Empire during the Crimea War 1853-1856, but also to support strengthening and development of economy in the Osmanli Empire. On the occasion of a new loan of Port in 1863, *Banque Impériale Ottomane* (*Imperial Ottoman Bank*) was established, which was legally Turkish but concerning money and leadership British-French and had its headquarters in Constantinople and branch offices in London and Paris. British capital that was still predominant was represented by *Frühling and Goschen*, and French was represented by *Société Générale de Crédit Mobilier*. The management consisted of a 20-member committee, half of them were appointed by the British owners and the other half by the French owners.⁸¹

The *Ottoman bank* soon expanded its business operations and as a universal bank became present in all branches of Turkish economy. In 1875, it joined the *Austro-Ottomanbank* in Constantinople. At the very beginning of 20th century, complete with the headquarters and several offices in Constantinople, it had twenty-five branch offices at all business points of the Empire, from Thessalonica and Jedren via Mitilene and Larnaka to Baghdad in the East and Alexandria and Cairo in the South. (Egypt was under the Sultan's sovereignty, although in British hands as of 1882).⁸² Some time later it opened branch offices in Bitolj, Skopje and Skadar.⁸³ As time went by French capital gradually overpowered, so it turned into the subsidiary of the Parisian financiers and primarily expressed French economic interests in Turkey.⁸⁴ Although Constantinople was still its headquarters, the managing center moved to Paris; from 1902 to 1913, top positions in General Management were held by the French (which they formerly used to alternate between Parisian and London financiers),⁸⁵ and before the

⁸¹ Archive Nationale de Paris (further in the text: AN-Paris), F23 154, Memoir, le 2 septembre 1918; K.E. Born, *Geld und Banken*, p. 242

⁸² *Banque Impériale Ottomane*, in: *Revue commerciale du Levant*, Bulletin mensuel de la Chambre de commerce française de Constantinople, no. 197, p. 4

⁸³ Austro-Hungarian services monitored these events with great attention: HHStA-Wien, AR, F23, many data about documents in several bundles.

⁸⁴ J. Thobie, *Intérêts et Impérialisme français dans l'Empire Ottoman (1895-1914)*, Paris, 1977.

⁸⁵ AN-Paris, F22 154, Memoire

World War I *Banque de l'Union Parisienne* had the largest share and influence in it, while *Hottinger et Cie*, *Mallet Freres et Cie*, *Mirabaud et Cie*, *De Neuflyze et Cie* and *Heine et Cie* had very strong positions.⁸⁶ In the autumn of 1918, the French kept 350 thousand out of 500 thousand shares, or 70%.⁸⁷ When *Deutsche Bank* started to build strong positions for the German capital in the Turkish Empire in the end of 1880s, the *Ottoman Bank* represented a major obstacle, sometimes as a rival, sometimes as a cooperator. Indeed, representing the French interests, it managed to take a place in the 'Baghdad railways' project, the most ambitious and strategically far-reaching investment of the German Reich, and at the same time the point of bitter British-German quarrel.⁸⁸ It existed until 1925,⁸⁹ but reorganized and oriented mostly towards Africa it exists even today under the same name, although the Osmanli Empire is long gone.

Business interests of the *Ottoman Bank* in the period of its full strength spread far over the Turkish border over the whole Balkan region, whereas it used Swiss and Belgian capital through the network of its dependent banks, especially *Soci t  Financier d'Orient*, which was founded in Brussels in 1897, and also *Soci t  Financiere Franco-Suisse*.⁹⁰ However, outside the Turkish Empire it developed truly big business operations and achieved important results only in Serbia. The *Ottoman Bank* appeared in Serbia in 1885, as a member of the international consortium for the completion of railway construction headed by *Comptoir d'Escompte de Paris* and where the third partner was * sterreichische L nderbank*. It stepped more firmly into Serbia in 1894/1895, at the time of profound crisis of Serbian state finances and ruined capability of the country to pay off the debts concluded in 1880s.⁹¹ It seems that at the initiative of *Berliner Handelsgesellschaft*, which started its operations in Serbia about ten years earlier and achieved very influential position, it participated in the conclusion of the contract of Karlovi Vari (Karlsbad), on June 20, 1895, and based on this contract in the creation of Independent Monopoly Management,⁹² by which the international control of financial capital over Serbian state finances was established.⁹³ The *Ottoman Bank*, as well as the stated Berlin bank (the representative of which, Karl Direnberger, remained until World War I) had the permanent place

⁸⁶ K. E. Born, *Geld und Banken*, p. 242

⁸⁷ AN-Paris, F23 154, Memoire

⁸⁸ G. Sch llgen, *quoted work*.

⁸⁹ K. E. Born, *Geld und Banken*, p. 648

⁹⁰ AN-Paris, F23 154, Memoire. See: G. W. F. Hallgarten, *quoted work*, Bde 1-2; Lj. Aleksi -Pejkovi , *quoted work*, p. 40, 239

⁹¹ AN-Paris, F23 154, Memoire. A. Mitrovi , *Berliner Handelsgesellschaft i Srbija*; A. Piperger, *quoted work*, p. 45

⁹² C. F rstenberg, *Die Lebensgeschichte eines deutschen Bankers*, Wiesbaden, 1931, p. 287-293; A. Mitrovi , *Berliner Handelsgesellschaft i Srbija*, p. 177-178

⁹³ H. Feis, *Europe, The World's Banker 1870-1914*, New York, 1965, p. 266-268

in the management and Compté de Saint-Balmont, Sallandrouze de Lamornaix, Joseph Simon and G. Bouniols took it as the representatives.⁹⁴

As of 1896, the *Ottoman Bank* became monetary the strongest, and somewhat later the decisive member of the consortium regarding Serbian state debts. It divided the leadership with *Berliner Handelsgesellschaft* concerning the 1902 loan, but took it over concerning the 1906 loan and strengthened it by establishing the syndicate for the conversion of Serbian debts, while it finally became sacrosanct allowing the loan of 1913.⁹⁵ It managed to gather all powerful Parisian banks under its leadership: *Société générale pour favoriser le développement du Commerce et de l'Industrie en France* (1896, 1906, 1913), *Banque d'Union Parisienne* (1911, 1913), *Comptoir National d'Escompte de Paris* (1896, 1909, 1913) and *Pariba* (1911, 1913), as well as *Banque Badac* (1906, 1909, 1911) and *Banque Hostier et Cie* (1896, 1902) or *Banque Cheneriere* (1906). It also financed the increasingly large French import in Serbia, and in time it invested more and more in the Serbian economy. A part of these business deals were closed by the mediation of Brussels 'daughter-bank' – *Société Financière d'Orient*.

In 1910, the *Ottoman bank* together with *Société Financière d'Orient*, its owner bank *Banque l'Union Parisienne* and its less powerful associate *Banque Bardace*, founded *Banque Franco-Serbe* with one headquarters in Paris and another one in the form of branch office in Belgrade.⁹⁶ It drew Serbian capital from the *Zemaljska banka* (*Land bank*) for this project, which was controlled by Old Radicals and from *Izvozna banka* (*Export bank*) under the control of the Young Radicals, and soon from *Vračarska štedionica* (*Vračar Savings Bank*), which was under the control of the Liberals. At the moment of its establishing in late spring 1910, *Banque Franco-Serbe*, with the nominal capital of 12 million Francs (actually 4 million Francs) was three times stronger than the strongest banks in Serbia at that time. At the same time it was also the most powerful subsidiary of the French capital in the Balkans; this was because the money actually belonged to the French, i.e. it was not gathered from the banks of other developed countries.⁹⁷ The financi-

⁹⁴ AN-Paris, F23 154, Memoire; A. Mitrović, *Beroner Handelsgesellschaft i Srbija*, p. 172-176

⁹⁵ R. Poldevin, *Les intérêts financiers français et allemands en Serbie de 1895 à 1914*, in: *Revue historique*, Vol. 88 (1964), p. 59-66; Lj. Aleksić-Pejković, *quoted work*

⁹⁶ AN-Paris, F23 154, Memoire; Francusko-srpska banka, *Pravila* dated June 24, (July 07), 1910, Yugoslav Archives in Belgrade, Ministry of commerce and industry – Department for banks and insurance, accompanying act VI. Nr. 1749, Beograd, April 01, 1924.

⁹⁷ R. Poldevin, *Les interest*, p. 62; Lj. Aleksić-Pejković, *quoted work*, p. 288-293; A. Mitrović, *Berliner Handelsgesellschaft i Srbija*, p. 185; *Ibid.*, *Pester Ungarische Commerzialbank na Balkanu*, p. 54-56. The activities of the French capital in Serbia were observed with the utmost interest, distrust and animosity by the representatives of Austro-Hungary and Germany. The appearance of *Banque Franco-Serbe* was estimated as the "emergence of dangerous competitor". (AA-Bohn, Ox. 575, Serbien 7, Bd. 20, Report Nr. 90, Beograd, September 21, 1910), even "the dangerous competitor who must be fought ferociously" (*Ibid.*, Report Nr. 109, Beograd, August 17, 1910). *Banka Andrejević i Ko.* Made known to the governments in Vienna and Budapest and Berlin that the French capital intends to expels the capital of

ers expressed their great interest openly in summer of 1912, when they founded *Société Franco-Serbe d'Entreprises Industriel et de Travaux Publics*, that was joined by *Société générale pour le favoriser le development du Commerce et l'Industrie* and private bank *Banque Louis Dreyfus et Cie*.⁹⁸ The same autumn the Serbian government assigned the tracing of Merdare-Priština railway, Raška-Mitrovica and Raška-Novı Pazar-Priboj-Uvac railway⁹⁹ to this enterprise. On April 05, of the same year, with its support in Paris, *Banque Vernes et Cie* and *Société Financière d'Orient* in cooperation with some other financiers established the agricultural bank *Banque français pour le Commerce et l'Industrie*.¹⁰⁰ Fund management in Belgrade was credited by *Banque français pour le Commerce et l'Industrie*.¹⁰¹

We should also note that in spring 1913, the Ottoman bank with its branch office in Skadar, prevented Austro-Hungarian and Italian capital to establish their dominance over finances of the newly-created Albania.¹⁰² However, the bank leadership appreciated the favourable results in the Osmanli Empire, but in addition to this it highlighted only their results in Serbia. In the "Memoire" made by the Ottoman Bank on the eve of the end of World War I, it underlines especially their successes in Serbia: foundation and very good results of the *Autonomous monopole administration of the Kingdom of Serbia (L'Administration Autonome des Monopoles du Royaume de Serbie)*, as a bearer of financial stability of the country and the basis of provided state loans of 1902, 1906, 1909 and 1913. It says that the issue of these loans was released at the French monetary market, and these were spent on the construction of railway tracks, the purchase of motor pool and weapons, whereas the orders fell mostly to the share of French manufacturers. Founding of *Banque Franco-Serbe* and *French-Serbian society* for

the Reich and Monarchy from Serbia (Ibid., Report from Belgrade May 03/16, 1910), while the Austro-Hungarian consul in Belgrade warned that "new serious losses" were threatening the already "seriously damaged" economic influence of the Monarchy (HHStA-Wien, AR, F. 23, K. 70, Report Nr. 43 res, Beograd, September 22, 1910). According to the German reports from Belgrade, the competent authorities in Berlin could be sure that "the French would not let down their friends" (BA-Koblenz, R 85, copy of the report A. 8758/13 from Belgrade, April 19, 1914), and the authorities in Vienna and Budapest found out from the reports of their representatives that *Banque Franco-Serbe* "gives all possible conditions both to the Serbian state and the individuals" (HHStA-Wien, AR, F. 34, K. 70, report Nr. 62/h.p., Beograd, April 25, 1913). Serbia found itself in the middle of economic and political conflicts of international importance and the protagonists of this conflicts were primarily German and French financial capital (See: R. Poidevin, *Les relations économiques et finacières entre la France et l'Allemagne de 1898 à 1914*, Paris, 1969).

⁹⁸ BA-Koblenz, R85, Report Nr. 212, Beograd, April 19, 1913; NA-Paris, F23 154, Memoire; Lj. Aleksić, Pejkić, *Quoted work*, p. 294-303, 342-343, 364, 751-752, 758, 785, 799-801

⁹⁹ P. Milinković, *Istorija gradjenja železnica i železnicka politika kod nas 1850-1935*, Beograd, 1936, p. 180

¹⁰⁰ HHStA-Wien, AR, F. 34, K. 70, Unnumbered report from Paris, April 29, 1913.

¹⁰¹ Ibid., F. 23, K. 58, Report Nr. 204, Belgrade, October 02, 1913.

¹⁰² Ibid., K. 65, Report 35/P, Skadar, February 02, 1914.

industrial enterprises and public works, which created the credit institutions for the important business activities in Serbia, was considered important.

7. Conclusion

The creation of independent states in the Balkan Peninsula in the course of 19th century was followed by ever increasing and quicker Europeanization of life and society, as well as by modernization that concerning its form and power was in accordance with special conditions prevailing in those countries. It was generally a complex process made up of the efforts to change the economy. Models were not sufficient for that process; it required money, loans and investments by the developed countries of Europe. So the financial capital supported the independent life of new small states in the Balkans influencing the strengthening of their economies, but at the same time endangering them since it entangled them into the dependency on the states with the powerful banking centers.

The most reputable European banks were interested in the Balkans, although the precedence was given to the business deals in other parts of the world, exotic ones and often with large gains. The interest in the Peninsula based on the concept that the Balkan-Near-East region was a unique geopolitical and economic area, which was considered the part of the Osmanli Empire heritage. This referred to the financiers both from Austro-Hungary and Germany and those from France. London bankers were the least interested in the Balkan business operations, and Viennese and Budapest bankers were those interested the most (making extreme efforts to acquire positions in this area which was really the most important for them since it was the neighbourhood reaching to the more and more unstable Near East). Berlin bankers showed the greatest ambitions and had a powerful performance on the eve of World War I, and Parisian bankers were the most successful and achieved this success relatively easy. The important form to provide business deals was to found dependent banks in all major Balkan towns. These banks were not only the centers to carry out regular banking activities such as loans and investments, but were also the potential cores of further development of branch-office network and dependent societies for the operations in various prosperous sectors of the economy. As the outbreak of World War I got nearer and nearer, the French and German bankers that had the official policy of their states behind them became unrelenting rivals in Romania, Bulgaria and Serbia, while the bankers from Austro-Hungary could only try to maintain and somewhat improve their positions.

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MANAGING CURRENT DEVELOPMENT IN ECONOMIES IN CRISIS

Abstract: *The experiences of many Latin American and East Asian countries show that leaning on “market fundamentalism” when fighting economic disturbances can result in dangerous consequences. In Argentina, for instance, in which this new dogma, formulated on the basis of the “Washington consensus”, was carried out in the most consistent manner and it caused the biggest crisis disturbances. In East Asia, the crisis was less destructive and easier to overcome to the extent to which the “Little tigers” managed to resist it choosing the governed market. In both large regions, the bearers of economic policy are aware that today the economy cannot be left at the mercy of a market.*

Key words: *economic crisis, the “Washington consensus”, “market fundamentalism”, Argentina, the ‘Little tigers’.*

1. Introduction

The hardships of our domestic economy force us to seek a lesson from foreign experiences in managing current development. The most instructive, at least at first sight, appear to be the experiences of East Asia and Latin America, primarily Argentina. A common feature of the crises in both regions is the foreign factor that contributed to their emergence. The considerable differences exist regarding the internal causes of crisis and the manners to overcome it. The same therapy resulted variously in these two regions: the crisis in Latin America becomes chronic; countries of East Asia are again on the path of the boom.

2. “Little tigers”

Apart from China, which is the “story of success” without precedence in the economic history of the world, the other countries of this region that achieved “economic miracles” during the last few decades entered a crisis. Japan fell

behind in 1992, and other successful countries – Thailand, Malaysia, South Korea, Indonesia and the Philippines – joined it as of 1997. As the experiences of China and Japan can hardly be used, they have been left out of this analysis.

2.1. Emergence of crisis

In order to explain the origin of economic crisis of East Asian “little tigers”, it is useful to establish first the origin of their economic rise.

The origin of economic rise. Five Asian countries – Thailand, Malaysia, South Korea, Indonesia and the Philippines – were marked as the countries of economic miracles. Their economic policy was recommended as an example to other countries.¹ The World Bank recommended especially the export-oriented economic policy of these countries. This recommendation based on their undoubted successes.

In the period from 1970 to 1995, the average rate of economic growth was near 7% a year, which is over two times higher than in the OECD countries for the same period.² Such a success in the growth of per capita income and diminishing of the unemployment rate achieved by East Asia during the three decades of their rise was not noted in any other region in the world.³

According to Joseph Stiglitz, the main factors of East Asian “economic miracles” are:

- instead of the invisible hand of the market privileged by the “Washington consensus”, the government in these countries took a big part in directing economic flows and in shaping the market itself;
- these countries had the well-considered industrial policy;
- the rate of domestic savings and the profitability of investments were higher than in any other group of countries in the world;
- the state directed large investments into education of its population, including women;
- when shaping development policy, the governments of these countries managed to resist the dictation of the “Washington consensus”; the countries of East Asia accepted only one element from this program – macroeconomic stability; as opposed to this program, these countries emphasized improvement of export in their foreign trade and not removing the obstacles to import; the liberalization of foreign trade was carried

¹ World Bank: *The East Asian Miracle: Economic Growth and the Public Policy*, Oxford University Press, New York, 1993.

² “The Developing Economies”, Institute of Developing Economies, Tokyo, 1999, no. 1, p. 3

³ Džozef Stiglitz: *Protivrečnosti globalizacije*, SBM-x, Beograd, 2002.

out gradually, in accordance with the growth of domestic import activities;

- since they had a high rate of growth of domestic savings, these countries were cautious regarding the liberalization of their financial markets; their governments considered that the ‘hot money’ coming along with the liberalization of the capital market represents a danger for their economies;
- the yields of economic rise were divided more equitably than in other parts of the world; at the same time, economic inequality and unemployment were reduced; the result was social and political stability, as the important factors of the investment climate favourable both for domestic and foreign investors.⁴

Origin of the crisis. As of the middle of 1997, the “Asian tigers” have faced economic difficulties.

According to Stiglitz, there are two patterns of crisis in East Asia: Thai and South-Korean.

The end of the rise of the “Asian tigers” begins with the currency crisis, which started first in Thailand with the depreciation of Baht from 26 to 36 Baht for one US Dollar, between May and November 1997. According to Stiglitz, the cause of this crisis is a combination of speculative demand attack and high short-term indebtedness. Counting on Baht devaluation, speculators bought Dollars. The value of domestic currency was falling. In order to defend the exchange rate of their currency, Thai government sold Dollars. Since it exhausted the foreign exchange reserves, it had to release domestic currency down the river. Its rate of exchange declined steeply.⁵ Thai economy fell into crisis.

South Korea had highly efficient development policy. In the course of three decades, South Korea increased per capita income eight times and decreased poverty significantly; it achieved full literacy, improved significantly the technological level of economy and joined the company of the developed countries. As it had high rate of savings and very profitable investments, it controlled financial market firmly so that the inflow of foreign investments was low. “In the course of the three previous decades, South Korea enjoyed the extraordinary economic growth without the important foreign investments. Their growth was based on their own savings and their own companies were managed by their own people. This country did not need Western funds.”⁶

However, the country had to liberalize its financial market under the pressure of the USA. Korean companies started to incur foreign debts. In the end of 1997, the Wall Street releases a signal that South-Korean economy faces difficul-

⁴ Ibid., p. 101-105

⁵ Stiglic, quoted work, p. 106

⁶ Ibid., p. 113

ties and the Western banks that used to grant loans to South-Korean companies cease any further crediting. South-Korean economy falls into crisis.⁷

The crisis in South Korea started when foreign banks refused to continue financing its economy with short-term loans. High interest rates increased the number of companies in trouble and the number of banks that could not collect their claims. The fall of economic activity made their position even more difficult. "IMF effectuated simultaneous reduction of both aggregate demand and supply."⁸ The depression became unavoidable.

General economic fall followed in East Asia, which then reflected on the whole world economy. Since 1998, the majority of East Asian countries have recorded a considerably lower rate of economic growth than in several previous years. The average drop of exchange rate of domestic currencies in five countries in relation to US Dollar achieved 215%, and share prices fell for 72%. The value of Gross Domestic Product (GDP) also started to decline. As crisis progressed, unemployment also increased and banks started to close. The unemployment rate in South Korea increased four times, in Thailand three times and in Indonesia ten times. As a result, the countries that were economically rising for three decades fell into difficulties.

Empirically it is unquestionable that currency crisis caused the foreign capital, which used to foster Asian economic miracle for three decades, to escape.⁹

Sudden inflow of foreign capital was accelerated by the faith in the economic growth potential of this region and low interest rates in the developed countries. Sudden inflow of capital also led towards appreciation of currencies in East Asian countries. The growth of exchange rate led towards the deterioration of trade balance. Trade balance deficit was covered by the inflow of capital.

Financial systems in East Asian countries were insufficiently capable to respond to the challenges of world financial market. The weaknesses of these systems were disguised by pegging domestic currencies to US dollar. As soon as these weaknesses became obvious, speculators' moves accelerated the depreciation of domestic currencies.

This is how the "East Asian disease" originated, in the same manner as the "Dutch disease".¹⁰

The response of the International Monetary Fund. The IMF responded to the crisis in East Asia according to their established pattern. It provided a huge 105 billion dollars worth "bail-out". Their direct goal was to maintain the domestic currency exchange rates. However, "this money served another purpose: it

⁷ Ibid., p. 106

⁸ Ibid., p. 122

⁹ Neil Dias Karunarante: "The Asian Miracle and Crisis", *Intereconomics*, 1999, no. 1, p. 19

¹⁰ Takao Fukuchi and Sominori Rokunaga: "Simulation Analysis of Exchange Rate Dynamics: The Case of Indonesia", *The Developing Economies*, 1999, no. 1, p. 35-36

enabled the countries to provide Dollars to pay-off the debts based on loans with Western banks. This was, therefore, the bail-out as much for the international banks as it was for those countries.”¹¹ In those countries where the IMF was used to maintain temporarily the domestic currency exchange rate at an untenable level, the rich people used the opportunity to exchange their money for Dollars at favourable rates and to bring it out of the country.¹²

The IMF granted loans under the established conditions: increase of interest rates, decrease of public expenditure, increase of taxes and structural reforms. Some of these conditions have nothing to do with the causes of crisis.¹³

The IMF program failed. The exchange rate of domestic currencies could not stop falling. The IMF blamed the governments of countries in crisis. It only caused panic, which instigated the “flee of capital”. In this manner, the “IMF became more part of the problem in the countries where it engaged than part of the solution.”¹⁴

The IMF and the USA preached that the “full liberalization of capital account help the region to achieve fast growth.” At the end of 1980s and the beginning of 1990s, they imposed the liberalization of capital balance to this region, although the countries of this region had high rate of savings. “I believe,” writes Stiglitz, “that liberalization of capital account was individually the most important factor that caused the crisis.”¹⁵ Why? Because the “capital flows tend to be cyclical”. “The capital flows out of the country in recession at the moment when it is most required, and flows in at the time of economic boom increasing the inflation pressure, ..., when the countries require financing from abroad, the bankers want their money back.”¹⁶

2.2. A drop of theory

When interpreting the economic crisis of East Asian countries, two approaches seem to be characteristic. One is cycle-related and the other is structure-related. The most prominent representative of the former is Stiglitz, and the most prominent representative of the latter is Paul Krugman.

As it has already been said, according to Stiglitz, the crisis of “little tigers” was primarily the disturbance of current development caused by inadequate measures of economic policy of the relevant countries and international financial institutions, increased additionally by some structural discrepancies. It can

¹¹ Stiglic, p. 107

¹² Ibid., p. 107

¹³ Ibid., p. 108

¹⁴ Ibid., p. 108

¹⁵ Ibid., p. 110

¹⁶ Ibid., p. 112

be concluded, therefore, that crisis can be overcome by adequate current development management.

Paul Krugman announced that the “Eastern tigers” would be checked in progress as early as 1994.¹⁷ According to his opinion, the balloon of Asian “economic miracle” deflated due to the same reasons as the Soviet model of development: it leaned too much on “the accumulation factor”, i.e. more on the extensive use of production factors than on technological innovations. Krugman started from Alexander Gerschenkorn’s postulation¹⁸ that after the possibilities for quick economic growth based on the “advantages of backwardness” are exhausted, the law of diminishing returns would start to act, which would consequently reduce the rate of economic growth. In other words, the rate of economic growth had to drop because it was more the result of the extensive use of production factors than of “total factor productivity”.¹⁹

The historical experience in overcoming backwardness in economic development shows that the rates of economic growth are reversely proportional to the income level.²⁰ This is also shown by the experience of Western Europe and Japan. The golden age of economic growth in West Europe is the period from 1953 to 1970 and in East Asia from 1970 to 1990.²¹ The problem of the East Asian economies is bigger today because the incomplete financial systems are obstacle to further capital mobilization.²²

Krugman’s postulation is not new. Richard Barnet estimated in 1980, that all known natural resources of raw materials and energy would be exhausted in twenty years if the whole world spent them as much as the USA.²³ This is how the 1970 postulation of the “Roman Club” concerning “the limit of growth” was summoned.

Therefore, there are not enough natural resources for the development of the whole world in the manner in which the developed countries are progressing. This is why we should not expect the “miracles” of the first stage of overcoming backwardness to repeat.²⁴ It would not be in the interest of the protagonists of world economy globalization any more.

¹⁷ Paul Krugman: “The Myth of Asia’s Miracle”, *Foreign Affairs*, vol. 73, November/December 1994, p. 62-78

¹⁸ Alexander Gerschenkorn: “Economic Backwardness in Historical Perspective”, *A Book of Essays*, Belknap Press, Cambridge, Massachusetts, 1962.

¹⁹ Krugman, loc. cit.

²⁰ Robert Barro: *Determinants of economic Growth: A Cross-Country Empirical Studies*, MIT Press, Cambridge, Massachusetts, 1997.

²¹ Nicholas Crafts: “East Asian Growth Before and After the Crisis”, *IMF Papers*, vol. 46, no. 2, June 1999, p. 139-166

²² Ibidem, p. 139

²³ Richard Barnet: *The Lean Years: Politics in the Age of Scarcity*, “Simon and Shuster”, New York and London, 1980.

²⁴ Krugman, op. cit., p. 155

If these conclusions are true, then it follows that the countries of East Asia began to break the pillars of their economic rise by their fast economic growth.

First, fast industrialization reduced the monopoly in labour demand. There was a gradual rise in wages. This also increased the demand in raw materials and energy. This resulted in the increase of production costs and the decrease of the average profit rate. Loan capital was less and less profitable. The pay-off of foreign debts became more and more difficult.

Second, the development of real sector was faster than the development of financial sector. Financial market was not sufficiently developed. Banking sector did not adjust as fast as required. The loans were granted easily and inertly. On the other hand, banking system was not sufficiently protected. Even where they existed, the systems for deposit protection did not function well, so they did not prevent banks to engage in too risky businesses. Prudential control was not sufficient.

Third, during the Cold War, East Asian countries were important allies of the West against the main political opponents in the East – the USSR and China. The West therefore did everything to strengthen them economically. The USA enabled them free access to their market without reciprocity. The “tigers” highly protected their markets at the same time, and had the free access to the USA market. Under these conditions, the loaned capital yielded profit. “Total factor productivity” became thus considerably higher than it would otherwise be. Instead of their protégées, these countries became the most successful competitors for the USA in the world markets, both in the final products market and the market of raw materials and energy.

The “tigers” are not required as allies any more. In the name of globalization, they must abandon the sovereign decision-making on the degree of openness of their markets. From the analysis of the experiences of East Asian countries it follows mostly that the time of “economic miracles” has passed by and that we should count on economic crises, even on economic wars.²⁵

3. Argentina

The main elements of new strategy by which Latin America tried to respond to its main economic difficulties in 1980s – heavily in debt and slow economic growth – were financial liberalization, opening towards foreign capital and foreign trade, privatization of public utilities and deregulation. This strategy based on the postulation that first, the stabilization of economic conditions should

²⁵ More about this in: Blagoje Babić: „Ekonomaska kriza u svetu – zajednicki elementi u pojedinim regionima i iskustva u prevazilazenju kriza”; in: Ljubivoje Prvulović and Ivica Stojanović (Sub-editors): *Jugoslavija, tranzicija i svetska privreda*, Institut za medjunarodnu politiku i privredu, Beograd, 2001.

be established; then, on such a basis, the competitive, open economy should be built, and the role of the market should be increased over the role of the state.²⁶

Some results were encouraging. The foreign debts of this region were restructured, inflow of foreign capital increased and economic growth restored. Nevertheless, the rate of economic growth was lower than in the post World War II period, and in the second half of 1990s, there were financial crises that annulled a majority of the results achieved by that period.²⁷ “Contrary to the promise that the economic liberalization would lead to fast economic expansion, the growth rates since 1990, were half lower than Latin America achieved in the period of industrialization headed by the state. Powerful recession, which started in 2001, and became more profound in 2002, when gross domestic product of Latin America dropped for 0.5%, completed ... a half of the lost decade”.²⁸

3.1. Argentine leadership

Argentina used to lead the Latin America for ten years both in the economic rise and in economic crisis. This is why its model is especially instructive both for the economic science and for economic policy.

This test started very successfully. The country carried out market-oriented reforms and provided a stable currency.²⁹ During the first four years, the reforms resulted in spectacular economic growth.³⁰ This is why it was pointed out in 1990s as a “successful story”. It was recommended as an example of how the reforms should be carried out. Its economic policy of that time was praised by neo-liberal economists, explaining its growth at that time by its consistency in the application of orthodox standards.³¹

In the second half of the past decade, there were three years of contraction of economic activity of 8%.³² Argentine successful story ended in crash in December 2001. Argentina proclaimed bankruptcy with the foreign debt amounting to 132 billion dollars.³³

²⁶ Guillermo Ortiz: “Un nouveau soufflé pour les reformes”, *Finances et développement*, Septembre 2003, p. 14

²⁷ Ibidem, p. 15

²⁸ Jose Antonion Ocampo: Preface. In: Jan Hoost Teunissen, op. cit. p. xiii

²⁹ Michael Mussa: “Argentina and the Fund: From Triumph to Tragedy”, *Policy Analysis in International Economics*, 67, July 2002, p. 112; <http://www.iie.com/>

³⁰ Edwin Truman: “Fixed exchange rates – The lessons from Argentina”, *Interamerican Bank Daily*, March 12, 2002, p. 18

³¹ Dani Rodrik: “Argentina: A Case of Globalisation Gone Too Far or Not Far Enough?”, in: Jan Joost Theunissen and Age Akkerman: *The Crisis That Was Not Prevented*, FONDAD, The Hague, 2003, p. 16

³² Truman, op. cit., p. 18

³³ Rodrik, op. cit., p. 15

3.2. Doctrine-based economic policy of Argentina

Key issues about which the economists quarrel are why Argentine “big leap forward” ended so ingloriously. What did actually bankrupt in Argentina: economic philosophy or economic policy?

Jose Antonio Ocampo starts from the postulation that doctrine basis for economic policy of Argentina and other countries of Latin America was wrong. “Argentina was not the only country in Latin America that was affected by the mixed results or program of reforms known as the “Washington consensus”.³⁴

John Williamson disapproves of the widespread belief that this notion means “a set of measures of neo-liberal economic policy that were imposed to helpless countries by the international financial organizations with their headquarters in Washington and that shoved them into crisis and poverty,”³⁵

In 1989, this British economist prepared reading-material for the symposium in the Institute of International Economics in Washington in which he listed all the reforms that “all or almost all in Washington considered necessary for the Latin America at that time.”³⁶ This is how a ten-item program of reforms was made up, known as the “Washington consensus”.³⁷ This program, which was originally made for the countries of Latin America, soon became the pattern for the whole less developed part of the world.

It is undisputed that the countries of Latin America took the “Washington consensus” as their guidance at the beginning of 1990s. The benefits of such a choice were: lower budget deficit, lower inflation rate and lower coefficient of debts as well as reviving of economic growth. The reverse of the medal appeared to be much less shiny: in the majority of Latin American countries there was a rise of unemployment, poverty took root, and opening of domestic markets resulted in exposing of domestic economies to the consequences of globalization with which they could not cope; primarily, it was the inflow of short-term private capital ready to retreat as quickly as it came.³⁸

Financial crises that shook the world in 1990s flagged the enthusiasm concerning deregulation and liberalization among the economists. Leaving the domestic economies at the mercy of the market started to be evaluated as dangerous and the creation of institutions and national policies that would be capable to protect domestic economies from the consequences of fluctuation

³⁴ Ocampo, op. cit. p. xiii

³⁵ John Williamson: *Did the Washinton Consensus Fail?*, Institute of International Economics, Washington, November 6, 2002; <http://www.iie.com/>

³⁶ John Williamson: “Consense de Washinton: un bref hitorique et quelques suggestions”, *Finances of development*, International Monetary Fund, Septembre 2003, p. 10

³⁷ Williamson: *Consensus de Washinton*, op. cit., 10 – Williamson: “Did the Washinton Consensus Fail?”, op. cit., p. 1

³⁸ Jeremy Cliff: “Au delA du Consensus de Washington”, *Finances et Developpment*, Septembre 2003, p. 9

of speculative foreign capital was recommended.³⁹ Even Jeffrey Sachs, who put back the economies of many countries by his neo-liberal advices recommending them deregulation and liberalization exactly, assessed the “Washington consensus” as nonsense.⁴⁰

Why did the “Washington consensus” become so disputable?

Two interpretations of the “Washington consensus” took a more definite shape over time.

According to the first one, it has been made equal to neo-liberalism, especially with its extremely right version put into words by Mont Pelerin Society after World War II at the initiative of Friedrich von Hayek. According to the second interpretation, the “Washington consensus” is a joint policy of institutions located in Washington, which provide advices to the developing countries: the International Monetary Fund and the World Bank, Interamerican Bank for Development, the USA Department of Treasury and, perhaps, the USA Federal Reserves Board.

Williamson acknowledges that in his “Washington consensus” he was wrong in his estimate of what Washington really represented. While he suggested competitive exchange rate, Washington gave precedence to either fixed exchange rate or free-floating exchange rate. Second, Washington whole-heartedly supported the policy of capital account convertibility in 1990s, while he was against it. The other gap in the “Washington consensus” admitted by Williamson is that it does not include the use of macro-economic policy for the stabilization of economic conditions and correction of the “terrible inequality in income”.

Williamson underlines especially that his program of the “Washington consensus” does not include: monetarism, low income taxing (which is inseparable from the theory of supply side economics), minimum of state and free capital flow. Interpreting the “Washington consensus” as market fundamentalism, he complains, it was easier to the opponents of the reforms to dispute this program. Their resentment resulted largely from the fact that Washington imposed the reforms that were not in the national interest of the countries of Latin America.⁴¹

Impartial analysis of the original “Washington consensus” strengthens Williamson’s self-defense. The British economist, however, admitted unwillingly that “Washington consensus” synthesized a new philosophy of international economic relations that has not made a less developed part of the world happier.

The developed countries gathered in the OECD stuck in a persistent and orthodox manner to three attitudes: (a) macroeconomic discipline, (b) market economy, (c) openness to the world. At the same time, after World War II they

³⁹ Ibidem

⁴⁰ Jeffrey Sachs in the article published in the *Economist*, September 1998. According to: Clift, op. cit., p. 9

⁴¹ Williamson: *Consensus de Washington...*, op. cit., p. 11-12

admitted for a long time that less developed countries were not capable to keep up with these orthodox postulations of economic policy theory, so they were acknowledged the right of: (a) a certain degree of inflation so that they could use inflation tax and stimulate investments; (b) leading role of the state in the establishment of industrialization; and, (c) import substitution.

Therefore, the “Washington consensus” marked the end of apartheid in the world economy.⁴² All economies, both of the developed and the less developed countries, are equally subjected by the invisible hand of the market.

According to Stiglitz, Argentina as “the best student of the IMF”⁴³ implemented the “Washington consensus” most consistently. According to Dani Rodrik, it went even further than any other country of Latin America in liberalization of foreign trade, fiscal reform, financial reform and privatization. Not any other country has spared more effort in order to open towards world financial markets. The application of neo-liberal orthodoxy culminated with the introduction of currency board.⁴⁴

3.3. Economic policy

Fiscal policy. Michael Mussa speaks in favour of the thesis that Argentine authorities at all levels persistently led irresponsible fiscal policy, even when Argentine economy managed well.⁴⁵ Edwin Truman also thinks that Argentine “fiscal policy was extravagant.”⁴⁶ Ricardo Hausmann and Andrés Velasco point out, contrary to this, that falling of the country in recession was not caused by the state extravagancy. “There is not a single proof of a spending boom: a portion of primary government expenditure in gross domestic product was basically unchanged in the period from 1993 to 2001.” These two authors point out that “the largest part of fiscal problem was a consequence and not the cause of trouble. The source of trouble was recession. It decreased the inflow of the assets into the budget and lowered the capability of the state to service foreign debts. This is why the government decision dated July 15, 2001 to turn to the zero-deficit policy was wrong, since it assumed momentary lowering of the wages in public sector and pensions for about 13%. This, among other things, increased country investment risk.”⁴⁷

⁴² Williamson: *Did the Washington Consensus Fail?*, op. cit., p. 2

⁴³ Joseph Stiglitz: “Argentina, Shorthand – Why the Nation that Followed the Rules Fell to Pieces”, *The Washington Post*, Sunday, May 12, 2002.

⁴⁴ Rodrik, op. cit., p. 16

⁴⁵ Myssa, op. cit.

⁴⁶ Truman, op. cit.

⁴⁷ Ricardo Hausmann and Andrés Velasco: *Hard Money's Soft Underbelly: Understanding the Argentine Crisis*, mimeo, Harvard University, July 2002, in: Jan Joost Teunissen, op. cit. p. 8-9

To make the trouble worse, as Rodrik says, Argentina adopted the austerity policy at the time when every fifth worker was already unemployed. Business people doubted that the Argentine parliament, provinces and ordinary people would agree to Hoover-like policy, which was already discredited in the developed countries. This had to be accepted soon by the Argentine government, which was forced to resign by the rebellion of the population.⁴⁸

Monetary policy. The economists agree that monetary policy is either the main or one of the main causes of economic crisis. In 1991, Argentina, struggling with inflation, chose two measures as the main instruments to achieve stability of prices: fixed exchange rate system and currency board.

Rigid system of exchange rate was introduced by the law, which guaranteed convertibility of a Peso into a Dollar at one to one ratio. Stabilization that bases on the exchange rate in order to stop inflation quickly and on linking inflation to the fixed exchange rate often ends in economic and financial crash. It is not just that the exchange rate was fixed in Argentina. The system became so rigid because the law prescribed convertibility and monetary policy based on the currency board while there was no exit strategy. Such a rigidity of exchange rate and monetary policy left the country without the appropriate protection from foreign economic and financial impacts: steadily strong Dollar, for which Peso was linked after 1995; outbreak of financial crises in Mexico, Asia, Russia and Brazil and fall of world current development in 2001.

Briefly, rigid exchange rate and monetary system did not allow Argentina to respond to unfavourable foreign influences.

Monetary policy based on the currency board has never actually passed an exam. The supply of money did not rise and fall (and interest rates did not fall and rise) in accordance with the rise and fall of official monetary reserves. Factor and commodity markets were not flexible enough in order to achieve realistic depreciation of Peso and not to sacrifice rise. Current account deficit rise pointed to the widening of the gap between the savings and investments and to the overprotected and uncompetitive economy.⁴⁹

According to Mussa, firm linking of domestic currency to Dollar at one to one par of exchange, played the central role in both the starting success and the ultimate crash of Argentine efforts concerning stabilization and reforms.⁵⁰

Guillermo Perry and Luis Servón⁵¹ also attributed pagging of Peso to US Dollar as a key factor to Argentine crisis. Argentina practically waived the key

⁴⁸ Rodrik, op. cit., p. 18-19

⁴⁹ Truman, op. cit. p.18

⁵⁰ Mussa, op. cit.

⁵¹ Guillermon Perry and Luis Servón: *The Anatomy of a Multiple Crisis: Why Was Argentina Special and What We Can Learn From It*, mimeo, World Bank, May, 2002, in: Jan Joost Teunissen, op. cit. p. 6-7

levers for managing current development – foreign exchange and monetary policy. As the exchange rate of Dollar went up, Peso exchange rate went up as well. In addition to this, only 20% of Argentine exports went to the USA. The main trading partner of Argentina was neighbouring Brazil. In 1999, there was a devaluation of the domestic currency in Brazil. In this way, the overrating of Argentine Peso reached 55% in 2001, which caused the competitiveness of Argentine exports in world market to collapse. This also decreased the capability of Argentine economy to expand supply, i.e. production for exports and opening of new jobs.

Hausman and Velasco underline the joint effect of three factors: overrated domestic currency, fall of country's credit rating and decrease of exports and imports. Argentina became increasingly risky mostly because Peso was linked to Dollar, which decreased the country's capability for growth and export. The decrease of export income decreased the capability to pay off foreign debts, and thus the possibility to be granted new loans. The lack of external resources resulted in the decreased investments and production, which on the other hand negatively affected the demand for domestic production.

As the nominal rate of exchange was fixed, real rate of exchange could adjust only by lowering wages and prices. Moreover, the deflation leads to recession and rise of unemployment. The contraction of economy made the burden of foreign debt pay-off unbearable.⁵²

Briefly, the fixed rate of exchange and currency board together made the government incapable of managing the current development. The results were economic contraction, deflation and increase of public debts.⁵³ The failure of the government to provide economic growth in the second half of 1990s undermined political support to the policy required to maintain the system of the fixed rate of exchange so this resulted in devaluation and bankruptcy.

3.4. *The role of the International Monetary Fund*

The economists agree that IMF is partially responsible for the economic crisis in Argentina. According to some of them, the Fund simply pursued the wrong policy regarding Argentina. According to others, it was wrong for not being persistent in pursuing its policy.

The fact is that the Fund strongly supported the policy of stabilization and reforms in Argentina for ten years. It supported Argentine economic programs with counseling and money in the course of ten years during which foreign exchange regulations according to which Peso was pegged to Dollar were effective. At the 1998 Annual Assembly of the Fund, its Executive Director made public that the Argentine economic policy is "the best in the world".⁵⁴ At the

⁵² Hausmann and Velasco, loc. Cit.

⁵³ Truman, loc cit.

⁵⁴ Jose Antonio Ocampo: *The Mistaken Assumptions of the IMF*, in: Teunissen, op. cit., p. 26

end of 2001, when the Argentine economy fell into crisis, the Fund pulled a rug from under it.⁵⁵

Where did the Fund make a mistake? There are two opposing interpretations.

According to Mussa, the Fund, which supported “the convertibility plan” as a basic choice of Argentina while it was effective, made a mistake in summer 2001, when it offered solid support to untenable policy, instead of insisting on the new policy that would alleviate the consequences of the inevitable crisis. The main mistake of the IMF was that it did not force Argentina persistently to pursue responsible fiscal policy.⁵⁶

According to Stiglitz, the IMF offered wrong advices to Argentina and made the same mistakes as in the cases of Russia and East Asia. Its policy became especially destructive when it ultimately refused to grant funds to Argentina.

3.5. *The balance*

The economists who analyzed the Argentine crisis underline the following arguments:

First, the domestic bearers of economic policy and their main foreign advisors neglected the third interested party. As Rodrick highlights, the faith of Argentina in the eyes of the world financial market was not sealed by what the Argentine government had done, but by what the Argentine people were not ready to accept.

Second, Argentine was respected because of the policy it pursued, but neither the Argentine government nor the international financial institution/international financial markets paid any attention to the risks involved by such a policy.

Third, financial crises and instability of financial markets delivered a hard blow to social security and chances for the economic growth of the region.

Fourth, privatization was often just “turning state monopolies into private monopolies.”⁵⁷

Fifth, Argentine was not the only Latin American country in which the “Washington consensus” gave results opposite to the signs, but the failure of this concept was the most obvious in it.⁵⁸

⁵⁵ Mussa, loc. cit.

⁵⁶ Mussa, lo. cit.

⁵⁷ Ortiz, p. 15

⁵⁸ More about the Argentine crisis: Blagoje Babić: “Pouke argentinske krize”, *Ekonomski anali*, Nr. 12, December 2003, p. 225-236

4. The “Tigers” and Argentina: similarities and differences

Asian currency crisis is similar to currency crises of Latin America. The similarity is in the bubble in asset prices, dependence on the foreign capital and huge flee of capital after the “bubble of asset prices” burst and domestic currencies exchange rate dropped rapidly.

However, there are important differences between East Asia and Latin America. First, the population behaves differently both concerning consumption and savings; second, fiscal discipline in the East Asia is stricter than in Latin America.⁵⁹

The crises in Latin America were brought about by extravagant government consumption and loose monetary policy, which resulted in huge deficits and high inflation. East Asia was far more different than Latin America. East Asian governments had surpluses in the budget, the inflation was low, but the corporations were heavily indebted.⁶⁰

These differences implied the differences in economic policy as well. First, in the high-inflation surroundings of Latin America it was necessary to reduce the excessive demand. Taking into account the expected recession in East Asia, the problem was not the excessive demand but the insufficient demand. The suppression of demand could have made the things even worse. Imposing high interest rates upon already high level of indebtedness, even for a short period, is like signing a death sentence to many companies – even the economy as a whole.⁶¹

Eastern scale of values is favourable for the operation of companies. Its main elements are economizing, work and willingness to sacrifice for the community. In Latin America, the scale of values is of European origin. It is essentially hedonistic. Selfishness or personal interest is its essential element. This is why the concurrence of economic stimulus and economic coercion is important for the development of operations of companies, as in Europe.

A great advantage of Eastern societies is that they have unique cultural heritage. This uniqueness protects their autonomy. These societies are much more resistant to the demonstration effect coming from the Western countries to other parts of the world. In Latin America, which belongs to European cultural heritage, the demonstration effect transfers directly and often causes devastation in the economies of these countries.

Thanks to the unique cultural heritage, the economies of East Asian countries are not in “the system of communicating vessels” with the West, as is the case with the economies of Latin American countries. In economy, “the system

⁵⁹ Shuntaro Shishido and Tomozoshi Nakajima: “Asian Currency Crisis and the Role of Japan“, *The Developing Economies*, 1999, no. 1, p. 3-5

⁶⁰ Stiglitz, quoted work, p. 116

⁶¹ Stiglitz, quoted work, p. 116

of communicating vessels” always acts in favour of a more powerful economy - “Il mare attire tutte le aque” (The sea attracts all waters.)

These are the reasons why East Asian countries managed to achieve economic growth using any socio-economic model and any model of economic policy. We therefore conclude that the stated differences provide evidence in favour of superiority of East Asia and as far as the chances for the faster recovery of economic activities are concerned, for faster economic development as well.

5. Conclusion

Many experiences of East Asian and Latin American countries in their fight with economic disturbances can be useful for economic policy measures in Serbia and Montenegro. The following could be the most useful:

5.1. Economic philosophy

Rebellion against the dogma. If anything should be remembered from the experiences of these two regions, we should remember the fact that they confirm in a harsh way that economy could not stand any dogmatism regardless of the prefix. “Market fundamentalism”, the latest dogma that has been devastating world economy since 1980s, resulted in dangerous consequences in both East Asia and Latin America. In Argentina, where it was implemented the most consistently, it made the greatest devastation. In East Asia, the crisis was less devastating and easier to overcome to the extent to which these countries managed to resist it by choosing the governed market. In both regions, the bearers of economic policy became aware that the economy could not be left at the mercy of the market. For the successful management of its development and current trends, “the correctors” of market failures are required.

It seems that the proponents of market fundamentalism read Adam Smith in a wrong way. He recommended the invisible hand of the market to all countries but his own. As a great patriot, he warned the government of his country that it must have the strongest fleet in the world in order to be able to defend the freedom of world trade, in which the Great Britain held monopoly.

The factor of state is revealed again, both in defining the strategy of economic development and in defining economic policy, i.e. directing current development. Educated, highly skilled state administration is, certainly an important factor of economic development.

The experience has confirmed many times: as the state, so the economy.

Therefore, it is not disputable whether the state should take part in management of the economy in case of Serbia and Montenegro; the question is to what extent it is ready and capable of it.

Destiny of domestic economy in domestic hands. The experience with import solutions for domestic economic troubles is unfavourable. As a rule, the countries that have leaned on foreign advices the most fared ill. Malaysia and China did not accept the programs of the IMF and resisted recession the most successfully. South Korea recovered quicker than other Asian countries in crisis because it ignored the advices of IMF. Instead of closing its largest banks, it restored them financially. Thailand, which acted according to the IMF instructions, came out of the crisis more slowly.

Liberalization. This measure can be favourable for the development of domestic economy under the condition that it is implemented in accordance with its requirements and possibilities. Liberalization of foreign trade must not be understood only as removing obstacles to import. The first concern should be to provide export market. This is why import liberalization should be coordinated with the growth of export capability of the country. Impoverished country, as Serbia and Montenegro must take special care that the import of foreign products means export of jobs. At the same time, disproportional liberalization of financial markets makes domestic economy too vulnerable for the impacts from outside and delays necessarily its coming out of the crisis.

Social dimension. In order for a development policy to be successful, it is necessary to acquire social approval. Social stability is the most important element of investing climate in any country. Social inequalities such as those in Latin America are easy to become street violence. Decades of social stability in the East are mostly the result of more equal distribution of national income. The state can count on self-sacrifice of all citizens if they all participate in the yields of progress.

5.2. Managing current development

The first task of macroeconomic policy is to protect domestic economy from disturbances and outside impacts. Stabilization policy and foreign exchange policy are therefore especially important to that effect.

How to manage recovery of current development depends on the causes of the disturbances. The state should save in the period of growth so that it could build up the reserves and decrease indebtedness. This would also create an opportunity for the expansive economic policy once the current development begins to subside.⁶²

⁶² Pedro-Pablo Kuczinsky and John Williamson: *After the Washington Consensus: Restarting Growth and Reform in Latin America*, Institute of International Economics, Washington, 2003.

When current development crashes, standard response is the Keynesian recipe: expansive fiscal and monetary policy.⁶³ The state must stimulate economy, either by monetary policy (lowering rates of obligatory bank reserves, lowering of discount rate by the central bank) or by fiscal policy (lowering of taxes, increase of consumption). “In the last 60 years never have renowned economists believed that the economy heading towards recession should have balanced budget.”⁶⁴

It should, however, be taken into account that the Keynesian recipe is limited to great extent. It implies the existence of a large number of unemployed factors of production that should be employed by the creation of financially sound demand. The trouble is that this assumption has been worn out. It has been worn out by the fast development of world economy after World War II, which was guided by the very Keynesian recipe. Industrialization spread over the whole world. Raw materials and energy are becoming scarce. There are not conditions for the development of the whole world in the Western manner. Neo-liberal restoration, in fact, aims at reserving the conditions for the development of the rich countries by stopping the growth of the rest of the world.

The solution is not to choose between the fixed or floating rate of exchange, but to choose “the competitive rate of exchange.”⁶⁵ The aim is to limit accumulation of debts when the capital flows in, and if needed, it is justifiable to limit the inflow of the capital, as the experience of Chile showed.

If Argentina had pegged its currency to a currency basket instead of Dollar in 1996, it could have avoided nominal appreciation of Peso of over 30% in the forthcoming years. It would not have to make use of deflation as a measure of adjustment, which decreased the realistic Peso appreciation only to a half. The result would be a higher rate of economic growth, lower current account deficit and more favourable condition of public finances.

It must be taken into account that stabilization based on the exchange rate is not the only way to suppress inflation. Maintaining desirable economic growth and stability of prices together with constant exchange rate is really hard to achieve. It succeeds in the countries of East Asia thanks to their unique scale of values – high tendency towards saving, work cult and preparedness to sacrifice for the community. It is well known that Germany achieved economic miracle after World War II just because it used strategy based on the belief that the fruits of economic restoration should be divided among all those who had devoted themselves to its realization.

⁶³ Stiglitz, quoted work, p. 132

⁶⁴ Ibid., p. 116-117

⁶⁵ Pedro-Pablo Kuczynski and John Williamson: *After the Washington Consensus: Restarting Growth and Reform in Latin America*, Institute of International Economics, Washington, 2003.

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THE INTERNATIONALISATION OF SMALL & MEDIUM SIZE ENTERPRISES AND EXTERNAL SUPPORT: A FRENCH REGIONAL EXAMPLE

Abstract: *This paper considers why small and medium size enterprises (SMEs) may need significant assistance to undertake international development, since they display different characteristics and behaviour when compared to larger firms. One model of public agency support for such activity is examined. The starting point in offering financial support to SMEs is the fact that these firms build their own, specific business organization which cannot be compared to the business organization of large export companies.*

Key words: *SMEs, public funding, economic development agency, internationalisation, external support, regional development, organizational behaviour.*

1. Introduction

This paper revisits a research project completed by the author in the mid-1990s and examines the development since 1987 of an original and pragmatic French response to the difficulties encountered by small and medium size companies in their international development.

Table 1. SME: 2003 definition

Enterprise category	Headcount	Turnover	or	Balance sheet total
medium-sized	< 250	≤€ 50 milion		≤€ 43 milion
small	< 50	≤€ 10 milion		≤€ 10 milion
micro	< 10	≤€ 2 milion		≤€ 2 milion

Source : www.cnropa.eii.int 2003

2. The 1990s SME research project in the Rhone-Alpes

This project was carried out in France, in order to gain a better understanding of how French SMEs organise themselves to manage their international activities, and what kind of international business skills they possess. A sample of SMEs in a variety of sectors was investigated through telephoning and mailing questionnaires. Prior to this, a literature search gave the following indications.

2.1. Literature Search : Management Styles of the 1990s SMEs in France

In the 1990s there was some scepticism regarding the supposed decline of the patriarchal, idiosyncratic SME. Although such data is difficult to obtain, a series of case studies into six Rhone – Alpes PMI (*Petite et Moyenne Industrie*) pointed to a variety of approaches to the problem of export management, not all to the highest standards of professionalism.¹ Chief executives in the French SMEs researched had a 'predominant' influence on all aspects of company life. A Lyon Chamber of Commerce survey of 100 SMEs concluded that often export management is a *chasse gardée*, or a 'protected hunting' area for the boss. It is reserved territory, irrespective of whether or not the individual concerned is an experienced or trained hunter! What is more, export management training courses were primarily for chief executives. Any assistants in their companies would be sent on such courses to enable them to lend support to their bosses, not to replace them.²

2.2. Company organisation

Chevanne's six case studies pointed to the "overwhelming influence" of owner-managers in decision-making and to a distinct lack of specialist knowledge

¹ D. Chevanne: *Pratiques de formation et l'international dans les PMI*, Thèse DEA Lyon 3, 1, 1989.

² *Le PME et l'exportation*, CCI, Lyon, 1988.

³ D. Chevanne: *Op. cit.*

of international trade techniques and procedures within the firms researched.³ Indeed, a further Ministry of Industry study published in 1987 pointed to the severe organizational difficulties encountered by firms of below 100 employees in their export management.⁴ These firms typically lack the resources needed to create and structure an identifiable export department, preferring instead to add such activity to the duties of employees whose primary functions (and therefore competencies) are different.

A later study on the same subject examined whether SMEs' internationalisation leads to significant changes in internal organization.⁵ Like Chevanne, Louet looked in depth a small number of cases, this time all from the same sector of activity: furniture-making. Again the conclusions suggest that careful planning, proper resourcing and the relevant training do not form part of SMEs' action for internationalisation. The style identified here is reactive, not anticipatory. There are few new posts and little training. The main priority in the four firms appeared to be to minimise costs. The impression is one of unplanned, erratic development, often involving initial crisis and failure before success at the second or third attempt, with some changes in internal organization. These observations obviously fit badly with the 'multinational in miniature' view of increasing SMEs' professionalism.

2.3. SME organisational models

A literature search revealed two opposing descriptions of the organizational characteristics to be found in SMEs. The aim of this research project was to take these two models and test their accuracy in relation to existing SMEs. The two models were :

Type A – “Progressive”: the multinational in miniature, where delegation is practised, and specialist departments are created, staffed by qualified professionals.

Type B – “Traditional”: the family fiefdom, where delegation, specialist departments and qualified professionals are rare.

The aim of the qualitative research project was to obtain further empirical signs in support of the 'progressive' and 'traditional' models. The following table summarises the main characteristics :

⁴ *Ministere de l'industrie: enquete statistique 85*, Paris, 1987.

⁵ M. Louet: *L'Internationalisation des PME*, Thèse DEA Ly on 3, 10, 1993.

Table 2: SME behavioural models

<p>Type A “Progressive” Delegation practiced Specialist departments Qualified professionals</p>	<p>Type B “Traditional” Owner-manager + family predominant Absence of specialist departments Absence of qualified professionals</p>
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2.4. Empirical cases of the two opposing models

Type A : The Case of *Biophysic Medical*, the perfect progressive

In this company the ‘ideal type’ of progressive SME appeared to have found its incarnation. Although a small firm, it employed 3 export managers who have responsibility for different markets, visit those markets regularly and have delegated authority to make decisions on behalf of the firm. The nature of its product, sophisticated electronic hospital equipment, implies a high level both of initial education and skills amongst marketing and support staff. The case of *Biophysic Medical* reported by Molina illustrates what can be done even in small companies.⁶ This SME of 60 employees exports sophisticated ophthalmic laser equipment to 55 countries, and derives 72% of turnover from foreign markets. In this it has little choice, since domestic demand cannot possibly absorb an annual production of 400 units. Export success is a condition of survival, which creates a deterministic pressure, but does not fully explain how the firm has been able to develop its international activities so effectively.

Human resources and organization are also part of the explanation. Despite its relatively small size, the firm had 3 specialist export managers, each responsible for a particular zone. Their major function was to devote time and effort in the field, in direct contact with their respective markets and their local agents. Reference is also made to an organizational factor which contributes to their success when faced with competition.

“The company directors, who put their trust in (the export managers), give them a degree of autonomy in their decisions, on which their competitiveness and negotiating success depend.”⁷

Delegated responsibility is obviously a key factor in this firm’s success in export markets. So on all three counts – delegation, specialisation and qualified professionals – this firm, despite its size, is a perfect example of a ‘progressive’ with regard to its export management.

⁶ N. Molina: “Biophysic médical”, *Revue française de gestion*, jan-fev, 1985.

⁷ *Op. cit.*

Type B. Traditional style and behaviour

Examples include cases from Chevanne's work and the Lyon Chamber of Commerce. Chevanne's findings suggested a continuing lack of professionalism in SMC international activities, with the owner-manager exercising close control despite lacking the necessary skills, or failing to provide the necessary training for those with responsibility. Generally these are good examples of the owner-manager's refusal to delegate international responsibilities and a failure to recognise or accept the need for specialist skills, which enforces a status quo in terms of low skills and an absence of training.

2.5. *The 1990 research results*

My research came up with a wide diversity of responses to problems of organization and requisite skills in French exporting firms, which cannot be fully understood in terms of the 'progressive' and 'traditional' models. In any case, a 'black or white' approach of two alternative models is too simplistic, since no correlations between variables have been found. This means that many firms fall in between the two models, 'progressive' in certain respects and 'traditional' in others. This research has also endorsed the idea of SMEs as a distinct form of organisation, not scaled down versions of large firms. Now we shall consider how SME organisations develop, and what factors influence those working in them.

3. Are SMEs shaped more by voluntarism or determinism?

From a theoretical standpoint, opposing explanations have been advanced to help understanding of international development: internal 'voluntarist push' is opposed to the external 'deterministic pull' of the environment surrounding the firm. Is the SME shaped by internal forces, the cognition and will of its owner-manager, or is it moulded by external pressures, inevitably adapting to its environment? Just as in the natural sciences, where geneticists and behaviourists opposed each other, it is likely, ultimately, that the two schools both have an important contribution to make. However, Jenkins compares the two and comes to the following conclusion regarding current research:

"The voluntarist orientation (...) appears to hold more promise. A continuing theme in the literature on international growth is the limiting effect of managerial abilities on the development of the business..."⁸

⁸ M. Jenkins: "Thinking about Growth: a Cognitive-Mapping Approach to Understand Small Business Development", *Small Business and Enterprise Development*, vol 1, part 1, 1994.

Through the research presented in Through the research of literature referred to herein, Jenkin's view is shared and a case is made for the voluntarist school as the more helpful in explaining the nature of SME internationalization. Indeed, the owner-manager's management style is felt to be a crucial element in explaining this diversity. In comparison to larger firms, where the managing director and the principal shareholders may be figures seen as remote from the main body of employees, and where policy decisions flow from the board of directors and shareholder reaction, in SMEs the owner-manager is omnipresent. In many cases the same may be true of the owner-manager's family. What is the nature of the relationship between the owner-manager and his firm?

3.1. What drives owner-managers?

In a major study by Bauer at the CNRS (network of French National Scientific Research Centres), the conflicting interests driving owner-managers are explored.⁹ It is suggested that issues of the owner's power and the family's influence are far more often at play in SMEs than in larger companies. Owner-managers are torn between the interests of the firm and its employees, their own personal role and influence, and the desire to do the best they can for family members. Much of their behaviour can only be understood in socio-political rather than economic terms. Overriding political motives can produce apparently irrational decisions. A successful firm may be sold to its most aggressive competitor because no family member is found to take over the leadership. For the same reason, owner-managers may tend to cling indefinitely to the reins of power, despite their declining effectiveness, reluctant to let go of their personal empire. They preside over the gradual decline of their firm, just as they once ensured its growth. In many cases where SMEs are sold to outside buyers, it is as a last resort because no-one within the family is available to take over. When French companies are sold, in 53% of cases death, illness or old age are given as the reasons for the decision to sell, rather than retirement and the advent of a chosen successor.¹⁰ In such ill-planned circumstances, it is hard to see how the perpetuity of the firm with existing employees can be guaranteed, and the firm may subsequently disappear regardless of their dependency on it. Such actions can be understood once we accept the strength of the owner-manager's conviction that the firm cannot survive without his leadership.

Overriding social influences are of equal significance. In 90% of French SMEs, shares remain in the hands of the owner-manager's family. Often there is a clear stipulation in the company statutes that shares can only be sold to other members of the family. A similar domination exists at board level: according to CEPME (French national SME Employers' Confederation) survey in 1987, as

⁹ M. Bauer: *Les patrons de PME, Interéditiions*, Paris, 1993.

¹⁰ *Op. cit.*

many as 44% of SME company directors are related to their shareholders.¹¹ In view of the extent to which blood-ties are important criteria for appointment, it is not surprising that the range of skills and organization varies enormously in SMEs.

In a context where the family is the dominant caste, irrespective of the qualifications and suitability for a given function in the firm, it is appropriate to ask oneself what value is ascribed to qualifications and skills. The recruitment of highly-qualified outsiders is seen as a threat both to the legitimacy of the owner-manager and to the professional security of family members. Such attitudes form major obstacles to raising levels of competence in SMEs. One French case reported the fate of a top business school graduate who was recruited to a position of marketing manager with responsibility for selecting a new range of luxury fashion items. After a six-month project working on a new range, the owner-manager's grandmother took a hand, informing the outsider that he had no business to meddle in such matters, being there simply to take instructions from members of the family.¹² In such conditions, gifted and ambitious young staff will not remain long. Again, socio-political factors explain behaviour which seems bizarre in terms of rational management practice. Research which focuses narrowly on the individual's professional activities, as some kind of sphere which can be separated from the rest of his interaction, is necessarily blinkered. Such compartmentalisation of human behaviour leads to incomplete pictures, as Watson points out:

“...managers setting up the systems and procedures that compose a work organisation need to be aware that, whatever they construct, their plans can go wrong because human beings who „people” those arrangements bring their personal or sectional interests, self-defence strategies and priorities to bear on them...”¹³

Of course, such problems do occur in larger firms, and the influence of the Ford dynasty is but one example. But are they not even more likely in a small organizations under the total and direct control of one individual and his or her family? Bauer's work presents a highly plausible means of understanding the failure of many owner-managers to delegate power and to introduce recruits with international skills.

¹¹ CEPME: *Enquete pme*, Paris, 1987.

¹² F. Aizicovivi: „Recherche homme souple peu ambitieux et diplomate”, *Le Monde*, 16. 6. 1990.

¹³ T. Watson: *In Search for Management*, Routledge, London, 1994.

3.2. *Internationalisation and the owner-manager*

SMEs often invoke the problem of cost as a reason for not taking on new blood. However, according to Bauer's research, this often hides a desire to avoid delegation as illustrated above, and in the six cases referred to. International duties are a particularly delicate area, in that they carry prestige, give rise to opportunities of travel, and cannot be scrutinised easily by other members of the firm if they involve the use of foreign languages and activities 'off-site'. These features can mitigate against the appointment of those with the necessary skills.

Yet examples of a very different nature can also be identified, contrasting totally with the images of conflict and low skill levels created by Bauer and Chevanne. The case of *Biophysic Medical* illustrates what can be done even in small companies, though it is tempting to seize on the particular sector – high value-added scientific instrumentation – as a further explanation for export success.

3.3. *Propensity to export: exporting and the non-exporter*

Research undertaken into the propensity of firms to export also suggests that a voluntarist interpretation of motives could be relevant, rather than other factors of market knowledge or risk. Firms, particularly small ones, may point to the costs and risks involved in exporting to explain their reluctance to participate, whereas the political factors described by Bauer are the underlying reasons. There may be concentration on the domestic market apparently through fear of the unknown, which makes preparation for export difficult and dependent on the reliable support of other people. Wiedersheim-Paul, Olson and Welch refer to the importance of an international 'outlook' or 'orientation' as a prerequisite for export activity.¹⁴ Their work presents firms who point to prior experience and knowledge of foreign cultures as a deciding factor in making the decision to begin exporting or to refrain from it. Such reasons may mask a fundamental aversion to organizational change. From a voluntarist point of view, a reluctance to open the firm up to external sources of expertise could also be an explanation.

There are also cases where risk of expensive failure is felt to be a genuine reason for refusal to export. Vozikis and Mescon point to the conclusion of a U.S. federal committee on SME exporting behaviour, which stated that "small business owners avoid exporting because they simply do not wish to expose their firms to the various risks and unknowns involved."¹⁵

¹⁴ O. P. Wiedersheim, M. Welch: „Pre-export Activity: the First Step to Internationalisation”, *Journal of International Business Studies*, vol. 9, no. 1, 1978.

¹⁵ G. Vozikis, T. Mescon: "Exporters and Stages of Development: an Empirical Study", *American Journal of Small Business*, Summer, 1985.

Similarly, Jaffe and Pasternak reported in a study of Israeli SMEs that where “perceived export risk” is high there is a corresponding low export activity, and vice versa in that when perceived risk is low, export activity is high.¹⁶ In the same work, a distinction is made between “active” exporters who seek out new markets, and “passive” ones who simply respond when they receive a foreign order. So even when a firm has got over the first hurdle and actually made a foreign sale, it may well remain a reluctant player, still concentrating on the domestic market. Once again, from a voluntarist perspective these cases may be understood by a simple desire to avoid disturbing the status quo, which would have implications for the firm’s internal power structure.

In conclusion, the 1990s research project showed a complexity and diversity of SME behaviour in relation to international development, confirming the different examples and explanations in literature on the subject. It shed light on the attitude shown by many public authorities, especially economic development agencies, in providing help for SMEs at international level.

4. External support: the Rhones-Alpes response

Many French regions, especially the Rhone-Alpes, make substantial help available from their own financial sources. The region, one of the country’s industrial centres, has over 5 million people and covers very varied economic sectors. International exchanges are a major factor in this success, and the regional authorities have made stimulation of these a significant part of their economic policies. They include three main types of subsidies which are of direct interest to SME exports:

- **Recruitment of an export manager**
Subsidy of up to 50%, up to a ceiling of 27000 euro (£18,000).
- **Setting up an overseas office/subsidiary**
Costs of employees, accommodation, plus administrative and legal expenses involved in creating the subsidiary. Subsidy of up to 30% of cost, with a ceiling of 55000 euro (£37,000).
- **Feasibility studies**
Subsidy for initial prospection up to 50% of costs, with a ceiling of 9000 euro (£6,000).

¹⁶ N. Jaffe, D. Pasternak: “The Export Behaviour of Small and Medium-Sized Israeli Manufacturers”, *Journal of Global Marketing*, vol. 2, 2, 1989.

4.1. Further help : ERAI (*Entreprise Rhone-Alpes International*)

The international development agency ERAI was created in the 1987 with the specific intention to assist regional SMEs in their international development. This was a service unique to the Rhone-Alpes area.. By 1995, through a network of offices around the world (Milan, Turin, Barcelona, Stuttgart, Brussels, Toronto, Shanghai and Tokyo) coordinated from Lyon, SMEs could virtually furnish themselves with a surrogate export department. ERAI supplied market surveys, organises trade fairs, locates potential partners and (through its Brussels office could have early and complete information about European affairs, for example calls for tender of potential interest to smaller firms.

5. ERAI revisited in 2003

What has become of the attempt to encourage reluctant SMEs to take the risk of becoming active internationally? The development of their network suggests that this initiative continues to be asked to help by regional SMEs. Today they have added further offices in Cracow, Sao Paulo, Montreal, so reaching 11 around the world. The network can provide market intelligence from the different zones and in Lyon financial advisers help to find the export funding available at European, national and regional level. The Shanghai showroom is a particular success, offering showroom, sales and secretarial support on a customized basis. Here, SMEs can hire the services of a complete sales organization, tailored to their needs and budget. This can include local technical sales personnel, full or part-time, at local salary levels and so eliminate the need for expensive sales trips by European staff.

6. Conclusion

SMEs remain very diverse and varied in their response to the challenge of international development. Many of them continue to rely extensively on external support. The activities of the support provided by ERAI to SMEs in Rhone-Alpes region in France has now been used as a model by other French and European regions.

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THE IBEROAMERICAN COMMUNITY OF NATIONS – THE UNUSED POTENTIAL OF A STAGNANT SYSTEM

1. Introduction

Abstract: *Due to the fact that at the beginning of 1990s the countries of Latin America started to pursue the policy of open regionalism, democratic recovery and economic reconstruction, the Spanish government initiated the establishing of a new cooperation framework with this region: the Iberian-American Community. Since its establishment in 1991, the Iberian-American system of cooperation has constantly developed primarily thanks to the efforts of Spain, while the countries of Latin America sat on the fence. The lack of interest of Latin –American countries in the Iberian-American system of cooperation is in close connection with the fact that the countries of this region no longer consider Spain as a supporter to their interests within the European Union. This is because the European Union today pays attention mainly to the Easter European countries, while the cooperation with Latin America has been pushed aside. In addition, there are many differences in the interests of the European and Latin American members of Iberian-American community regarding many international issues. Despite all this, the Iberian-American system of cooperation has vast unused potentials for further development. There are close interests among the member countries based on the equality in decision-making and mutual responsibility – which are the specific characteristics of Iberian-American identity that had originated much before this community was established.*

Key words: *Iberian-American system of cooperation, open regionalism, Latin America.*

In 1991 the First Iberoamerican Summit took place in the city of Guadalajara, Mexico. In this meeting the heads of state of 21 countries came together: two of them were European, Spain and Portugal, the countries responsible for the conquest and colonization process of the territory that today is known as Latin

America; the other 19 countries were the nations arising after the independence from these European powers.

The First Summit didn't establish the specific objectives of the Iberoamerican System that had just been created. In fact, the Iberoamerican countries that attended this meeting only committed themselves to having summits in the future in order to strengthen the Iberoamerican Community of Nations. This Iberoamerican Community was meant to be an influential international player, recognized by the rest of the countries in the world. The Iberoamerican countries didn't set more specific aims and they didn't create means in order to require the presidents to act on their acquired commitments.

Since this summit in 1991, the Iberoamerican countries have met on thirteen occasions, once a year. During these thirteen years important advances have been produced in the Iberoamerican Community and, in specific areas such as development cooperation, the results have been substantial. However, for several years, comments about the stagnation of the system are very usual among the Iberoamerican countries. This is the reason that explains why in the last meeting in Santa Cruz de la Sierra (Bolivia) in November 2003, the Iberoamerican countries discussed the need of introducing changes into the system. In fact, in this meeting they approved a series of measures in order to support the Community, an unmistakable sign of the existence of lacks that are essential to correct.

In this article I am going to refer to different and often contradictory aspects of the Iberoamerican System: the context of its creation, its successes and the weaknesses that hinder its consolidation. I want to pay special attention to the critical situation of the Iberoamerican Community since the conflict in Iraq began. The invasion on Iraq has caused an important division among the members of this system because they have conflicting opinions about the legality of this war. These conflicting opinions make it difficult to reach the objective of making the Iberoamerican Community a homogeneous and recognizable player in the world. In this moment, there is not a solid political coordination inside the Iberoamerican system and this coordination was the main backbone of the Community during the nineties.

2. The creation of the Iberoamerican System: political climate and founding principles

At the end of the eighties, there was a special situation on the international scene that encouraged the appearance of the Iberoamerican System. In the first place, the international system was immersed in an intense process of change because the end of the Cold War polarity allowed for the birth of a multi-polar system. In this multi-polar world agreements among several states became usual. In the second place, since halfway through the seventies, the Iberoamerican

countries have been involved in democracy recovery processes that put an end to different kinds of authoritarian governments. And finally, after the so called “lost decade”, Latin America began a period of economic reforms creating large expectations.

In this context of open regionalism, democratic recuperation and economic regeneration, the Spanish government considered the advantages of building a new framework for its Latin American relations: the Iberoamerican Community of Nations. Latin American countries gladly received this proposal and accepted it because they perceived several advantages in this project.

For Spain, the Iberoamerican Community was a form of exploiting its close relationship with Latin America. Moreover, after the entry of Spain in the European Community in 1986, the Madrid government wanted to gain weight and prestige offering itself to Latin American countries as a link to Europe; at the same time, Spain could present itself to its European partners as the natural representative of the emerging Latin American region¹. Spain launched the Iberoamerican project without a clear idea of its framework and content. Despite this, the Madrid government received a positive response from the Latin American countries. After the debt crisis in 1982, Latin American states were committed to applying profound economic reforms aimed at liberalization and deregulation. All of them were involved in a regional integration process. MERCOSUR, the Andean Community and the Common Central American Market were trying to establish trade agreements with partners like the United States and the European Union in that moment. In this context, the Iberoamerican Summits were seen as a space in which they could strengthen their presence in the international arena. In fact, the expectations surrounding the Iberoamerican System became so high, that some countries like the United States and Italy declared their interest in participating, even as observers.

Among the Latin American states, Mexico was the country that most actively supported the project to build an Iberoamerican System and it organized the first meeting. Mexico had domestic political reasons to offer its support. In that moment, Mexico was preparing its entry into the North American Free Trade Agreement (NAFTA) with the United States and Canada. By promoting the Iberoamerican System, Mexico was reaffirming its marked Latin American identity. Besides, the Iberoamerican Community was an opportunity to intensify relations with the European Union. This chance allowed Mexico to balance its close trade relations with the USA.

¹ The previous relation between Spain and Latin America and the creation process of the Iberoamerican project is described by Celestino del Arenal and Alfonso Nájera: *La Comunidad Iberoamericana de Naciones, pasado, presente y futuro de la política iberoamericana de España*, Madrid, 1992

3. The Iberoamerican System's Achievements

The Iberoamerican System started in Guadalajara without specific content. The summits were considered as a space in which all Iberoamerican countries could talk and reach common positions. They didn't accept medium term commitment and all of them rejected the creation of a permanent organism to manage its activities. The framework of the Iberoamerican Community was minimal, without permanent headquarters, made up of three members: the country that organizes the Summit, as well as the countries organizing the next and the previous meetings.

Although the first summit didn't establish specific content and aims, the Iberoamerican system has moved in two particular directions since the second meeting: political cooperation and development cooperation. In both areas the achievements have been so great that an unforeseen process of institutionalization was initiated.

3.1. Political Cooperation

Political cooperation was a fundamental pillar of the Iberoamerican Community during the nineties. It took place in two different spheres of action: on the one hand, all the Iberoamerican presidents came together at these summits; so these meetings are used to solve bilateral conflicts and to support joint projects between countries with problematic relations². On the other hand, political cooperation has worked on the international scene and the Iberoamerican countries have shown that all of them could act in unison. In this sense, the Iberoamerican Community states have negotiated their mutual support of Iberoamerican candidates in international organizations. Besides, all of them have built a strong doctrinal corpus in the area of International Law. The Final Documents that close every summit are the best expression of these beliefs, which defend the democratic system, human rights and the principle of non-intervention³.

Political cooperation has been a main backbone of the summits. However, the Iraqi conflict has produced great misunderstanding inside the Community. The reaction of some Iberoamerican countries was to take part in the conflict; Spain and some Central American states sent troops to Iraq. Another country, Colombia, supported the decision of invading Iraq without the legal support

² For example, Perú and Ecuador made use of the Iberoamerican Summit held in Oporto (1998) to advance in the solution of their border disputes. In that moment they were involved in an armed conflict. Also, the always difficult relations between Chile and Bolivia have improved since the Iberoamerican Summit in Panama (2000), in which they decided to promote a joint industrial focus in a border region.

³ Guadalupe Ruiz-Giménez Aguilar: "Tras diez años de Cumbres Iberoamericanas", in: T. Mallo y L. Ruiz Jiménez (coord): *El sistema de Cumbres Iberoamericanas. Balance de una década y estrategias de consolidación*, Madrid, 2002, pp. 43-49.

of the ed Nations. However, states like Brazil, Argentina Mexico, Chile and Venezuela rejected the intervention and they called for respect for the United Nations. The international positions of the members of the Iberoamerican Community have never been so divided. The new Socialist government in Spain has the pending task of promoting the political cooperation that once characterized the Iberoamerican system.

Different opinions among the members of the Iberoamerican Community have always existed. These differences were always known, but they never caused a division like the current one. For Spain and Portugal, harmonizing Iberoamerican interests with European interests is sometimes a hard task. There are some summits in which this conflicting situations rose. For example, during the Summit in Bariloche, Chile proposed to make a statement condemning harshly the nuclear experiments made by China and France. Spain and Portugal were very opposed to this condemnation and they managed to take the mention of France out of the Final Declaration. The Iberoamerican Community had always found the way to reach a consensus on the content of the Final Declaration. But lately, the disagreements among the countries are more and more visible and the harmony among them has been broken when they make the Final Declaration. In the last years, it is usual that several Latin American countries join together to sign a declaration condemning, for example, the European Union agricultural subsidies. These subsidies are a great hindrance to international trade and they are very damaging to Latin American exports. Before Iraq, this important question was never presented publicly in the context of the Iberoamerican Community.

3.2. Development Cooperation

Alongside to political cooperation, development cooperation is the other fundamental pillar of the Iberoamerican System. The Iberoamerican countries that attended the Second Summit in Madrid, decided to set up a series of cooperation projects. The number of projects has increased constantly along with the resources mobilized for them.

The Iberoamerican Community has developed projects in areas as different as education, culture, governance and scientific research. These Iberoamerican Projects are of high quality and some of them have received the recognition of very important organizations like UNESCO.

However, the most important aspect of the Iberoamerican Cooperation System is not the quantity or the quality of the projects; but rather the form of developing the programs. The design and the implementation of an Iberoamerican project are characterized by horizontality and joint responsibility. The projects inside the Iberoamerican Community break with the usual verticality in cooperation relations, in which the donor imposes a lot of obligations on the recipients. In cooperation relations it is very habitual, for example, for the donor to give funds to a beneficiary

that must use that money to acquire services and products in the donor country. The recipient prefers to receive any funds, even if it is tied aid. On the contrary, in the Iberoamerican system, every project must be proposed by three countries that have to get involved in it and they have to contribute funds or human resources. And the project must get the approval of four more Iberoamerican members. In this way, it is very difficult for the country that gives the funds to impose its own criteria. This Iberoamerican cooperation system of horizontal decision-making and joint responsibility, contrasts sharply with the usual form of practising cooperation.

Since the number of Iberoamerican projects increases constantly with every summit, it was necessary to create an organism to manage and evaluate them. In the Summit that took place in Habana in 1999, the creation of the Iberoamerican Cooperation Office (SECIB- Secretaría de Cooperación Iberoamericana) was approved and it was established in Madrid one year later. The SECIB is a permanent office, with a specialized staff and its own statutes. This Cooperation Office represents a very important step in the institutionalization process of the Iberoamerican System.

4. The Santa Cruz Summit: How to Relaunch a Stagnant Community

The members of the iberoamerican summits and the press have always recognized the success obtained in the area of political and development cooperation. But at the same time, since the Fourth Summit, they have begun to express their concern about the growing tendency of the System toward empty rhetoric. Since this meeting, this opinion has been gaining followers and the requests to break up these peripheral summits have been growing. The sensation that the meetings are not very useful is caused by the lack of specific aims and the lack of plans of action. Every Iberoamerican Summit closes with a Final Declaration, a non-binding document that gathers the aspirations and desires of all the members; but this declaration never contains commitments in order to reach them. The Santa Cruz Final Declaration, at the last summit held, is an excellent example of this rhetorical characteristic. On the one hand, the Declaration contains references to many situations that cannot be resolved inside the Iberoamerican System, although all of them are crucial for the development of this region. This is the case of the points in the Declaration criticizing the lack and instability of financial flows and the demands to stop the fall of exports prices. On the other hand, some points are in clear contradiction with reality, such as those that “confirm the commitment of the Iberoamerican Community to the principle of non-intervention, the prohibition of the use of threats and force in international relations, the reinforcement of multilateralism and the role of the United Nations as the forum to discuss international controversies”.⁴

⁴ These points were included in the third clause of the Final Declaration signed in Santa Cruz, when several Iberoamerican countries had troops in Iraq. The Iberoamerican Declarations are available on the web page <http://www.secib.org>

Every Final Declaration is simply a long list of wishes and principles that are never accompanied by a plan of action in order to develop them. This has consolidated the image of the Iberoamerican Summits as a space in which the main issues are never resolved. The sharp contrast between the declared wishes and the real achievements has caused the appearance of harsh critics in the press about the uselessness of the Summits. The most widespread idea has been that the Iberoamerican System is too expensive for its very limited achievements.

That widespread opinion in the media is shared by many politicians in the Iberoamerican Community. So, in the Summit held in the Dominican Republic in 2002, the countries decided to create a work group to find the way of relaunching the system. The Brazilian ex-President Cardoso was chosen to coordinate this group which was working during a year and made a dossier suggesting changes. The Cardoso Commission was presented in the last Summit that took place in Bolivia in November 2003.

The measures proposed by the Cardoso Commission include suggestions as different as the creation of a Risk Evaluation Agency to promote international investment and the reciprocal recognition of university degrees in all the Iberoamerican zone. In Santa Cruz, the proposal of creating a permanent office was approved. Its statutes, headquarters and representativ will be specified in the next Summit. The agreement to create this Permanent Office was very difficult to reach because several Latin American countries were very opposed to this proposal of the Aznar government. The opposition was only overcome when Spain assured its partners that this organism would never make declarations in the name of the Iberoamerican Community. This situation clearly reflects the important division inside the Community.

It is sure that the measures adopted in the last Summit will have positive effects on the Iberoamerican System. But these measures will be unable to solve the main problems of the Community: In the first place, they will not change the rhetorical character of the Summits so criticized for a long time. But, overall, the Cardoso Commission didn't think about a solution for the main obstacle to the consolidation of the Iberoamerican System: the lack of implication of the Latin American countries in this project. Until now, the Iberoamerican Community has advanced mainly through the effort of Spain which finances the most part of the programs. But without the implication of the Latin American countries, the Community has neither meaning nor future. The main reform that the Iberoamerican Community needs is the establishment of a shared leadership in which countries like Brazil and Mexico act closely with Spain. The new course of the system must be planned from this shared leadership.

The lack of implication of the Latin American countries began halfway through the Nineties and it is very connected to specific changes occurring on the international scene. These changes have decreased the Latin American hopes for the Iberoamerican Community: For example, Spain is no longer con-

sidered by them like a supporter of Latin American interests in the European Union. This support was intensive after Spain's entry into the EU in 1986. Spain achieved, among other things, the assignment of specific funds for Latin American countries; until that moment this fund was part of a general budget for Latin America and Asia. The Spanish role was also considerable in the increase of the resources sent to this region. But, after a decade, the European Union now pays attention mainly to the Eastern European countries and Latin America has been relegated to a secondary role. Latin American countries are conscious about the decreasing interest that they received from the European Union and they also know that Spain is unable to change this situation because its ability to pressure is very limited. The sharp economic and political problems that the Latin American states suffer and the new situation on the international scene have reduced the importance of the Iberoamerican System.

5. Is it possible to relaunch the Iberoamerican Community of Nations?

The Iberoamerican Community of Nations is going through a difficult moment. On the one hand, there are conflicting opinions and intense differences inside the system; on the other hand, multilateralism is receding on the international scene and the Iberoamerican system is only possible in a multilateral environment. But, despite this adverse context, it is possible to distinguish in the Iberoamerican system several elements that are an excellent starting point for it. There exists inside the Iberoamerican Community recognizable identifying elements that give it great potential. Despite the important differences existing inside the Iberoamerican Community, there is a clear proximity among its members. When, in 1991, the countries were called to take part in the first Summit, none of them questioned the advisability of attending. The fluidity in the initiation of the project, and the fact that a discussion about what countries had to be included in the Community was not necessary, show the existence of an Iberoamerican identity prior to the decision of doing the Summit. Furthermore, other players on the international scene recognize the twenty-one countries that take part in the Summits as a specific group. The spontaneity that characterizes the Iberoamerican meetings explains why not even those most critical with the system consider it artificial. All the Iberoamerican players know the great cultural differences that they have, but this reality does not deny the sense of being part of a specific Community.⁵

The close relationships existing among the Iberoamerican countries is a great advantage with a lot of potential. A high amount of institutions and

⁵ This recognition of the diversity inside the Community, compatible with the sense of belonging to a specific group is analyzed in the book of Joaquín Roy and J. A. March (Eds.): *El espacio Iberoamericano. Dimensiones y percepciones de la relación especial entre España y América Latina*, Universidad de Miami, 1996

very different organizations (universities, NGOs, companies, civil and professional associations) in the Iberoamerican countries have been cooperating for decades outside of public projects. If the Iberoamerican Summits did not exist, this network of intensive relations would remain the same. So it would be very advisable to use all these connections within Iberoamerican civil society. SECIB is very conscious of the potential of these close relationships, so it is working to find ways of connecting synergies. Accepting this starting point, the existence of an Iberoamerican identity, the Iberoamerican Community of Nations has great possibilities of consolidation.

The Iberoamerican space is not a fiction; it is a reality in which a lot of projects can be supported. After thirteen meetings, we have enough accumulated experience to make a diagnosis about the strengths and weaknesses of the system; and it is possible to make decisions in order to promote its consolidation. In this sense, in the future the Iberoamerican Community should move forward in two directions:

In the first place, it appears urgent to make changes in the Iberoamerican Summit format in order to make the meeting less rhetorical and more effective. It is essential to reverse the idea that the Iberoamerican Summits is synonymous with empty declarations. So, every summit must be used to set some aims and to check that the objectives marked in the previous meeting have been achieved. The Iberoamerican Summits are not the best place to make great declarations of principles. Since the Iberoamerican Community works effectively in political and development cooperation, they should be the spheres of actions.

Cooperation, always based on horizontality and joint responsibility, is the essential pillar to support the Iberoamerican Community of Nations. In the last years, Latin American states have been suffering a dramatic process of structural reforms in which this cooperation can be very useful; given the similarity in the public administration of Iberoamerican countries, the reforms developed by some can be an example for the rest. The judicial reform in one Iberoamerican country, for example, and the evaluations and lessons learnt through that process, could be used to make improvements in the other nations. The proximity among Iberoamerican countries and the existence of a horizontal system of cooperation allow for an exchange of experiences and technicians impossible to develop in other spaces. Few multilateral forums have such good conditions to develop forms of triangular cooperation in which the wealthiest countries give the funds and the others their experience in state reforms.

In the second place, it is urgent to establish inside the Iberoamerican Community a shared leadership in which countries like Mexico, Portugal and Brazil have a place alongside Spain. Until now, Spain has functioned as a self-proclaimed leader and the other Iberoamerican countries haven't involved

themselves in the project⁶. They accept the Spanish proposals and attend the meetings, but they do not have any interest in the consolidation of the Community. Iberoamerican countries have enough shared interests to motivate this process. For example, it is advisable for all of them to strengthen the presence of Iberoamerican culture in the world and to increase the use of Spanish on the Internet. These aims require joint actions that can be designed and implemented in the Iberoamerican Summits.

Among the members of the Iberoamerican Community there existed certain identity and mutual recognition long before their governments made the decision to initiate the Summits. That recognition is a solid backbone to build a Community that will have influence on the international scene if its members are influential. Spain, Mexico and Brazil are implementing different strategies to improve their position in the world and they are obtaining important achievements. Brazil, for example, is being recognized as an emerging power by both their neighbours and the principal countries in the world.. The future challenge is to manage a more realistic system, capable of assuming clear objectives and carrying them out effectively. From a shared leadership the Community can begin to be an international player with its own characteristics.

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⁶ Spain considers itself as the natural leader of the Community because it has the best economic indicators and a consolidated democracy. But Spain’s feeling of superiority is entirely compatible with a deep concern for Latin American countries. Spain presents itself as a example to Latin America because it perceives Latin America as similar to it. Laura Ruiz Jiménez: “Las Cumbres y los ciudadanos: imágenes en la prensa española de la Comunidad Iberoamericana de Naciones”, in the cited book *El sistema de Cumbres Iberoamericanas. Balance de una década y estrategias de consolidación*, Madrid, 2002, pp.83-94.

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ESTABLISHING INTERREGIONAL DIALOGUE BETWEEN SERBIA AND MONTENEGRO AND THE COUNTRIES OF LATIN AMERICA

Abstract: *From the Balkan viewpoint, it would be advisable to note the positive experiences in the development of Latin American regionalism at the end of 20th and the beginning of 21st century. The adopted theoretical model of complex interdependence has been adjusted in practice to the main specific characteristics of Latin America, in order to develop the network of sub-regional, regional and interregional cooperation and integration. So extraordinary diversification of regional cooperation has become today one of the key characteristics of Latin American practice. This cooperation includes also the possibility for certain states to combine very successfully and simultaneously bilateral and various multilateral forms and levels of economic integration.*

Key words: *regionalism, economic integration, Latin America, geographic specialization, economic reforms.*

1. Introduction

The main intention of this paper is to consider the possibilities for establishing new forms of political, economic, cultural, educational and scientific cooperation between Serbia and Montenegro and the countries of Latin America. Parallel to that a wider regional Balkan approach to the cooperation with this region should be initiated, whereas in accordance with its present potentials Serbia and Montenegro could aim at taking over the leading role. At the same time, this is also a framework for a new long-term research project of the Department for Latin America and the Caribbean of Geo-economics Faculty of Megatrend University of Applied Sciences from Belgrade.

Specifically, our intention is to define and pragmatically analyze the possibilities and ranges offered by the establishing of this dialogue, in accordance

with new international surroundings and with the aim to initiate and restore the relations with the countries of Latin America, with flexible application of new models and instruments of bilateral, trilateral and multilateral cooperation.

After thorough initial research of the main characteristics and priorities in the international political and economic relations of Latin America after the fall of bi-polarization in the world, we have concluded that the establishing of a completely new dialogue with this part of the world would strengthen the international status and reputation of Serbia and Montenegro. Parallel to that and under the current circumstance, it would influence favourably the diversification of the total international cooperation of Serbia and Montenegro.¹

In order to work out in detail our hypothesis, we started from the fact that the contemporary world has changed dramatically and that the consequences of these changes impose many challenges, which require adequate and long-term solutions to be found as soon as possible. They should be in accordance with the new national and regional interests, but also with the potentials of the recently established state union. We have also taken into account that the destruction of bi-polarization had particular influence on the international relations in Europe. The rapidity and unpredictability of these changes cause deep geopolitical and geo-economic transformation in that part of the world. At the same time, there is a high degree of interdependence in one part of Europe (the European Union) while there are various dangerous conflicts in the other part (European countries that remained out of the EU, parts of the former USSR and most of the former SFRY territory).²

Moreover, our knowledge suggests that new international constellation, in addition to the negative consequences, enables also formulation and institutionalization of wider regional interests. This refers especially to those regions – including particularly Latin America – where a high degree of complex inter-

¹ It is also important to note that in those parts of Europe that have recently integrated in the EU after the fall of bipolarisation there is a rise of all forms of interest for Latin America. For instance, the Center for Latin American Studies (Centro de Estudios Latinoamericanos – CESLA) was founded at the University of Warszawa in Poland as far back as 1980s. It became the main prime mover of the cooperation of the countries of the Middle and Eastern Europe and Latin America. Their model of cooperation, which at first sight seems reduced to comparative research in the fields of politics, economy, science and culture, acquires quite various dimensions and connotations with the powerful support of Polish Ministry of foreign affairs and the most important Polish companies. It successfully provides space for qualitatively and quantitatively new shift and diversification of cooperation of that country with Latin American region. At the same time, it should be noted that all diplomatic missions of the Republic of Poland in Latin America and on the Pyrenean Peninsula carry out coordinated additional advertising to that effect.

² About the characteristic changes in this part of Europe see: Marco Carnovale: „EC, NATO, CSCE and Security in Eastern Europe”, *Danubius*, vol. IV, no. 1, Belgrade, 1993; Edita Stojic, Slobodan Pajovic: „The Balkan in the 20th Century: Challenge for Europe”, *Review of International Affairs*, Belgrade, vol. XLIV, no. 1016-17, 1993.

dependence has been achieved, or where consensus has been reached about common regional interests and priorities regarding the cooperation in the stated region and its position in the world in which the unavoidable globalization phenomenon becomes increasingly dominant. We note that as far as this research is concerned, globalization has been understood and observed as a multi-layer process that practically becomes conditional for all spheres of life and activities of the humanity.

To put it briefly, in the existing international constellation geopolitical and geo-economic scenarios of the international life and activities of each particular state have changed. It is also evident that the importance to establish wide scope of regional interdependence and cooperation has increased, in accordance with the process of economic and political interest globalization in the world. The importance of these statements increases if we consider the fact that the concept of globalization and interdependence implies the most various phenomenology of international cooperation: military, economic, political, financial, technological, scientific, cultural, ecological, etc., together with explicit respect for the established code of conduct. Such an established starting hypothesis becomes almost inevitable if we wish to join the international community and contemporary flows of cooperation quickly, efficiently and pragmatically.

Accordingly, we would underline that there have been deep conceptual and ideological changes, especially in foreign policy platforms of Latin American countries, which aim to respond to the imperatives imposed by the new stage in the development of the international relations. We have noted that this adjustment trend can be seen in the Balkan countries as well. They try to redefine their foreign policy hoping to find the answer to the challenges of the adaptation to and joining in the new courses of international economic and political cooperation, both at the level of individual states and of the region as a whole.³

2. Main characteristics of the development of Latin American region at the end of 20th century

In an attempt to define the efficient and pragmatic strategy of cooperation of Serbia and Montenegro with the countries of Latin America, we must start from the fact that Latin American region is a complex geo-historical region (macro-region) consisting of several geographical entities – sub-regions. At the same time, mutual interaction and communication is particularly high.

³ We have as an example the Ministry of Foreign Affairs of the Republic of Peru, which in the second half of 1996, carried out deep structural and organizational changes with a view to improve functioning of the Ministry and to provide a high level of communication with other countries. A special place within the structure of the Ministry of Foreign affairs was given to the Directorate for economic issues (the number of Directorates was reduced to five). *El Comercio*, Lima, July 02, 1996.

Accordingly, while working out the stated strategy in detail, our conclusion is to conform pragmatically to the specific features of that region as well as individual countries in creation of bilateral cooperation, that is, to consider multi-layered quality of regional and national identities that exist within special geo-political and developing processes.⁴

Following the end of bi-polarization, terminologically defined as “post-Cold-War era”, the new structure of international relations is understood as a period of transition in which the basic principles of the international community functioning are not yet precisely defined. Within such a structure and due to collective and coordinate efforts, Latin America managed to find its place and re-establish its status and influence in the world under the circumstances of regional factors gaining in strength.

Namely, we estimate that from the Balkan perspective it is very advisable to consider and mark positive experiences in the development of Latin American regionalism in 1990s, its extraordinary dynamics and various forms of its manifestation. In this context, we underline that the attitude on defining theoretical approach to study and analyze Latin American regionalism phenomenon, as well as formal and informal sub-regional, regional and inter-regional cooperation prevails among Latin American experts for the international relations.⁵ In the middle and at the end of 1980s, the adopted theoretical model of complex interdependence has been practically accommodated to the main specific features of Latin America, which made it possible to identify within Latin American macro-framework the following prerequisites for the described phenomenon to appear:

High degree of interaction at various levels, with special emphasis on the development and intensifying of political relations among the countries in this region, especially under the circumstances when there were positive changes in their political orientation (process of democratization, stabilization of democratic institutions and respect of human rights);

Progressive dissociation, in some cases even isolation of international organizations in the region from their direct bases (the example is a serious crisis of almost all inter-American institutions that can be observed since the beginning of the Malvinas War and, parallel to that, redefining the aims and methodology of diversified process of regional economic integration);

Positive influence of changes on both the international relations in general and the relations among the countries in the region (the USA in particular), which became more fluid, flexible, open and globalized. Latin America expressed

⁴ Edmundo A. Heredia: *América Latina: Isla o Archipiélago*, Ed. Universidad de Córdoba, Argentina, 1994, p. 11-29

⁵ Alberto van Klaveren: „El lugar de los Estados Unidos en la política exterior latinoamericana”, in: Gerhard Drekonja, Juan Tokatlian: *Teoría y Práctica de la Política Exterior Latinoamericana*, Ed. CEREC, Bogotá, 1986, p. 119-141

firmly its full political readiness to open towards global requirements of contemporary courses of world cooperation both individually - at the level of respective states - and regionally.⁶

According to the analyses based on the application of this theoretical framework, we reach the conclusion that there are multiple sometimes even very specific channels of communication in Latin America. These channels have connected those countries for more than a century at state bilateral level, but also at multilateral level, in the form of developed sub-regional, regional and interregional network of cooperation and integration. This means that in Latin American practice there is a phenomenon of extraordinary diversification of regional cooperation, which includes the possibility for individual states to combine at the same time very successfully bilateral and various multilateral forms of cooperation. All this is possible since there is a natural and logical connection, positive historical heritage of the region, similarities in political and economic sphere, intertwined and direct reference to the establishing of higher forms of cooperation within the framework of parallel existence and functioning of various formal or informal integration models.

We will state two examples to that effect: the Kontadora Group peace process and the importance of the Rio Group.

Experts for Latin American issues have paid special attention to the study of activities and achievements of Kontadora Group. We would especially underline the fact that Kontadora Group combined individual and collective activities very successfully and thus contributed to the build-up of trust in its activities and its aims. It also contributed to the peace process and trust in Central America. Each member-country of this Group could initiate special peace initiatives independently or individually, but in the function of collectively defined and agreed aims, in accordance with its capacities, priorities and geo-political advantages or economically support some of Central American countries. On the other hand, collective actions of Kontadora Group were carried out in order to define and establish general framework for peaceful resolving of the crisis, with the equal participation of all member-countries and the countries of that region, participants of the peace process. The example of the Kontadora shows that there is a high level of flexibility in this new practice and methodology of political and economic cooperation in Latin America. Namely, Mexico and Venezuela were the main carriers of the Kontadora activities and aims regardless of the fact that there were differences in their approach, interpretation and analysis of the causes of crisis in Central America. Mexico pursued at that its well-known and traditional foreign-policy orientation, based on the principles of strict non-interference in the internal matters of other countries, respect of their independence and sovereignty. Even so, Mexico constantly tended, even at the most critical time of Central American crisis, towards the normal development of political and economic relations with Sandinista government of Nicaragua and supplied

considerable material and economic support to that country. On the other hand, the then Christian-Democratic government of Venezuela established a somewhat higher degree of cooperation with the government of the same ideological provenance in El Salvador, which gave good results and opened the space for all Central American states to join the Kontadora peace process.

It is important to note that the basic mechanism of functioning of this model of political cooperation based on the consultations at the level of foreign affairs ministers, often informal and under various circumstances, such as for instance on the occasion of the UN General Assembly session, but also in some special cases at the presidential level. The Kontadora also established special commissions for political, economic and social issues, with a view to achieve the higher degree of efficiency and to solve difficult economic and political crisis in that sub-region. This methodology and model of communication were met by the open support of almost all countries of Latin America and the international community as well. In this way, the original Latin American experience of informal political cooperation with a very low degree of institutionalization and extremely flexible structure received the international verification and credibility.

In addition to this, when the Lima Group was formed in order to support activities of the Kontadora Group, a new model of informal political cooperation appeared in Latin American practice. On one hand, this model decisively influenced tracing of direct peace negotiations among Central American states within the Esquipulas II Agreement. On the other hand, all those problems that directly influenced the international position of Latin America, such as debtor's crisis, process of democratization, problems with narcotics and ecological issues were included into the new group program of activities. To put it briefly, very positive experiences of these countries in the process of forming regional consensus, which referred to the main political and economic issues of Latin America, influenced the further promotion of political cohesion in the region. They also created a basis for the establishment of a qualitatively new trend in Latin American practice, which is relying on the coordination of official attitudes concerning almost all-important issues significant for the future of the region.

As it is known, this process had its culmination in December 1986, when the Permanent Mechanism for Political Consultations and Gathering (known under the name of the "Rio Group") was established in Rio de Janeiro. This act introduced systematic quality into the political consultations (three times a year at the level of foreign affairs ministers), together with the initiation of combined methods of negotiations with all institutionalized regional and non-regional groups. In addition to this, for the first time in the history of Latin American countries, the Rio Group introduced regular annual sessions at the presidential level into the structure of their activities. The decision reached by this Group

member-countries to gather regularly and coordinate their attitudes and activities regarding the most important international issues represents exactly that qualitatively new shift in comparison to the previous initiatives that were motivated by one theme only, i.e. finding a solution for a certain problem in Latin America. This means that they were defined in time and space. Besides, it must also be taken into account that the member-countries of the Rio Group represent 80% of the population and gross national income of the region and include the most developed Latin American countries: Argentina, Brazil, Mexico and Chile.

In short, all these positive experiences and further development and achievements of these movements in Latin America will depend on many factors, not always regional ones, considering a still high degree of political and economic dependence of this region on the USA. It is obvious that the consequences of deep economic and political crisis, recorded in this region at the end of 1970s and the beginning of 1980s accelerated the process of the new political and economic cooperation. They were aimed to include Latin America on a more equal footing into multi-polar international community in accordance with the existing potentials and newly formed influences and possibilities. The higher degree of political cohesion and irreversible process of democratization influenced crucially the increase of level of all forms of regional cooperation as well as the promotion of regional security based on cooperation and consensus. Furthermore, this new concept of cooperation strengthened considerably the international position of Latin America opening the space for it to influence more independently solving of regional problems, especially regarding the matters of economic development and security.

It is advisable to mention to that effect that Latin America established direct dialogue with the countries of the European Union, Japan, the ASEAN countries, the Pacific countries, the Russian Federation and the People's Republic of China.

Thanks to the stated advantages resulting from the changed structure of regional cooperation and strengthened and considerably redefined international projection of Latin America, substantial changes occurred in the relations between the USA and that region. Democratic and economically reformed Latin America becomes more and more attractive partner for the USA and Canada regarding more equal cooperation and integration. The best example for this claim is the Enterprise for the Americas Initiative (EAI) and signing of agreements on North American Free Trade Area (NAFTA) between the USA, Canada and Mexico in December 1992. Within this context we have to observe the dynamic development of the idea to establish Free Trade Area for the two Americas (ALCA – FTAA), which leads to the formation of the free market for over 800 million population.

⁶ In relation to the main characteristics of the international position of Latin America in the contemporary world, consult also: Pope G. Atkins: *Sudamérica en la Década de 1990*, Ed. Grupo Editor Latinoamericano, Buenos Aires, 1990.

Based on these data, we can conclude that for the first time in the history of relations between the USA and the countries of Latin America there has been a possibility for one country or in the future even more countries of that region to integrate formally economically with the USA and Canada.

2.1. Revitalization of the regional economy and integration process in Latin America

There is an agreement among the experts for Latin American issues in the assessment that 1980s were the lost period (*década perdida*) concerning the indicators of economic growth, social development and progress in general, as well as the modernization of economic and production structures in the region.⁷

On the other hand, it is a fact that almost all countries of that region managed during that period of the hardest economic crisis (after the one that affected the world in 1930s) to adjust to the new economic rules and trends as well as to start carrying out two considerably complex processes of modernization:

Deep and thorough democratization of political life with the emphasis on the respect of human rights and fight of corruption;

Economic and production re-structuring and adjustment to the laws and principles of free economy and open market.⁸

In short, it can be concluded that then already in almost all countries of the region there was awareness of the necessity to undertake urgent measures in order to provide integration into the international global economic flows. This would be achieved by maintaining macroeconomic stability, initiating sector programs that were at that time the only path to modernization and transformation of production structures, with the attitude that better use of the potentials of regional integration processes would provide for the faster economic recovery and trade expansion. In addition to this, the countries of Latin America had to innovate or overcome traditional concepts and models of economic integration, but also the governments whose overemphasized intervening in economic sphere was one of the main obstacles for the urgent liberalization of market flows and inflow of foreign capital.⁹

⁷ Gerd Langguth: „Positive Signals after the Lost Decade: Change in Latin America”, *Aussenpolitik III*, 1997, p. 278-290

⁸ Alberto Van Klaveren: *Integration Now: Option for Latin America*, Mimeo, Santiago de Chile, 1994.

⁹ According to the UNCTAD report on the increase of foreign investments in the world in 1997, published in “Politika” Daily on October 03, 1997, Latin America (together with the Caribbean) recorded the rise of 51,7%, by which the total sum of direct foreign investment into the region reached 349,2 billion Dollars. In the same period, the countries of central and Eastern Europe recorded the fall of 14.4% of direct foreign investments and they amounted to 12.3 billion Dollars.

According to this framework of development, the extraordinary importance was given to the private sector and the process of privatization in general. Economic planning was also important as well as the more balanced relationship between the domestic and foreign markets, especially to the role and potentials of agriculture in the development of countries in this region. In practice, this new political philosophy reflected in sometimes-unilateral application of measures to achieve very fast transition towards open market economy, trade and financial liberalization, more competitive currency policy, stimulating of foreign investments and privatization of the inherited huge and uncompetitive government sector.¹⁰

Professor Alberto Van Klaveren,¹¹ the respected Chilean expert in Latin American problems noted “in spite of the underlined pessimism in consideration and analysis of the stated political and economic trends in the region, it was at the beginning of 1990s already that positive changes were obvious. There were also indicators showing argumentatively favourable perspective for the future economic development of Latin America, considering its natural resources, human potential and the degree of industrial development which are not that moderate.”¹² Within this context, some comparative advantages of Latin America are especially highlighted when compared with other regions in the world. Special importance is given to the fact that the natural resources of that region are very competitive internationally, including still imprecised wealthy reserves of oil, but also agricultural sector, and mining industry. Parallel to the reforms in the industrial sector, the importance of which should not be underestimated, the most developed countries of Latin American region created the favourable conditions for the successful adjustment of the logics of integration into global courses of world economy and trade.

From the Balkan perspective, the special importance can be given to the fact that the new regional economic policy of the majority of Latin American countries bases on the method of “geographical specialization”, which implies fast integration into profitable transnational production processes.¹³ In the

¹⁰ John Williamson: *The Progress of Policy Reform in Latin America*, Institute for International Economics, Washington D.C., 1990.

¹¹ Professor Alberto Van Klaveren (Chile) is one of the most prominent Latin American experts for the international relations. He was an academic coordinator of the Society for the research and specialization in Latin American issues (A.I.E.T.I. – Madrid); Professor at University Institute Ortega y Gasset, a part of the prestigious Spanish foundation with its headquarters in Madrid; Director of the Institute for the International studies of National University in Santiago de Chile, Director of the Directorate for planning within the Ministry of Foreign Affairs of the Republic of Chile, and at the moment the Ambassador of the Republic of Chile in Brussels (European Union).

¹² Alberto Van Klaveren: *América Latina en el Sistema Internacional: Los Desafíos de la Adaptación*, Mimeo, Santiago de Chile, 1994, p. 4

¹³ Alberto Van Klaveren: op. cit. p. 4

analysis of new economic trends and destinations of foreign-trade activities of Latin American countries, it can also be noted that in addition to the strengthening of the phenomenon of geographical specialization of the export-oriented production, there is also a powerful directing of export towards the untraditional markets. As for the restructuring and modernization of production processes in the industrial sector, it is obvious that these changes are largely similar to the practice of the new industrialized countries of South East Asia.

Our conclusion is that the results of these reforms offer positive experience, especially in the field of exports that become more diversified and in addition to traditional export articles of the region (raw materials) it progressively includes semi-final products, component parts of some compound products, as well as final compound products.¹⁴

The next favourable factor according to Professor Van Klaveren for the further accelerated development of Latin American countries is the existence of well-trained young and ambitious technical personnel, especially within new sector production processes managed by high-quality managing establishment. The very fact that Latin America has at its disposal capable, young and educated managerial personnel, mostly educated in the USA and the countries of the European Union, provides for the flexible and compatible functioning of modernized economy under the very variable conditions of global world economy and somewhat less complex local labour market.

In short, although the process of economic stabilization of the region at the beginning of 1990s gave first positive results, especially in the field of trade, we note that these deep economic reforms of neo-liberal character¹⁵ proceed under extremely hard social circumstances with the existence of high inequalities in the distribution of national income. Namely, generally speaking, social indicators after the 1980s crisis reached dramatic levels, particularly concerning the percentage of population living in absolute poverty. According to the available data, this percentage has doubled and reached the alarming 44% of total population.

¹⁴ George Gereffi: *New Patterns of Industrial Integration in World Economy: Evidence from Latin America and East Asia*, paper presented at the seminar: "The Changing Global Context for U.S.-Latin American Relations", *Diálogo Interamericano*, Aspen Institute, 1993.

¹⁵ "Neo-liberalism" in this paper means various forms of application of classic liberal theory in which special place or importance is not given to social policy, not even to economic policy, except in the starting stage of model application. In other words, since it does not include the possibility for the state to intervene in the market, social and economic policy of the state would only burden the functioning of this economic model. Free market is the guarantee of the progress, and role of the state is to provide for the political, and especially for the ideological prerequisites for the uninterrupted functioning of free market based on its own auto-regulating mechanisms.

This resulted in instability in the sphere of social policy and provided space for severe criticisms and debates on the future of Latin American region.¹⁶

Special importance to that effect is given to the fact that 80% of newly impoverished (*nuevos pobres*), which according to the available data reach about 65 million people, live mostly in large cities. This has an unfavourable effect on the implementation of the policy for limiting further uncontrolled increase of urban population. This phenomenon makes it additionally difficult for all those programs directed at solving complex environmental and other problems (especially urban delinquency, black economy and illegal production and consuming of narcotics) in numerous metropolises across Latin America.¹⁷

All these observations in the sphere of social indicators can be understood if they are linked to the fact that in almost all countries of the region deep reforms of the state have been made, its institutions and competencies, including social policy. There was a transfer of competences in this field, lowering them from the level of government to the local level or, even directly to the market, with drastic limitations of the space for the government institutions to intervene. In this way, the logic of neo-liberal model of development was successfully applied, in the sense that the process of reduction of state competency and intervening in various spheres¹⁸ of Latin American practice was completed, which showed that this model is possible to apply only with a substantial aggravation of working and living conditions.¹⁹

Under the stated circumstances, as of 1991, there is a strong revitalization and promotion of all forms of cooperation and regional integration in Latin America. This new impulse reflected, primarily in diversification of regional integration process, highlighted pragmatism and parallel functioning and intertwining of various models of cooperation and integration. It can be noted at that there was a flexible use of formal and informal mechanisms, multilateral and bilateral activities within the existing and newly established regional and

¹⁶ On these issues, consult also: Gino Germani: *Política y Sociedad en una Epoca de Transición*, Ed. Paidós, Buenos Aires, 1992. and Carlos M. Villas: *De Ambulancias, Bomberos y Policías: "La Política Social del Neoliberalismo"*, in: *Desarrollo Económico*, vol. 36, no. 144, January-March 1997.

¹⁷ Carlos M. Villas: op. cit., p. 936

¹⁸ It is important to note that during 1980s and at the beginning of 1990s, many countries of Latin America started important constitutional changes with the aim to provide conditions for deep political and economic reforms. According to the available data, we give the following examples: Ecuador in 1978, Chile and Brazil in 1989, Paraguay in 1992, Peru and Bolivia in 1993, Argentina, Guatemala and Nicaragua in 1994. For more detailed information about the recent constitutional changes in Latin America countries, see: Roberto Gargarella: "Recientes Reformas Constitucionales en América Latina: Una Primera Aproximación", in: *Desarrollo Económico*, vol. 36, no. 144, January-March 1997, p. 971-990

¹⁹ Catherine M. Conaghan, James M. Malloy: "Democracia y Neoliberalismo en Perú, Ecuador y Bolivia", in: *Desarrollo Económico*, vol. 36, no. 144, January-March 1997.

sub-regional patterns of cooperation. The scope of these innovations in Latin American practice is various. They primarily refer to mutual trade, connecting of markets, coordinated development of infrastructure, joint exploitation of natural resources, fight against illegal production and trade of narcotics, solving of common economic problems, technological development, as well as coordination of common attitudes regarding economic development and position of the region within the international relations at the beginning of 21st century.

2.2. Regional integration and cooperation in Latin America: a brief review

In order to consider the main characteristics and scope of regional integration process as realistically as possible, it is necessary to point to some facts. The main aim of that process development in Latin American practice in the previous period (in 1960s and 1970s), was to protect the market and to encourage the accelerated process of industrialization and trade, along with a pronounced state intervention.²⁰ Today the interests of Latin American countries are thoroughly transformed and turned towards a higher degree of competition in the international market and, to that effect, the promotion of multi-layered regional liberalization.

This essential change had direct influence not only on the functioning of the existing integration models in the region, or the emergence of new forms of cooperation between Latin American states, but also on the methodology of their integration into world political and economic courses at the beginning of 21st century. In short, this process of thorough political and economic transition and modernization almost gradually changed the sphere of interest and activities within inter-American system and put on the agenda the following issues:

- Protection of human rights and further continued development of democracy in the region;
- Adapting to new trends in world economy;
- Fight against poverty, illegal production and trade in narcotics, migration;
- Environmental protection.

How it looked like in practice can be best seen in a brief review of the state and trends of the most important models of regional integration.

²⁰ Dr Slobodan S. Pajović: "Novi oblici političke saradnje u Latinskoj Americi", in: *Latinska Amerika i savremeni svet* (priredila dr Rozita Levi), Institut za međunarodnu politiku i privredu i Jugoslovensko udruženje latinoamerikanista, Beograd, 1995, p. 226-239

Latin American Integration Association (*Asociación Latinoamericana de Integración – ALADI*),²¹ undoubtedly the most ambitious integration model in Latin America, did not manage to adjust fully to the newly originated situation and the conditions in the region and wider international surroundings of Latin America. However, its far-reaching character and flexible institutional framework enabled the initiation of several bilateral and sub-regional initiatives (for instance, Amazon Pact or Agreement on Cooperation in the Plat River Basin). From today's perspective, *Mercosur* is of the special importance, which developed into a very successful model of sub-regional cooperation, i.e. powerful economic and political integration.

Mercosur originated after signing the Agreement on integration between Argentina and Brazil (November 1988), which then functionally adjusted to the existing sub-regional conditions, to transform a little bit later into the Agreement of Asuncion on the establishing of the common market for the southern part of South America on November 21, 1991. The members of *Mercosur* – Argentina, Brazil, Paraguay and Uruguay – started the realization of the project leading to the establishing of common market, providing of free circulation of goods, services, capital and labour. According to the expert evaluation, *Mercosur* relied primarily on the high degree of political and economic interdependence between Argentina and Brazil, which could be seen from the increasingly emphasized harmonization of their developing policies. It is important to point out that the successful beginning of cooperation within *Mercosur* influenced directly the decision of several neighbouring countries of that sub-region to intensify their relations with this group and to apply for the membership in it. It refers, first, to Bolivia and Peru, while Chile, although having the most developed economic and trading relations with this group, remains consistent in its attitude not to connect to any integration model if the achieved degree of liberalization and open market in it is not compatible with Chilean indicators. The most recent trends in Latin America show that *Mercosur* represents a skeleton of a new swing directed to harmonization of multi-layered process of Latin American integration. This group was also joined by The Andean Community of Nations (CAN). It can be noted that *Mercosur* pursues a very active policy in the complex and uncertain negotiating process directed at the establishment of ALCA, representing the attitude of the equal participation in the realization of this project.

As for the development of cooperation in Central American region, a sudden shift is notable after X Summit at the level of Presidents of Republics, which

²¹ ALADI was founded in 1980, inheriting the structure of Latin American Association for Free Trade (*Asociación Latinoamericana de Libre Comercio – ALALC*), founded in 1960 (Montevideo Agreement) with the aim to make the whole Latin American region into a common market. At the beginning, ALALC gathered ten South American countries (Argentina, Bolivia, Brazil, Chile, Columbia, Ecuador, Paraguay, Peru, Uruguay and Venezuela) and Mexico.

was held in July 1991. It was then decided not only for Panama to join the sub-regional integration structures,²² but also to reactivate the work of Organization of Central American States (Organización de Estados Centroamericanos – ODECA), established in 1951 (Charter of ODECA founding). The founding of Common Council (Consejo Comunitario) successfully initiated the coordination in the agricultural field in the form of adopting common policy for that sector. In short, there was a powerful shift in this part of Latin America by adoption of specific measures in the fields of political and economic cooperation and integration in general. It can be explained, first, by the existence of a high degree of interdependence in Central America, additionally promoted within the framework of political coordination process and above all successful process of pacification of this region.²³

In comparison with the development of the Andean Pact (Bolivia, Columbia, Ecuador, Peru and Venezuela), the group which showed the best results in 1970s regarding the aims of economic and political harmonization and integration in the Andes,²⁴ it can be noted that the member-countries at the beginning of 1990s did not spare pains after the crisis and stagnation of the previous decade to revitalize and innovate integration mechanisms in that sub-region. Namely, in December 1990, at the meeting of the presidents of the Andean countries (La Paz, Bolivia), it was decided to start establishing free trade area as the first prerequisite for formation of the Common Andean Market and developing of the group (1996) into the Andean Community of Nations (*Comunidad Andina de Naciones – CAN*).

On the other hand, an example of the Andean Pact shows in the best manner to what extent the cooperation and integration flows in Latin America are intertwined. We would also remark that this phenomenon, if there was not a flexible harmonization, would result in stagnation and the emergence of new bilateral, trilateral and multilateral priorities.

While Bolivia keeps turning progressively towards *Mercosur* market and expresses willingness to become a full member of this group, Columbia and

²² Central American common market (Mercado Común Centroamericano – MCCA) is considered the most successful and the most agile integration model in Latin America. The historical heritage is very influential on this phenomenon, considering that five countries of this sub-region was in con-federal relation from acquiring independence 1823) to 1838. General agreement on central American economic integration was signed in 1960.

²³ Alberto Van Klaveren: op. cit. p. 9

²⁴ The states of the Andean Pact founded as far back as 1979 the Council of Ministers of Foreign Affairs (Consejo de Ministros de Relaciones Exteriores) with the aim to define and coordinate joint activities in the field of foreign policy group. Essentially, it can be said that the Andean Pact from the very beginning of its activities insisted that the process of economic integration was inseparable from political cooperation, in other words on précising the common foreign policy platforms. For more details about the Andean Pact see: Slobodan S. Pajovic: *Concertación Política Regional en América Latina: El Caso del Grupo de Río*, Ed. Instituto de Política y Economía Internacional, Belgrado, 1996, p. 66-68

Venezuela founded together with Mexico the so-called “Group of three”, as a higher instance for the mutual political, economic and trading cooperation. This group took a very active role in the cooperation with the Central American and Caribbean region, offering agreements on free trade. As for Peru, it can also be noted that commitment for the integration with *Mercosur* is strengthening, but also with the Pacific region. It should also be pointed out that Columbia and Venezuela, the two most important and most developed countries of the CAN, concluded the agreement on free trade.

To put it briefly, in Latin American practice all these development tendencies and changes of regional cooperation and integration were followed and innovated by signing of very important bilateral agreements. In addition to those already mentioned, special importance is given to the Agreement on economic complementation, signed by Mexico and Chile in September 1991. In practice, this Agreement leads towards establishing of free trade area between these two countries, while it should be noted that Chile concluded the same trading agreements with Venezuela and Columbia, but also successfully completed the negotiations concerning joining the NAFTA. Also in January 1991, Mexico signed the Agreement with the states of Central America (*Tuxtla Gutiérrez Agreement*) on the establishing of free trade area. The same agreement was concluded between Venezuela and Central America.

To sum up the results of this new stage of economic integration process in Latin America in the course of 1990s, we can say that it developed and diversified largely. Within this framework, it was possible to identify numerous multilateral, trilateral and bilateral forms of institutional and formal connections. The existence and functioning of various mechanisms of connection and cooperation in that region could also be determined. The complexity of these cooperation trends shows that it is very difficult to envisage the promotion of some of integration models in the region, such as ALADI or SELA (Latin American economic system – *Sistema Económico Latinoamericano*). This is primarily because of the differences in the degree of economic development and the promptness or thoroughness in implementation of economic and political reforms and adjustments to the requirements of global world economy.

It is very important for Serbia and Montenegro and its strategy of getting closer to Latin America to identify successfully the factors that led up to fragmentation of Latin American integration process. This is, first of all, an attempt of the countries with approximate degree of economic and political development to integrate as soon as possible and to create economic and trading unions that correspond fully to their potentials and priorities. Accordingly, great possibilities open to Serbia and Montenegro to initiate and develop economic cooperation with small groups or bilaterally with those states in the region that take part in several integration arrangements. Here we think primarily of Mexico, Argentina, Brazil, Chile, Peru, and in the near future, Columbia and Venezuela.

At the end of this review, it is necessary to point out once again that despite intensive adjustments in the sphere of economic cooperation and integration in Latin American region, the process of political cooperation and gathering strengthens parallel to that, as was already mentioned. The special importance at that is given to the founding of the Rio Group (*Grupo de Río*), which in less than twenty years grew into one of the most important political authorities in Latin America and, at the same time, the successful regional representative and collocutor with other groups in the world. It is important from the Balkan perspective to observe the fact that the Rio Group established regular and very fruitful political dialogue with the European Union and other important factors of the contemporary world. In brief, this mechanism of political cooperation has direct influence on stabilization of political and security circumstances in the region, but also the great influence on the economic development of Latin America. It can openly be said that the establishing of regular political dialogue between the Rio Group and the European Union contributed to the intensifying of the relations between Brussels and countries of Latin America. This, among other things, reflects in signing of the agreement on the establishing of free trading area with Mexico and Chile, as well as the negotiations with *Mercosur*. The European Union also maintains very intensive cooperation with the countries of Central American region.

At the initiative of the Ministers of Foreign Affairs of the Rio Group, a meeting at the ministerial level with the former socialist countries of Eastern Europe was held in Budapest on April 12, 1990. The then SFRY did not take part in this meeting. That was an attempt to intensify the relations with this part of Europe, i.e. to establish certain institutional framework for the future cooperation. After this meeting, there was a progressive stagnation and reduction in the relations between the countries of Latin America and the countries of Eastern Europe.

It would be wise to consider from the perspective of Serbia and Montenegro, but also from a wider Balkan perspective, the scope and aims of the newly established Iberian-American Community of Nations (*Comunidad Iberoamericana de Naciones*). It was established at the initiative of Spain, which after the break up of the SFRY considerably strengthened its presence and protagonist role in the countries of former Yugoslavia, including the present state union of Serbia and Montenegro.

Spain started to work out this initiative with the aim to celebrate appropriately together with the countries of Latin America (its former colonies) 500 years from the discovery of America or the “encounter of the two worlds”, as this historical event is called by Latin Americans. The first top level meeting of the newly established group was held in Mexico, in Guadalajara, on July 18- 19, 1991, with the participation of all Latin American countries as well as Spain and Portugal.²⁵ In

this way, another forum has been established in rich Latin American practice, but turned towards the implementation of a completely new model of interregional cooperation and communication. Essentially, Iberian-American Community of Nations represents a framework for political dialogue of 21 Iberian-American countries and initiation of various forms of cooperation at Spain-Portugal-Latin America relation, which in many ways resembles the OESC thanks to the efforts by the Spanish diplomacy. Although it is of a very flexible structure having low institutionalization and bureaucracy, this process has successfully consolidated so far. This is primarily because of immortality of historical and philosophical importance of universal values included in the notion of Hispanic and Iberian-American civilization, which strongly support and inspire it. The fact that all countries, especially Spain,²⁶ made considerable efforts in creating the attractive image of the community, diffusion and introduction with the essence and aims of cooperation in all its forms shows that this is true. A special impulse was given to the development of economic, social, cultural and educational cooperation.

Regardless of the achieved and positively evaluated initial results, the Spanish-Mexican initiative that grew into a specific inter-regional model of cooperation faces with certain doubts regarding its future development and scope. We can say that the future of Iberian-American Community of Nations will depend primarily on the strengthening of its institutional framework. Urgent measures have already been taken to that effect in order to precise the mandate and jurisdiction of community's institutions, especially of the permanent Secretariat with its headquarters in Madrid, which took over the functions of contemporary Secretariat (*Secretaría Pro-Tempore*). It is important to point out that the group has a permanent Secretary and aims to get the functionality and efficiency to the higher level.²⁷

²⁵ Thirteen meetings at the summit have been held by the Iberian-American Community of Nations. After Guadalajara, the meetings were held in the following order: Madrid (1992); Salvador – Brazil (1993); Kartahena de Indijas – Columbia (1994); San Karlos De Bariloche – Argentina (1995); Santiago de Chile – Chile (1996); Isla de Margarita – Venezuela (1997); Oporto – Portugalia (1998); Havana – Cuba (1999); Ciudad de Panama – Panama (2000); Lima – Peru (2001); Bavaro – The Dominican Republic (2002) and Santa Cruz de la Sierra – Bolivia (2003). Nest meeting will be held in San Hose – Costa Rica in November 2004.

²⁶ According to UNCTAD data from 1999, Spain was the sixth country in the world according to the scope of direct foreign investments (8 billion pesetas). In 2000, Spain invested to the amount of 10.5 billion pesetas, while it should be mentioned that half of this was invested in Latin America banking sector, transportation network, electric power industry and telecommunications. Spain was the biggest foreign investor in Latin America that year.

²⁷ During the several recent years all Iberian-American countries have been considering seriously, the results achieved so far. There are many approaches, praises, but also some serious criticisms of the over-dimensioned role of Spain in the activities of the community. About the scope, shortcomings and future of Iberian-American community of nations see: Celestino del Arenal: "El futuro de las cumbers iberoamericanas", in: *Meridiano CER*, no. 11, October, 1997.

3. Perspectives of relations between Serbia and Montenegro and Latin America

Mexican Professor Víctor L. Urquidi, PhD, is an internationally renowned economist and former president of the reputable scientific institution El Colegio de México, the International Economic Association (1980-1983) and member of many scientific institutions worldwide. In his work "New Economic Relations between Europe and Latin America" he says that former SFRY was the only socialist country that managed to establish and develop significantly (as distinguished from other socialist countries) trading cooperation and investments in that region, excluding naturally the special relations between Cuba and the former USSR.²⁸ This attitude of Professor Urquidi is quoted in order to prove that Serbia and Montenegro have positive historical heritage, as well as the comparative advantage in relation to other Balkan countries (including those that originated after their separation from the SFRY), which must be used to work out the platform to revitalize cooperation with this part of the world.

Regardless of the changed international constellation, including the changes at geo-political map of South-Slav region and those surrounding Serbia and Montenegro, we think that it is necessary to start defining priorities in the relations with Latin America with utmost pragmatism. All those possibilities offered by the heritage in the field of political and economic relations with that part of the world should also be taken into account.

Under the present conditions, this first means urgent and thorough reconsideration of Serbia and Montenegro interests in Latin America, or specifying the position and importance of Latin America within a redefined foreign-political platform of the newly established state union. Parallel to that, this requires identifying of new priorities with the special emphasis on economic cooperation. It is implied that we have to take into account new realities in Latin American practice. In other words, we have to accept that in addition to the government sector, private sector would also be a bearer of these two regions getting closer and of the cooperation between them. The private sector would soon take a lead considering that under the changed circumstances of development and business activities in Latin America this very sector became the most agile social and market factor (corporations, foundations, private financial institutions, specialized agencies, non-government organizations, universities, etc.).

According to our assessment, future relations between Serbia and Montenegro and the countries of Latin America must base on the following elements:

- Establishing or restoration of regular political dialogues with the most important countries in that region (Argentina, Brazil, Chile, Columbia,

²⁸ Víctor L. Urquidi: "Hacia una nueva relación económica entre Europa y América Latina", in: *Síntesis*, no. 4, January-April 1987.

Cuba, Mexico, Peru and Venezuela), considering the fact that in the course of Yugoslav crisis the official contacts stagnated or ceased. This measure would imply full normalization of diplomatic relations with the stated Latin American countries and not closing of our embassies, as was the case in Chile in 2002. This is now the most prosperous economy of the region with which our economy has a high degree of compatibility (copper, agriculture, biotechnology, investments). We would note here that in October 2003, the Ambassador of the Republic of Peru, Mr. Alan Wagner Tizón, officially visited Belgrade after seventeen years from the interruption of the political dialogue with that country. This was the first visit of a Latin American Minister of Foreign Affairs to Belgrade.

- Endeavours to present Belgrade to Latin America as an initiator and bearer of all initiatives and new forms of cooperation at bilateral plan and inter-regionally at the Balkans. Considering the fact that there is already a certain positive heritage regarding relations of Serbia and Montenegro and Latin American countries,²⁹ the degree of affinity and friendship, this comparative advantage in relation to other Balkan countries should be adequately exploited to initiate wider Balkan-Latin American inter-regional dialogue, which would primarily include the issues of economic development and the position of developing countries in the process of globalization of economic interests in the world. The future dialogue should also take into account and coordinate its goals with the new political and economic interests and priorities that appeared on both sides. In other words, this dialogue would fulfill the existing gap that is the main characteristic of the relations between the Balkan countries and Latin America. This would perhaps initiate one whole “paralyzed potential” of relations between Latin America and Europe out of the European Union.

²⁹ There is an example of Energoprojekt company, which is actively present in the Andean region for 33 years and has a regional headquarters in Lima (Peru). The reputation of this Yugoslav holding is great thanks to successful business activities realized in that part of the world and, especially, in the construction of many capital development projects, including a very complex irrigation system Chira-Piura. The first and second stage of the construction of this irrigation system was financially supported by Energoprojekt. It is also important to note that the first stage of Chira-Piura project started in 1971, after signing of the contract between Energoprojekt and the government of the Republic of Peru. The estimate is that total investment into that stage of the project reached 251 million Dollars with the equal participation of two parties. The following stages of this project were co-financed by the World Bank, Energoprojekt and the government of the Republic of Peru. It all shows the great advantage of our country in relation to other Balkan countries, since according to our research (Lima, July-September 1996), not one of the Balkan companies was significantly present in that part of Latin America. For further information on Chira-Piura Project and the presence of Yugoslav holding Energoprojekt in Peru, see: *Mil años atras*, Caretas, October 19, 1995.

- Urgent introduction of new forms of cooperation on bilateral and inter-regional plan. Clear priority should be given to the cooperation in the field of science and technology, taking into account the fact that the achievements of Serbia and Montenegro, but also of the Balkans, and the degree of development in these fields are still attractive enough and financially more accessible to some of Latin American countries. We would therefore suggest systematic exports of knowledge and technology, especially in the fields of construction, chemical and pharmaceutical industry and metallurgy. This would also include training of appropriate expert personnel capable to maintain and improve certain technological processes based on domestic scientific and technological knowledge and equipment. Agriculture and food production are the fields which have particularly good perspective regarding cooperation, and Serbia would have to use to the maximum extent its biotechnological potential and knowledge.
- Further intensifying and development of military cooperation, considering that there are good prerequisites for that and already established practice and channels of communication. The example of Peru shows that Yugoslav weapons have acquired great respect, as for its technical and technological quality so for its relatively easy handling or application in the army and high degree of adaptability to new geographical and climatic conditions. The renewal of cooperation in this area is considerably important for Serbia and Montenegro and its specified-purpose production, which fell into deep crisis. We think that the moment for revival of contacts in this field is extremely favourable. There are two reasons for this: first, there is a tendency of some countries in the region – primarily Peru, Columbia, Ecuador, Chile and Mexico – to diversify import of weapons and military equipment and lower the extent to which they depend on the USA or regional weapons exporters (Brazil and Argentina). Second, there are favourable conditions in Latin American economies that have recovered considerably.
- Reaffirmation of cultural, educational and scientific cooperation, as the most appropriate instrument for systematic approaching and better acquaintance between the countries of the Balkans and the countries of Latin America. The existence of huge cultural and ethnic wealth in both regions influences this segment of cooperation very favourably, but also the fact that there is great interest for Latin American civilization in Serbia and Montenegro. As for Belgrade, we would point out that it is necessary to start restoring all forms of cultural, educational and scientific cooperation, especially in the segment referring to reciprocal award of scholarships for post-graduate studies.

4. Instead of a conclusion: a few initial suggestions

The new strategy of development of Serbian-Montenegrin-Latin-American relations must benefit from all advantages of double communication channels: bilateral and multilateral.

In practice, this would mean that the strategy of Serbia and Montenegro towards that part of the world would rely upon the combination of individual and compatible regional Balkan interests. In addition to the existing bilateral cooperation, this would also open possibilities for Belgrade, to initiate contacts with one or several existing models of regional or sub-regional integration in Latin America (for instance with *Mercosur* countries, the Andean Pact, Central American common market or the Amazon Pact). This would promote the idea of establishing interregional cooperation between the Balkans and some of the stated groups.

There is also an outstanding question of the capability and readiness of political elite and diplomacy of Serbia and Montenegro to coordinate certain aims of the Balkan policy in an extremely pragmatic and professional manner with a new but still unformed Latin American political platform in those segments where there are certain parallel characteristics and correspondence of their own interests with the interests of some other Balkan states. Accordingly, after certain verifications, Belgrade would gradually introduce into its Balkan policy compatible inter-regional aims from its strategy towards Latin America. In this way, it would not only have the advantage over other Balkan countries to that effect, but also develop into the main collocutor of Latin America for this part of Europe outside the European Union. It would be wise to point out that Argentine Council for the International Relations (*Consejo Argentino para las Relaciones Internacionales – CARI*) together with Romanian Association for the International Law and International Relations (*ADIRI*) and the Ukrainian National Institute of Strategic Studies (*NISS*) organized two seminars – in 1996 and 1997 – on the subject of cooperation and connecting of *Mercosur* with the countries of the Black Sea region. In addition, we have to mention that in 2000, there was a conference in Sofia with the similar topic, but it was held at the initiative of Bulgarian Center for Development Studies (*CDS*), which tried to include the Balkan region into the relations of *Mercosur* with these parts of Europe.

Taking into consideration all the above stated elements, our conclusion is that this dialogue must promptly be initiated, promoted, but with efforts to develop it systematically and gradually in accordance with the degree of consolidation and development of economy of Serbia and Montenegro, as well the overall situation in the union.

In the first stage of development of this strategy, the emphasis would be on the intensive renewal of political cooperation since this form of communication

almost did not exist for the fifteen previous years. These obstacles should be overcome agilely and ambitiously, taking into account that there are still certain psychological barriers resulting from the current international position of Serbia and Montenegro. It all shows that Serbian-Montenegrin-Latin-American relations as well as Balkan-Latin American relations can transfer from the stage where they are not defined and certain into the stage of efficient, flexible and above all pragmatic redefining, which is at the same time the prerequisite to revive the mutually useful cooperation with that part of the world. The main challenge for the creators and protagonists of Serbian-Montenegrin foreign policy strategy is to coordinate individual interests towards Latin America with the existing regional Balkan interests and the strategy towards the Balkans. The degree of symbiosis and efficiency of this new Serbian-Montenegrin strategy would depend primarily on the readiness and capability to coordinate the internal potentials with the newly defined priorities in which, at least now, Latin America does not have an adequate position.

On the other hand, achieving a wider Balkan consensus regarding this issue would allow to articulate and strengthen the position of the Balkans in the international relations and further contribute to the affirmation of Serbia and Montenegro within the Balkan and wider European frameworks.

There is a strong and rather an emphasized pessimism in the new state union regarding the relations with Latin America resulting from primarily obsolescent traditional knowledge and approach that is clearly limited by outdated geographical criteria and the ignorance regarding the contemporary Latin American potentials. Despite this fact, we think that the situation now is much more favourable for appreciation and introduction of new contemporary criteria of cooperation with that part of the world. Namely, the process of political and economic reforms, which is in progress or is completed in both regions offers a number of topics of common interest (trade liberalization, establishing of free trade areas, market economy, etc.). It also offers an opportunity to exchange and consider the experiences or to formulate common interests towards some other region (for instance, towards the market of the former USSR, including the Black Sea region).

The policy of Belgrade towards Latin America must base on clear economic and political interests and projections. Looking into documentation of the achieved degree of cooperation in the past shows that the territory, economic capacities and potentials of today's Serbian-Montenegrin state union represented the nucleus of the relations of the former SFRY with these countries. In accordance with this, when developing strategy of the relations with Latin America, it must be taken into account that some important countries of that region, primarily Chile and Argentina would develop intensive relations with Croatia (thanks to a numerous emigration of Croats in them), regardless of the limited potential of this country. On the other hand, the emigration factor offers

a certain lead to our country comparing with other Balkan states, excluding Greece, which has a numerous and influential emigration in Argentina, Chile and Brazil.

Taking into account all stated elements of analysis, we would suggest the following priorities in the strategy of relations between Serbia and Montenegro and the countries of Latin America:

In accordance with the altered political and economic configuration of the Balkan, the promotion of free customs areas is suggested as well as the advantages offered by the Serbian-Montenegrin legislation that is particularly favourable for the investors from that region. Intensifying geo-strategic and infrastructure advantages of Serbia and Montenegro and free customs areas in its territory, Latin American countries would be given an extraordinary opportunity to establish their “central deposits”, which would facilitate considerably diversification of their export destinations in Southeast and East Europe. In addition, all potential Latin American partners should be introduced in detail with the advantages of possible joint approach to the former USSR market, where Serbia and Montenegro have good reputation and great experience. Using this comparative advantage, Belgrade³⁰ can attract Latin American capital – much faster than European or American – especially Chilean, Brazilian, Mexican, Argentine or Peruvian, considering the fact that such defined and export specialized production projects are very attractive for the manufacturers of these countries and compatible with their intention to be present at that market.³¹

At inter-regional plan, we should speak in favour of the idea of establishing of General Balkan Deposit in one of Latin American states. The intention would be to boost expansion of Serbia and Montenegro export and the export of those Balkan states that would support the strategy of connection and cooperation development with that region, and, of course, the leading role of Serbia and Montenegro in that process. Elaboration of a strategy to link Serbia and Montenegro with Latin America and all these ideas/suggestions require very careful and measured assessment based on extremely expert research and analysis. Within this context, perhaps it would be the simplest for the first stage of revitalization of our relations with that region to make a shift by making a decision on the urgent restoration of the most-favoured-nation clause. Parallel to that we should consider other preferences concerning various trading limits that

³⁰ Former SR Yugoslavia – now Serbia and Montenegro – is the only Balkan state having the concluded Agreement on free trade with the Russian Federation.

³¹ The author of this introductory study of the Sector for Latin America and Caribbean of Geoeconomic faculty of Megatrend University of Applied Sciences had an opportunity in 1997 to discuss this issue personally with the then Minister of Foreign Affairs of the Republic of Peru, Professor Francisco Tudel Van Brougel, PhD., and engineer Ricard Marquez, Vice-President of the Republic in charge of international economic relations. These discussions were held during the stay of Professor S. Pajović to Lima (June-September 1997).

are standing in the way of free trade area establishing (including border zone), customs unions, etc.

As for the cultural, educational and scientific cooperation, it would be very useful to suggest to our Latin American partners to open Latin American Information Center in Belgrade. A relevant Balkan information center in the capital of one of Latin American countries should also be founded, in the country that shows the greatest interest and is willing to be the main co-initiator of such a conceived strategy of relations between Serbia and Montenegro (the Balkans) and Latin America. In addition to cultural, scientific and educational promotion, this interdisciplinary concept of these centers would enable them to grow into the entities that would thoroughly support various forms of cooperation between Balkan countries and Latin American region.³²

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³² This idea was also verified during the author's stay in Lima (1997). Peruvian Ministry of Foreign Affairs expressed then considerable interest in strengthening of Peruvian-Yugoslav scientific cooperation within the establishing of direct communication between the Diplomatic Academy of Peru and the Institute for the International Politics and Economy from Belgrade. Unfortunately, these ideas have never been realized.

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FUNDAMENTAL AND TECHNICAL ANALYSES OF SHARE PRICES

Abstract: *Trading with shares under the developed market conditions is fun for some people, for some other it is a way to preserve the real value of their property, and for many it is a challenge to make big money fast and easy.*

The dreams of stock exchange alchemy are based on the development and improvement of special systems, which ultimately aim to come to the bottom of secrets of share prices and their changes. What are the chances to make that happen?

The chances are minimal according to the experiences acquired at the leading world stock exchanges in the past. The complexity of stock exchange activities, the number and unpredictability of factors on which the share prices depend and unexpected changes or stability do not offer much hope to those who know what will happen in the future. In such attempts, the chances are equal both for the stock exchange experts as for the complete amateurs.

Due to all this, if you cannot beat or deceive stock exchange market, then it is best to join it. This means to form a diversified portfolio of securities which would bring safe profit, a somewhat higher than the annual inflation with minimum risk.

Key words: *share price, efficient financial market, financial prediction.*

1. Introductory notes

In the countries with the developed market and long-lasting stock exchange tradition, trading with securities represents an attractive activity both for stock exchange experts and insufficiently instructed investors. To be more exact, a large number of small and big investors try to beat the market by predicting the future events. Stock exchange material is sold or bought based on the expected changes of prices. Various approaches are used at that: general indicators of economic development are analyzed or various patterns applied. The aim in both cases is the same: to sell when the price is at the top and to buy when it is at the bottom.

The proponents of fundamental analysis study macroeconomic aggregates and based on the existing conditions and expected changes they reach the con-

clusions about the prices in the future. Such an approach is based on the real economic categories and rational elements of conclusion.

Technical analysis acquires the increasing popularity of wide public. The reasons are seemingly quite persuasive: based on the prices of securities in the past, the attitude on future tendencies is formulated. Such an approach does not insist on scientific basis of the method applied, but emphasizes its applicability in practice. This is how various forms of statistics analyses used by stock exchange experts have been developed.

Can the market be beaten using fundamental or technical analysis? Alternatively, has the alchemy of stock exchange prices been discovered?

The knowledge of this kind is particularly interesting for the countries that intend to establish market economy and stock exchange transactions. Periodical disturbances at financial markets re-inspire the thoughts of possibilities to predict sudden changes the prices of securities, especially of ordinary shares. The crisis of South Asian market, dramatic changes in Russia and intensive changes at the American stock exchanges actuate the ideas on the creation of analytical models that would offer successful prediction of the future events.

What do the prices of securities depend on? Is it possible to establish the degree and direction of price changes at stock exchange? Can the price changes be controlled? These are only some of the questions asked by all those who intend to invest in the financial market.

The problems related to investment and trade with securities are so numerous and complex that they require more space. Regardless of the degree of intensity and the type of analysis, the meaning of the research is the same - how to make the maximum position in the financial market and make the highest profit within the shortest time?

Skilled analysts can be very persuasive and their predictions are often used to formulate strategy of investors, especially when dealing with huge investments. The principles of fundamental or technical analysis are used at that, sometimes even various combinations of these polarized approaches. What are the realistic prospects for the expectations of analysts to realize might be clearer after we are acquainted with the text that follows.

2. Market efficiency theory

As far as financial markets are concerned, the *efficiency* has a different meaning than in other fields of economics. *Efficiency of financial market means that the prices of financial instruments reflect minimum of all information that are publicly available, and probably of all information that the best analysts can uncover.*¹ The *efficiency* here does not mean that the resources give maximum production

¹ Richard J. Teweles, Edward S. Bradley, Ted Teweles: *The Stock Market*, p. 443

results but it means *fast adoption of information*. Efficiency of financial markets can be expressed by a simpler formulation in the following way: a market cannot be deceived.

The efficient market has a large number of successful and especially well informed participants who tend to maximize income. Namely, it is considered that the majority of actors in financial markets have the majority of relevant information, but their success in business operations is different. Is the better success in making financial decisions the result of well-considered business policy based on the knowledge of market circumstances, or is it the result of coincidence and hazardous behaviour?

There is not one answer to this question. Many papers and analyses carried out under various conditions emphasize the numerous advantages of well-informed participants who make decisions on financial investments. However, the number of participants that can influence the profitability of investment decision is so large that it is difficult to assume that they can be fully included and exactly valued. In spite of unimagined development of information systems, it is not always certain that all the factors, which might influence the ultimate effect of buying shares, bonds, foreign currencies, futures or options, may be predicted. Various successfulness of investors cast doubts about the thesis on the efficiency of financial market so that it could be subjected to critical examination, even disputed.

The study of Alfred Cowles researched to what extent various brokers were successful; the criterion was an annual return in relation to the total invested amount. Cowles determined that the shares chosen by brokers on an average were not successful more than the randomly chosen portfolio of shares.²

This discovery served as the basis to formulate the Darts Theory: you can throw a dart at Wall Street Journal, as one of the ways to choose shares, or buy a small amount of all respective shares in the market. The ultimate effect would not be a bit worse than if you listened to your broker's advice when choosing, only in the latter case, you would have to pay brokerage, and the result is still the same!³

The proponents of the approach according to which the financial market functions efficiently emphasize that many important factors, which influence the successfulness of financial investment, may change, some of them cannot even be predicted, but the prices may always be expected to adjust fast to new circumstances. In this way, there is no doubt about the main thesis on efficient functioning of financial market; mathematical interpretation of efficient conduct can even be deduced, known as "random trend". Random trend does not mean that the prices cannot be changed, but it emphasizes that the successive

² Richard J. Teweles, Edward S. Bradley, Ted Teweles: *The Stock Market*, p. 444

³ Richard J. Teweles, Edward S. Bradley: *The Stock Market*, p. 433

changes of prices are independent and determined by the factors that influence the future unpredictably.⁴

The efficient market is the one where the participants understand all new information easily and include them in prices immediately. This is why the well-functioning financial markets exclude constant excessive profit.

It is hard to say that the theory of financial market efficiency is fully proved, but it is quite certain that there is not any persuasive evidence to prove the opposite opinion. It is easy to understand why such an attitude is not popular among stock actors. If the financial markets are efficient, the research aiming at predicting short-term price trends is extremely difficult at best. Such a research that is supposed to lead a large number of people to the significant profit can hardly be expected to be successful.

The analyses also confirmed the following paradox: the more research is done and the more fields are researched, there are new confirmations on the efficiency of financial markets. It is only the research that becomes less useful for business decision-making! All those who accept such an attitude are advised to diversify the portfolio of assets to the extent that the greatest risks referring to individual activities can be determined. Here we have to note that the risk of chosen forms of investment of financial assets must be acceptably low, and the opportunity to earn must be sufficiently attractive to keep the sustainable interest of potential investors. The portfolio is necessary only to clearly differentiate the degree of risk that the transactor is ready to accept, which provides him a good view of the possibilities and successful selection among the offered alternatives.⁵

Such an approach accepted by many buyers of securities understandably does not provide big profit. Many of them are therefore unwilling to accept the hypothesis of the efficient market and its mathematical model (random trend), regardless of the fact that a number of buyers has good information on all-important aspects of the intended assets investment. Theoretical analyses and more importantly practical experience confirm that keeping of diversified portfolio is the best protection for the investors in the financial market. Of course, those who think that there is a way to see through an eternal mystery of stock exchange success point out that such knowledge is never revealed to others, since the secret of success would be passed on a large number of people who would use this method and devalue its successfulness.

Trained analysts and self-taught stockbrokers agree on one thing: the concept of the efficient financial market is inconvenient. If all or the majority of important information is transferred to prices, the stock exchange experts are expected to know something more about the final effects of the changes that occurred before others. However, there are always those who have similar knowledge, and

⁴ Burton G. Malkiel: *A Random Walk Down Wall Street*, p. 24

⁵ P. L. Bernstein: *Capital Ideas*, p. 43

there are those who look after others or follow their own instincts when taking the same steps as well as the top experts of stock exchange activities.⁶

It is in the human nature to seek for the ways and manners to make more money easily and within a short time. Such a driving mechanism stimulates many people to develop stock exchange systems that would bring them a fortune. The fact is that there are people such as stock exchange business experts and experts in business arbitration who make big profits. They make profit more thanks to the advantages of the position they hold and the capital they have available than thanks to extraordinary assessments of the market. The important part of their income may be the result of lower costs or other financial benefits by the brokers, which is not available to smaller traders who are not so well connected.

In the analysis of stock exchange business activities, it is the hardest to understand numerous factors that influence the prices. It is not easy to understand how and why the prices change and there are not reliable rules, which would provide for the fast and safe earnings in the market. The price trends are, however, often more important for the possible investor than the trend of dividends.

There are various factors influencing the stock market prices. The first group of factors includes the conditions outside the financial market, such as: technical innovations, new raw materials, change of company's status, state of current economic developments, political changes... These factors represent important reasons for long-term price changes.

The second group of price factors includes the conditions acting inside the financial market and has short-term influence on the prices, such as the changes of interest rates, disturbances at other markets, expected changes of prices in the future, psychological factors...

Sometimes both groups act simultaneously and in the same direction, and sometimes in extremely divergent fashion. The following is always certain: the degree of influence of both groups of factors on the stock material is uneven.

The efficient market theory explains in a rational manner practical situations and real possibilities to make profit at the financial market. This theory provides the model for analysis of price trends at organized markets. According to this approach, the price trend is capricious – like a random walk, because all that can be predicted is already incorporated in the price at an efficient market. The appearance of new information is the element influencing the price change, in that such information must be unpredictable or it would have otherwise already been incorporated and it would not be real news. Accordingly, the prices respond to surprises only, in other words to unpredictable circumstances. Since the market responds to such unpredictable events, the share prices trend is capricious, like a random walk.⁷

⁶ Burton G. Malkiel: *A Random Walk Down Wall Street*, p. 25

⁷ Burton G. Malkiel: *A Random Walk Down Wall Street*, p. 24

There are several remarks that may be directed at the efficient market theory:

- a) If everyone would accept the logic of efficient market, the need to process information quickly would cease. In other words, if everyone assumes that share prices are determined correctly, would the prices no longer be precise?
The question is, naturally, more theoretical. The moment the majority of people would stop predicting, the market would stop being efficient. Then the profit would be made based on old information, and the efficient market would become a stable condition – the condition that controls balance by itself.
- b) There are brokers who are quicker or more intuitive than others are. Would they make the same profit as others because of the efficient financial market? The answer is no. Namely, the competence influences the efficiency to be checked and balanced, but the efficient market theory implies that only a small number of people, as in any other activity, would have the privilege of earning much more than the others.
- c) It is appropriate to ask the question: Are the sudden changes of share prices the result of new information? Trying to find the answer to this question, James Tobin analyzed the sudden drop of prices at stock exchange from October 15 to October 19, 1987, and concluded the following: “There are not any visible factors that could lead to 30% difference in share price in the course of these four days.” The proponents of the efficient market did not have an adequate answer.⁸

The efficient market theory is applied to individual shares and not to the whole market. However, there are reasons to believe that speculative markets can create waves of pessimism or optimism without any strong economic impulses that would direct such trends towards the postulates of the efficient market in a short time.

The proponents of technical analysis often use the concept of the efficient market and deduce general conclusions based on individual and special cases. Sometimes they achieve excellent results in predicting future events at stock market and then they emphasize the appropriateness of the chosen approach that helps them predict the future. However, the prices do not respond very often in the way the analysts expect them to and they then have a universal answer: the market is unpredictable.

⁸ Richard J. Teweles, Edward S. Bradley: *The Stock Market*, p. 445

3. Fundamental analysis

Various theoretical approaches to share prices and factors they depend on can be found in financial literature. Fundamental analysis is an attempt to explain the price changes at financial markets under the influence of factors coming from economic and political surroundings. Depending on the initial impulse that is considered the driver of price mechanism, the explanations pretending to be generally valid are formulated. All theoretical concepts that belong to fundamental analysis, regardless of certain differences in approach, may be ranked into two main directions.

3.1. Classical theory of share prices

Classical⁹ theory that explains the share price trends has existed long since. To be brief, this theory could be expressed in the following way: the most important reason for share price changes is the prediction of stock profits. It is assumed that the profits make the most important or key factor in determination of stock exchange prices. The potential investors therefore must estimate correctly all changes of fundamental conditions, since they influence the future profit. This is why there is a belief that brokers and investors “decrease” both the sales and profit when buying and selling before the changes occur under the influence of fundamental conditions. Waiting for the actual changes in profit to happen is too slow for achieving maximum profit.

The proponents of this theory claim that share price is the current value of all expected dividends in the future. However, they are aware that dividends may result only from profit. The changes of profit will change the perspective of dividends and thus justifiably influence the share prices. Any indication of change in profit of a certain company, industry or the whole economy will influence the share prices, which would usually move before there were actual changes in profits and dividends.

This is a classical theory or the explanation on share trends. Naturally, there are exceptions, but the share prices would mostly change before all changes in business operations and before the changes in possibilities for making profit. This theory considers the momentary dividends to be an important factor in determining share prices, but still attaches them second-rate importance in relation to the expected change of profit in the future.

In short, any condition or situation that indicates the change in profit of a certain company or specific industry, or many companies or whole economy, will influence the share prices, which would change before those expected changes in profits and dividends happen.

⁹ It is also called fundamental, orthodox and conventional theory.

3.2. Confidence theory

Confidence theory as a theory of share price trend is less formal if compared with the conventional theory. It can rarely be found in standard stock market literature, although there are many people who think that this theory deserves at least the same attention as the classical theory of share price trends.¹⁰ From the point of view of many trends characteristic for contemporary stock market flows, it would be good to give it precedence as dominant interpretation of stock market price trends.

Confidence theory could be formulated in the following manner: the main factor in share price trends is the increase or decrease of confidence between the traders and investors in the future trend of share prices, profits and dividends.

At first sight, this theory may seem as a variation of the classical theory that prices depend on profits. Actually, the essential difference between these two approaches is that confidence theory explains the share prices based on marketing psychology more than based on statistical data. Its advantage is in that it can be used to explain numerous machinations of price trends at stock market, which are not explained by the conventional theory.

Confidence theory does not accept precise principles of conventional theory. This theory starts from the understanding that fundamental conditions are cold, objective facts referring to profit, dividends, level of interest rates, changes of prices, production, sales, gross national product, political conditions... The theory does not base on the premise that the decisions on buying and selling of shares are made based on well-elaborated rules and standards, such as the rule that shares should not be sold in accordance with the determined price-profit relation, or that the shares should yield income higher than those of bonds should. Based on such simple and practically verified principles, both a well-informed statistician having valid information and investment experts might predict market events easily and with high degree of certainty.

The conventional theory of share prices starts from the assumption that when fundamental conditions are favourable the share prices follow upwards trend in accordance with the changes of profit and dividends. If the conditions would become unfavourable, the share prices would follow downwards trend in accordance with the change of relevant profits and dividends. According to such a simplified, even mechanical understanding of price changes at share market, the proponents of confidence theory do not have a positive attitude. They believe that market does not respond to statistical and economic data with great accuracy and that market is unbelievably indifferent to both good and bad changes. They are aware that the level of relations at stock markets, such as the relation of prices, profits and dividends is constantly changing: sometimes this relation is extremely high, sometimes very low, but it is rarely a static category.

¹⁰ Richard J. Teweles, Edward S. Bradley, Ted Teweles: *The Stock Market*, p. 374

Finally, they are very well aware of the imperishable topicality of axiom that says: "Market can do anything."¹¹

Based on the confidence theory, if a sufficient number of traders and investors are optimistic regarding the fundamental conditions or concerning the future of an individual company, they will decide to buy shares. If they become too optimistic, they will keep buying shares until the prices reach the level, which does not guarantee the favourable relation between prices, profits and dividends.

In an opposite situation, when the traders and investors are pessimistic regarding the perspective of a certain company, they will sell shares regardless of the level of fundamental indicators of that company. If they become too pessimistic, they will sell shares even at very low prices until their level drops under the real value measured by normal standards.

Therefore, according to the confidence theory, share buyers and sellers are extremists whose disposition ranges from utmost optimism to over-exaggerated pessimism; they often make mistakes, but they never doubt that their decisions were correct.

The confidence theory may be used to explain many machinations in the market such as rising or lowering of share prices, the appearance of which cannot be explained by the classic theory. It can explain speculations in the market under the conditions of very unfavourable economic surrounding, as well as the drop of share prices at times when salaries rise.

There are many examples that can be given to illustrate the changeability of the confidence theory when interpreting stock exchange flows in situations when the classic theory cannot offer a rational explanation. One of such situations happened at the American stock exchanges in 1946. At that time, all-important economic parameters were very favourable: gross national product was increasing, price control was abolished, the prices were stable, dividends of corporations were also rising, and profits were relatively high. Then there was a wave of pessimism and doubts grew stronger: after a powerful prosperity, the crisis was expected as it used to happen in the past. The shares were sold at increasingly low prices, and the market bankrupted in August and September of the same year.

Many recent experiences persuasively confirm the basic postulates of the confidence theory. This especially refers to the events at the American stock exchanges from 1985 to 1986 and in 1991. In both cases, the situation was almost the same: the interest rates were high, which reflected unfavourably on economic activities, and attracted the investors to invest their capital in banks and not in shares. Foreign competence was fierce. Dollar was too strong, which contributed to the creation of a record-high trade deficit. Budget deficit was chronically high. Unemployment was becoming alarming and big companies

¹¹ Richard J. Teweles, Edward S. Bradley, Ted Teweles: *The Stock Market*, p. 378

recorded huge losses. Nevertheless, the share prices in both cases kept rising dizzily.

These examples only confirm that it is extremely difficult, sometimes even impossible to predict the course of stock exchange events, especially the share price trend. Uncertainty concerning the direction and intensity of share price changes is increased by the difficulties regarding measuring the public confidence in the market. Many sellers and buyers of shares who deal with technical aspects of share market functioning try to measure the confidence of shareholders using various methods, but often obtain the results that are far from the actual disposition of the public. This is why many investors still trust the classical theory more. Its obvious exactness and unlimited statistic material give it persuasive dose of realism and act convincingly to a large number of investors. However, the followers of classic theory are often perplexed and astonished because their precise calculations do not bring the expected results that they predicted with so much confidence.

3.3. Technical analysis

The proponents of fundamental analysis of the prices of securities focus their interest on the influences of economic and political surroundings, while technical analysts think that the prices change under the decisive influence of changes in the market itself. Technical analysis bases on the assumption that all information from the previous period relevant for the conduct of participants can be used now and in the future, or that the conclusions regarding the future conduct of participants in the market may be drawn from their conduct in the past. Therefore, based on the valid technical analysis, which would include previous period it is possible to come to reliable conclusions regarding price trends at financial markets in the future.¹²

3.4. Basic premises of technical analysis

Although those considering themselves fundamentalists often use technical analysis as an attempt to elaborate perfectly timely coordination of buying and selling at the stock market, technical approach is primarily used by those who are interested in the interpretation of share price trends within short periods (one to three months). One of the ways of trading that offers frequently illusory and uncertain hope that a high profit would be earned in short period is the investment in ordinary shares using various methods of technical analysis that are used today.

¹² One of the most profitable professions in the USA during the last decade was the profession of economic physicist – this is an expert who predicts movement of share prices using various methods of technical analysis and who earns profit on the expected differences in prices.

There are three premises on which technical analysis bases:

- Market reduces everything to the right measure.
- The prices follow trends.
- The history repeats.¹³

The claim that “market activities reduce everything to the right measure” is probably the corner stone of the technical analysis. If we do not fully understand and accept the meaning of this postulation, the rest that follows makes no sense. The technicians believe that anything of possible influence on the market price of the commodity futures contracts – fundamentally, politically, psychologically or otherwise – reflects really on the price of that commodity. It can be deduced that the study of price trends is the only thing required. The conclusions regarding the current prices and the future prices are made based on the trends from the past.

All that a technician really claims is that price activities should reflect on supply and demand trends. If demand exceeds supply, the prices should rise. If supply exceeds demand, the prices should fall. This interaction is the basis of all economic and fundamental prognoses. The technician then reverses this claim in order to conclude that if the prices rise due to any special reason, the demand must be higher than supply and the fundamental laws must be such to take into consideration the rise of prices. If the prices fall, the fundamental laws must be such as to include the fall of prices. If this last remark on fundamental laws is surprising to you, you should not be surprised. After all, the technician indirectly studies these fundamental laws. The majority of technicians would probably agree that these powers lying in the basis of demand and supply - fundamental economic laws of market behaviour – are what causes the prices to rise or fall in the markets. Price trend charts are not the cause of market downturn or upturn. They simply reflect the psychology of the market that stimulates the prices to rise or fall.¹⁴

As a rule, those who make the price charts do not spare efforts on the reasons that make the prices rise or fall. Very often at the very beginning of a price trend or at critical turning points it seems that nobody knows exactly why the market behaves in such a manner.

While technical approach may sometimes look like an oversimplified approach according to its requirements, the logic behind the first postulation – that market reduces everything to the right measure – becomes increasingly necessary as an individual gets more experienced at the market.

The technicians conclude that if everything reflects on the market price, then it is necessary to study only that market price. By studying price charts and many other additional technical indicators, a chart-maker essentially lets the market tell him what the most probable way to take is. The chart-maker does

¹³ William F. Eng: *The Technical Analysis of Stocks*, p. 29

¹⁴ *Bullish or bearish psychology.*

not attempt necessarily to outwit or predict the market too far forward. All technical accessories discussed later are simply the techniques used as assistance in the process of studying the market behaviour. The chart-maker knows that there are reasons for upward and downward market trends.

Undoubtedly, the trend concept has an essential importance for the technical analysis. Here, again, if we do not accept the postulation that markets actually make trends, there is no point to continue reading.

The only purpose of making futures market price charts is to identify trends at the initial stages of their development so that the trade would be done in the direction of these trends. In fact, most techniques used in this approach are the trend-following techniques, meaning that their premeditation is to identify and follow the existing trends.

There is an addition to the postulation that the prices follow trends: it is more probable for the trend in motion to continue than to reverse. This addition is the adjusted Newton's first law of motion. The other way to express this is that the trend would continue in the same direction until it reverses. This is another of these technical claims, which seems as clear as an axiom. However, the whole approach of trend following bases on the claim that the existing trend is not abandoned until it shows signs of reversing.

Much of the essence of technical analysis and study of market activities is related with the study of human psychology. Patterns at charts, for instance, that have been determined and categorized in the last hundred years, reflect certain images that appear on price charts. The images reveal the market psychology – bullish psychology (expecting the prices to rise) or bearish psychology (expecting the prices to fall). Since these patterns functioned successfully in the past, they are considered to continue functioning well in the future. They base on the study of human psychology, which tends not to change. Another way to express this last premise (that history repeats) is that the key to understand future is in the study of the past, or that the future is simply the repetition of the past.

3.5. *DOW theory*

In order to understand Dow Theory, it is necessary to remind in brief of the past events. Namely, on July 03, 1984, an article titled “One Hundred Extraordinary Deeds of Charles Dow” was published in Wall Street Journal. At the same time, Barron magazine, which belongs to the same publisher as the Journal, published the story “Investors Have Used Dow Theory for the Whole Century”. Both articles were published on the occasion of a centenary of the Charles Dow's first edition of statistical data at stock market, which was published on July 03, 1884.

The first analysis that Dow made included only 11 stocks, nine of which belonged to railway companies. Until 1887, the original index was divided into two parts: one contained 12 stocks of industrial companies, and the other con-

tained 20 stocks of railway companies. During 1928, industrial list was extended to 30 companies, and in 1929, the register of services was also included.¹⁵

DOW theory is topical even today and well accepted since the main ideas of technical analysis originate from it. It is considered the precursor of technical analysis. Even under the contemporary conditions of computer technology, along with the development of new and better technical indicators, Dow's ideas still have significant application. The majority of 'technicians' today probably are not aware to what extent their modern analytical devices depend on the principles set by Dow.

Basic principles of Dow theory may be expressed in the following manner:

Everything is based on estimation. Does it sound familiar? This is, of course, one of the basic premises of technical theory. Theory bases on the assumption that every possible factor concerning supply and demand must reflect on market estimations. These influences include also the influence of Force Major, such as earthquakes, floods and other natural disasters. Although the market laws cannot predict them, they are adopted quickly and reflect on price changes.

Market trends have three directions. Dow Theory on trends says that a progressive trend exists as long as each consecutive rise and fall was bigger than the previous one. In other words, progressive trend must have the pattern with minimum and maximum amplitude. A regressive trend would be contrary to negative minimum and maximum amplitudes.

Dow divided market trends into three different categories: primary, secondary and slight (insignificant).¹⁶ The main interest focuses on primary or major trend, which usually lasts for more than a year, often for several years. Dow was convinced that the majority of investors are interested in major trends primarily.

He compared primary trends with sea streams. A secondary or medium trend was compared with the waves made by the sea stream, while slight trends are similar to the murmur of waves. Using the sticks to measure the highest point on the beach reached by each consecutive wave, you can measure the direction of sea stream. If each consecutive wave moves further inland than the previous one, the stream would still exist. Only when the waves start retreating, an observer would know that the sea stream disappeared.

¹⁵ Unfortunately, Dow never wrote a book on his theory. He set forth his ideas on stock exchange trends in a feuilleton of Wall Street editorial at the end of the last century. Only after his death (in 1902) the feuilleton that Dow had published earlier was reprinted under the title "The ABC Stock Speculation". The reprint appeared in 1978, published by Fraser Publishing Company, Burlington. The term 'Dow Theory' was used in that work for the first time, and in the Preface to this edition, Richard Russell compared Dow's contribution to stock exchange theory with Freud's contribution to psychiatry.

¹⁶ Dow compared the three categories of market trends with sea stream, waves and murmur of the sea.

Secondary or medium trend represents a correction in primary trend and usually lasts from three weeks to three months. These medium corrections exceed again 1/3-2/3 of previous trend, and often amount to about 50%.

Slight or short-term trend lasts less than three weeks and represents a shorter period of fluctuation in the medium trend.

Major trends have three stages. Major trend usually occupies three stages. The first stage, or stage of accumulation, represents buying based on the wisest investors being well-informed, after all bad economic news were finally discarded by the market. Second stage, where the majority of followers of technical trends start to participate, happens when the prices start rising and business news are getting better. The third final stage is characterized by the increase of public participation, when the press starts publishing stories of the increase of stocks that keep coming in increasing numbers. Economic news is better than ever and the speculating space increases. During this last stage well informed investors, who started to “accumulate” at the lowest market price when nobody wanted to buy, now begin to “place” at the market when the other do not want to sell.

Estimates must confirm each other. In this part, Dow pointed to railway and industrial estimates. He thought that some insignificant signals of the market expecting the rise or fall of stock prices (bear or bull market) may be taken into account if both estimates send the same signal. In other words, both estimates must exceed the previous secondary minimum so that the market, expecting the stock prices to fall, could start. If only one estimate would signal, then there would not be this market. Signals need not appear at the same time, but it is better if they are close. If these estimates miss each other, a reliable conclusion is hard to get.

The scope must confirm the trend. Dow determines the meaning of the scope as secondary but important factor of confirming signals received from price chart. A simple formulation of the principle would be that “the scope should extend in the direction of the main trend.” If the major trend is upwards, the scope should extend as the prices rise. Otherwise, the scope should reduce as the prices fall.

The stated trends must be emphasized although the scope is just a secondary indicator. Real signals of buying and selling in Dow Theory are based on the closing prices.¹⁷

Trend is considered effective while it sends certain feedback signals. This principle makes the basis of the approach of trend monitoring and it is still used today. This is another way to explain how any actual trend tends to continue to last. Naturally, it is not always easy to determine the position of the feedback signal. The study of the level of support and the level of resistance, price patterns, trend lines and unstable predictions, is often used as technical device to show when

¹⁷ The prices reached at the time of closing of stock exchange.

the existing trends are entering the stage of change. The use of oscillators helps predict even the earlier warning signal of impulse decrease. The analysts favour in their predictions the continuance of trend mostly, and such logic helps the investor to be right more than to be wrong.

Dow relied exclusively on the closing prices. Therefore, the estimates had to be formulated beyond maximum or minimum. Daily exceeding was not of any great importance. The limits of estimates pointed to the trends moving horizontally, which could be seen on the charts. These scopes of side trends often take the correction stage and often look like integration, and they could be on peaks or on lower lines. Such patterns can be recognized as “rectangles”.

4. Financial predictions

A frequently asked question is the question concerning validity of using data on prices from the past in order to predict future. It is surprising how often the critics of the technical approach put this on the agenda, since each known method of prediction, from weather forecast to fundamental analysis, bases completely on the study of the data from the past. What other data are there to be used?

The technical analysis makes difference between descriptive and inductive statistics. Descriptive statistics refers to making of graphic data representation, such as the data on prices at standard column graph. Inductive statistics refers to generalization, prediction and extrapolation to which we come based on the conclusions from these data. According to that, the price charts belong to the descriptive statistics, while the analysis technicians process price data belonging to the realm of inductive statistics.

As one statistical text points out, “the first step in predicting business or economic future thus consists of gathering observations from the past.” The analysis by charts is nothing more than the analysis of time series. The only types of data with which everyone must continue to work are the data from the past. “Predictions of population, industry and similar are based largely on what happened in the past. In business as in science, as well as in everyday life, we project our experiences from the past trying to predict what might happen in the uncertain future.”¹⁸

Technical analysts conclude from this that using past data on prices to predict the future is based on healthy statistical concepts. If anyone doubts the validity of the stated attitude, he must at the same time examine any other form of prediction that is based on historical data, which includes the complete economic and fundamental analysis.

¹⁸ John J. Murphy: *Technical Analysis of the Futures Markets*, p. 399

Investment in and trading with stocks is much more complex than it might seem at first sight. The motives for investing capital into stocks are various: desire to keep the value, attempt to earn more profit than is the interest rate on savings deposit, hazardous motives or gambling at the stock market in search of quick and easy earnings...

The experiences of the developed well functioning financial markets show that too great expectations of those investing in stocks and expecting big profits in a short time are unrealistic. The theory of the efficient market has its best stronghold at stock markets, confirming that the financial markets exclude constant claim of above average profit.

The investors, who wish to achieve certain return of invested assets with the lowest risk and proper earnings, buy widely diversified portfolio of ordinary shares. The most secure protection of property is achieved in combination with diversified bonds and savings deposits, with the gain of several index points above inflation.

The choice and structure of portfolio of securities represents a great dilemma, as for the experts in stock exchange activities as for those appearing at financial markets for the first time. Regardless of the degree of knowledge of stock exchange transactions, portfolio structuring must be shaped based on the decision made by the investor. Such a conclusion is imposed because of many factors, which must be taken into account when the decision to buy securities is made, and anyone's help here is of very modest range.

The attempts to predict the stock price trends are most often unsuccessful. Regardless of many attempts to uncover the secret alchemy of stock market and to determine the degree and direction of stock price change without any risk, the prices remain beyond control. The analysis of stock exchange events from the past points to the instructional experience: the stock prices are unpredictable at least to the extent to which the factors influencing them are unpredictable. The number of these factors is large: company profit, dividend, price-earnings relation, interest rates, savings bonds premiums, general economic situation, individual economic indicators, and possibility of strikes...

According to the conventional approach, the most important factor of stock price change is prediction of stockholders' dividends. According to the confidence theory, the stock prices are decisively influenced by the raise or fall of confidence between traders and investors regarding the price trends in the future.

Based on these ruling concepts of fundamentalist explanation of stock prices, we might get an impression that it is easy to come to the bottom of a hidden world of stock price changes at stock exchanges. However, it is most frequently just an illusion. The experience shows that stock price trends are often quite contrary from the expectations, so that the investors' hopes remain unachieved. Further, it happened many times that the prices of individual companies have

quite a different logic of changes in relation to the general trend. In such situation, even a serious analyst becomes helpless to offer a satisfactory explanation.

Because of all these reasons, the advice of a great American financier Bernard Baruch might be precious, especially for those who expect quick and huge earnings from stock trading:

“If you are ready to renounce everything else in order to study the whole history and background of the stockmarket and all major companies having their stocks enlisted, so carefully as a medical student studying anatomy, if you can do all that and, in addition to this, you have good nerves of a great gambler, the sixth sense of a clairvoyant and the courage of a lion – you have a small chance.”

Much of what has been said in this paper is not very encouraging neither for the proponents of the technical analysis. Very disciplined and careful traders might be capable of achieving above average returns because of their skilled use of well-organized useful data. The insiders can also successfully operate based on their legal and useful knowledge. Some people might be specially gifted like those who are born as great musicians or painters. A technical analyst indisputably arranges and organizes data that might help investors make reasonable judgments of the market. However, organized data may serve well only to describe what the markets had done, not what they would do. If long-term successful prediction is really possible, the success is perhaps the result of investor's estimate and not of technical data, no matter how well they were organized.

The traders will keep attempting to make a fortune by identifying some illusionary device in order to accomplish returns above those that would be the result of simple possession of diversified portfolio. When so many people put their skills in this game to the test, it is certain that with a sufficient number of filters some devices would prove functional, at least for a short time, in spite of their lack of logical basis to do so. Many indicators were given trust due to the successful predictions of market growth. Serious market experts who use acknowledged statistical principles rather than selective observation, generally concluded that a century-long quest for a simple, easily achievable mechanical system of rules that would result in above average returns from stock market predictions (futures or options), is almost certainly doomed to failure.

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COMPETITIVE INTELLIGENCE

Abstract: *Competitive intelligence includes gathering, selection, processing and analysis of economic information about the market, competition, current economic development, consumers and competitive products. Based on these activities a company's strategy of performance and conduct in the market is prepared. The responsible conduct of modern management requires the decisions regarding business ventures to be made on the basis of studious analyses, after the data gathered by competitive intelligence either by their own specialized services or domestic or foreign specialized agencies have been processed. Each company having an ambition to conquer the market and remain at it should have a special, well-organized and equipped competitive intelligence service appropriate to its size. For small companies or firms that possess neither the financial or personnel potentials to organize permanent work of such a service, the only and necessary solution is to order precisely and intentionally such information in various stages of processing from specialized and equipped competitive intelligence agencies.*

Key words: *competitive intelligence, economic intelligence, economic knowledge, competitive struggle.*

1. Introduction

Debates on the subject of competitive intelligence rank high among modern economic theories of expansion and current development, or in other words modern economic diplomacy. There are many reasons for this. One of the key reasons is of course the knowledge that in the global world and economy of today everyone (either the company or country) who intends to try out at the world market and take one piece of it for himself must previously use all the advantages of modern organized competitive intelligence. Without that, they are doomed to great risks and probably failure. In modern time, competitive intelligence cannot be replaced with the so-called feeling for business, experience or capability for useful machinations. The examples I am to present confirm this most convincingly. When you are facing studious and analytical competitors who act based on the knowledge and conclusions of the whole teams of competitive intelligence agents and their performance strategy is also based on them,

“the nose for business” does not help, neither the business talent. If we do not have similar resources, potentials and instruments, we would better not engage in a risky undertaking to conquer market.

In order to define the term competitive intelligence, it is necessary to differentiate it from the term economic intelligence.

2. Defining the basic terms

Competitive intelligence (CI) is the recent term and can be defined in several ways. First, it can be defined as an obligatory part or prerequisite to performance strategy of a company or economy in the market. It is a complex activity on gathering, selection, processing and analysis of economic information concerning market, competition, current development and other conditions, consumers and competitive products, on the basis of which the performance strategy and conduct at the market is prepared. Competitive intelligence is a part of everyday economic competition of various subjects (companies, national economies, multinational concerns, economic integrations, etc.) at both domestic and world markets. For many analysts the key feature of competitive intelligence is that it functions based on strict ethical codes and standards, in other words that it uses legal devices for collecting and analyzing data and turning them into the *economic knowledge* of a company or country. These ethical standards are guaranteed by the domestic laws of each country or by strict standards of domestic or international associations of CI professionals (for instance, The American Society of Competitive Intelligence Professionals).

Based on many attempts to define competitive intelligence, we come to the definition that it is a set of techniques and methods for monitoring and analyzing competition in order to predict and hinder their future performance.

Jennifer Breshnan in her article published in CIO Enterprise Magazine (on July 15, 1998, p.4) gives her definition of CI, which says:

“CI is collecting and analyzing public information in order to obtain the picture of competition, clients, market or economic branch of a company. Unlike its dark sister – espionage, CI is completely legal and ethical skill.”

The above-mentioned Society for Competitive Intelligence Professionals (SCIP) offers their definition of CI:

“Competitive intelligence is a systematic and ethical program for gathering, analyzing, and managing external information that can affect your company’s plans, decisions, and operations. Put another way, CI is the process of enhancing marketplace competitiveness through a greater – yet unequivocally ethical – understanding of a firm’s competitors and the competitive environment.”
(*What is CI?* www.scip.org)

In any case, it must be concluded that competitive intelligence is unavoidable and irreplaceable device of everyday monitoring of market developments,

in other words elaboration or updating of company's or economy's strategy to appear and conquer domestic or foreign market, or to stay at it under the tough competitive conditions.

For the French authors Bernard Besson and Jean-Claude Possin, competitive intelligence is the means of anticipation, management of knowledge, but also management based on knowledge. According to them, its purpose is to reduce the uncertainty and to create vision in order to make decisions with as little risk as possible.

As opposed to the previous terms, economic intelligence is a complex set of aggressive activities directed *a priori* against competition with the purpose to force them out of the market or destroy them in the process of economic war at domestic and world market. Economic intelligence uses legal, but also illegal means to gather confidential economic information, as well as other methods to break business secrets, plans and strategies of competitors, presenting them negatively and purposely preventing their plans and activities. Economic intelligence is implicitly contrary to ethical norms and standards of business, fair competition and regular economic contest. Economic intelligence represents, therefore, means and methods of economic war making *par excellence*. In case of big national and multinational companies, these activities are carried out by specially trained and educated professionals. In the USA but also in other countries, they are carried out by national intelligence services and services collecting data by sophisticated devices and equipment (satellite systems, eavesdropping services, data gathered by intelligence network in the field) and these data are then made available to big companies and national economy in general. Small companies use for this purpose ordered and paid services of relevant agencies dealing professionally in economic and other intelligence activities (STRATFOR American agency, ECHELON Anglo-Saxon satellite system, American eavesdropping station "Big Ears" in south Bavaria, etc.).

Economic intelligence, as a rule, is a costly, complicated, well-organized activity, which must be technologically extremely sophisticated. It is necessary to underline therefore that it is better for the companies, even the national economies of small countries that are not ready, equipped and trained for it, not to engage in such activities than to risk and make an irreparable damage by their unskilled procedures. In competing with multinational companies and developed countries that have the afore-mentioned systems and devices, small companies and small countries are forced to use services of relevant agencies or national intelligence services, if the regulations of these countries allow it. Such activities require constant intelligence by teams of professionals (both in the country and abroad) who are equipped with the most up-to-date means of communication and eavesdropping and who have funds to use informers or "moles". It is not a secret that after the victorious ending of the Cold War and disappearance of bipolar world, the developed Western countries have put the

most important intelligence capacities (that were originally used for military purposes) into the service of their economies and transformed them partially into complex systems of economic intelligence. This especially refers to the USA, but also for other Western countries, (ECHELON satellite system was formed by the USA, Great Britain, Australia, Canada and New Zealand, for instance). Their concept is that diplomacy in general and economic diplomacy in particular, even economic intelligence, serve to protect economic interests of their companies at the world markets and not to state services that would supply their knowledge in small portions to relevant departments, which would then send them further to the important state companies, which is characteristic of European countries.

3. Basic hypotheses

The main hypothesis that I would try to confirm in this paper is the following: under the contemporary global business circumstances, it is impossible for a company or a country's economy to penetrate the world market and remain at it successfully without an efficient modern organized and equipped service of competitive intelligence.

A supporting hypothesis, which is supposed to clear all possible doubts regarding the afore-stated main hypothesis, is the following: competitive intelligence is not economic intelligence, so the possible objections of its being allegedly unethical are discarded.

Another supporting hypothesis, which should eliminate further doubts about the possibilities of the main hypothesis, is that concerning competitive intelligence, small and medium-size enterprises, or developing economies or countries may use high-quality services of the relevant specialized agencies, national or international. These agencies professionally deal with these services in various aspects and degrees of analysis, depending on the needs of the ordering party.

These hypotheses have the purpose to impose a new way of business thinking and acting of not only successful, big companies and economies that managed to penetrate and become established in the world market, but also for the companies and economies that intend to do so. This complex business undertaking is impossible without a constant and analytical use of the knowledge and information of competitive intelligence. Such a change of thinking and acting is not at all easy, especially in economies in transition and countries the economies of which need to come a long way of consolidation and recovery (such as the economy of Serbia and Montenegro), and then the required exchanges with the world without which there is not an economic and social progress.

4. Elaboration (Current condition)

The majority of companies in Serbia and Montenegro do not have specialized services that would deal with competitive intelligence, and quite a large number of them does not have an idea that there is a need to form such a service. In some of them, which had certain experience and success in foreign trade in the previous period, such activities have been given in charge of top management, or more often in charge of the director and his closest associates. The research showed that the managing structures of these enterprises trust the experience and business instinct of the foreign trade department managers, their being well informed or their knowledge acquired during their carrier or every day supervision and work. This certainly is not a good practice, and the results speak for themselves. After a long period of isolation and difficulties with which the economy of Serbia and Montenegro faced, some state or parastate mechanisms that could have helped were also dying gradually. The majority of branch offices of the Chamber of Commerce abroad were closed. Economic services in diplomatic and consular representations were reduced to minimum (one person or as the incident jobs of diplomats). Many companies have closed their own representative offices abroad because of rationalization, so that they deal with foreign companies only based on some scarce information, which they get directly from potential partners. They often find out about the competing companies or products only when they have already got involved into the risky business of penetrating the world market. This, of course, is neither wise nor economically justified and does not guarantee the successful positioning of the company in the world market. There are numbers of examples for this claim.

There is the example of the most recent unsuccessful and pompously announced business deal of Belgrade Company "Delta-Holding" with the French hypermarket chain Cora. Although extensive preparations were made to provide several locations and even first 700 people were hired for the big project, the project was abandoned in the end. This shows how not to run business with the world. The excuses such as the internal political instability, legal regulations being insufficiently elaborated and the uncertainty of foreign investors are quite understandable. However, without previous analytical research and conclusions, the risk is too big. Subsequent knowledge after the big project failed and the damage that such a failure is going to make when investors are concerned are too big a price for impoverished economies. For foreign companies that operate on the basis of competitive intelligence information, such information would have a deterring and wording off effect for a longer period and the economy of Serbia and Montenegro would suffer incalculable consequences in general.

Are we capable of learning from mistakes or do we need new business failures in order to turn to business dealing based on previous hard and studious gathering, selection, processing and analysis of data before getting involved into a big project? In this case, we have had an example of our big and successful

business holding, which obviously failed regarding competitive intelligence and suffered major damage because of it.

The enquiries also showed that the majority of companies do not have an adequate person in charge of competitive intelligence. They are not willing even to discuss it, erroneously believing that they were asked about the business secrets, known only to top management who are authorized to speak about them. The remnants of the traditional way of thinking according to which one person holds all the data on possible business deals and decides what is beneficial for the company and what is not, are obviously deeply rooted. There are not big 'Businessmen' any more, who can lead a company towards a colossal success based on their instinct. The time has passed when they were thought irreplaceable and that without them there was not a way to the world market. Responsible modern management requires the final decisions on business ventures to be made based on studious analyses, after processing of competitive intelligence data obtained by their own specialized services or domestic or foreign specialized agencies.

These things happen not only to companies in Serbia and Montenegro and there are the examples to support it. These are the examples of the gigantic companies, one with mostly state ownership, one multinational and one privately owned, but having global ambitions. The companies belong to two highly developed countries – the USA and France. The mistakes, which led these companies into huge difficulties, were the result in first case of the mistakes of government structures and mechanisms of management and control, in the second case of the mistakes of the top management, and in the third case of the omissions of the omnipotent and absolutistic company leader.

Let us start from the last case. The multinational company (of French origin) *Vivendi-Universal* has the ambitions to conquer the whole world. Their income far exceeds the gross national product of majority of developing countries. From their French beginnings – monopolistic exploitation of drinking, industrial and waste waters in the French largest cities (its mother companies are *Lyonaise des aux* and *Generale des aux*), this company developed into publishing, media and film giant with planetary ambitions under the firm leading hand of Jean Marie Messier. As a huge whale, *Vivendi* started to swallow first French, then multinational, and finally American media companies (publishing houses, newspapers, radio and TV station, film producing companies, games of chance centers, etc.). When it finally bought worldly famous old American production company *Universal*, and added its name to its own, the company became a true world multinational giant. Absolutistic leader Jean Marie Messier moved the headquarters of his new company and his family to the USA and gradually climbed up the list of the most powerful executives of the world today. The stock exchange experts and he himself almost forgot the basic activities of *Vivendi* – monopolistic charging of drinking, industrial and other water consumption in 60-million people France. Since he had come into possession of one of the

pillars of the third-rank industries in the USA and California, *Universal Studios*, Jean Marie Messier thought that he conquered a part of empire reaching to the farthest point of the planet. However, the bills for unrealistic ambitions and acquisitions and inadmissible bad managing of an economic giant by one man started coming. In spite of his business and managing genius, he obviously could not consider rationally overall economic trends and competition, so the result of these omissions was first stock exchange fall and collapse of the company, then bankruptcy and forced sales of certain branches with all the following consequences – firing of personnel, strikes, court orders. The sales were necessary in order to save the organism, wrong estimations and investments paid, as well as court orders and terminal pays for the fired staff. The court search for Jean Marie Messier followed in the country of his and company's origin – France. For the time being, *Vivendi-Universal* is still alive and capable of paying for the omissions of his founder and leader. However, for how long? It is obvious that competitive intelligence was not seriously used when getting involved in huge business deals in the course of very fast rise and fall of this multinational company.

The second example: Big American and multinational company for research, transport and exploitation of oil and gas *ENRON*, caused a world scandal in 2002, when it announced court order of bankruptcy. This shook the American and world stock exchanges, American state administration and auditing system that were nurtured for centuries, as well as the whole system of economic values of the Western liberal capitalism. The surprise was huge because the company presented its branched business activities as positive, with constant rise of income and investments, such as oil pipelines in Brazil and Turkey, while the auditing reports were falsified and company actually recorded big losses and debts to creditors. There were fierce reactions, hearings before the Congress and Senate Committees, determining mechanisms of deception, fraud, and claims by 178 big creditors for damages.

When the leading American telecommunication company *WORLDCOM* bankrupted according to the same scenario and system of illicit records machinations, and it was found out that media giant *AOL Time-Warner* conducted business irregularly, even President Bush had to make a public statement, demanding severe measures against the defrauders and stricter auditing procedure in order to avoid similar scandals in the future.

If the absolutistic director Jean Marie Messier was to be blamed for the *Vivendi-Universal's* agony, the whole collective management of *ENRON* American giant with world ambitions was to be blamed for the bankruptcy, since they consciously falsely presented its financial state and created false image of successfulness of this company which was actually in deep trouble. In addition to the damages for the employees, creditors and partners, this also represented a criminal offense of cheating stockholders and stockbrokers and endangering the whole system of stock market in practice. *ENRON's* management, naturally,

consciously and skillfully used legal loopholes regarding business auditing. By skillfully acting as brokers, the management invested, bought, entered into big expensive international projects and unsparingly spent the funds for covering business failures, representing these expenses as the rise of income and profit of the company by the skillful bookkeeping. It was unheard of! These moves of the mentioned companies were named corporate crimes and many charges were brought against them. Preventive regulations in general were improved. It is obvious that instead of using competitive intelligence before getting involved into risky undertakings, it was used to cover up failures and false representation of business results.

The third example is of a majority-held state company (it is one of the largest French and European banks – *Credit Lyonnais* – again from Lyonne) that crashed along with its collective management because of the weaknesses of its competitive intelligence.

It is a huge bank whose ambitions exceeded state borders long ago. In the last ten years, the bank covered an arduous path and when the management changed, it seemed that it stepped onto the green branch. Since it was a pet of French government like all state institutions, before reconstruction the bank used to spend unsparingly on representation, marketing and on enormous and increasingly large sponsorship of Tour de France bicycle race. When it fell into debts, it was almost swallowed by the mixed-ownership bank *BNP-Paribas*. After strikes and negotiations with government, the management was replaced, the state covered the debts and raised pays to the employees and the bank was stabilized.

Since then it started rising very fast and penetrating foreign markets, first the American banking, which made the French authorities and public proud of it. This is why it came like a bolt from the blue when it was announced in the news that the bank (in other words France) would have to pay 700 million Euros fine for illegal acquisition of one American small state-owned company, which must under no circumstances be bought by foreigners. The public started to ask questions how it was possible that neither the intelligence or other state institutions or internal bank services did not know acquisition laws at a market where they conducted business with great ambitions. Is it possible to neglect the basic facts and fail to request the previous expertise of one's own state institutions and American authorities? French economic intelligence is one of the most capable in the world. Is this possible to happen even in the system of collective management such as those in French state companies, and not to ask for intelligence information first?

France was forced to activate many diplomatic and other channels of negotiations with the USA competent authorities in order to try to save what can be saved, and primarily to reduce the inevitable costs, to prevent the ban of banks business dealing in the USA territory. The most recent news tells that

it has partially succeeded. France has accepted to pay 500 million Euros fine because of serious business misconduct of *Credit Lyonnais*, with the promise that the bank would be allowed to continue to operate in the USA. Naturally, all illegally acquired property would be taken away. French taxpayers would pay a high price for the business failure of their bank (in which many are not even clients) because of the weaknesses of its competitive intelligence service that did not know the basic regulations of acquisition within the USA. Even the relevant state structures did not help it in that. Alternatively, the help was not even required.

As the previous examples show, the weaknesses of competitive intelligence activities can happen even to powerful companies in the global world. It is a weak comfort and big instruction that those who still have a lot to do to recover and stabilize economically cannot allow themselves such mistakes.

5. Conclusions

Considering the current situation whether to use or not to use competitive intelligence in order to conquer and remain at either domestic or foreign markets, it is possible to determine several conclusions:

1. Each company having ambitions to conquer both domestic and foreign markets and to remain at them must have special well-organized and equipped service for competitive intelligence, which is appropriate to its size. This service should gather, select, process and analyze economic information and data continuously and systematically. After studious processing it should offer them to the company's management as a basis for decision-making regarding a business undertaking, or more importantly, for establishing a strategy of performance and survival of a company at domestic or foreign market under the conditions of severe competition and variable economic circumstances. The knowledge gained by such a service after all stages of processing and operative functions in determining company's strategy or decision about the specific business undertaking, belong to what is called collective company's intelligence, as one of the factors of its successful activities.
2. Taking into account that the knowledge collected by competitive intelligence is part of economic competition of companies at both domestic and foreign markets, there is an increasing need for them, their systematic and continuous gathering and processing, as well as their actualization and constant supplementation. Many small companies or firms do not have financial and personnel potentials to organize permanent work of such a service. The only necessary solution for them is precise and well-conceived ordering of such information within various stages of processing from specialized and equipped agencies for competitive intelligence,

private (if they exist and if they are allowed by law) or state, domestic or foreign. Companies pay for such services depending on the requests stated in the orders, and are free to use information or to subject them to further processing according to their needs.

3. Services and knowledge of specialized state intelligence agencies, especially in the countries where there are not private agencies, as is the case of Serbia and Montenegro, must legally but also in practice be available and approachable to the economy according to the usual and not special or arbitrary procedure. Domestic regulations should be innovated in this field to allow transfer of knowledge of competitive intelligence to potential users, considering that the majority of companies do not have their own services for that purpose, and the issue of private agencies that could deal with these activities is not regulated.
4. The knowledge acquired through competitive intelligence, gathered and processed by a foreign company or obtained from foreign state specialized services and agencies must in the future be incorporated in business strategy of the companies and economy of Serbia and Montenegro, regardless of whether they act on domestic or foreign market. Without this the recovery and progress of domestic economy, its return or penetration and maintaining of companies at domestic and foreign markets would not be possible, nor their preparation to get involved in the competition with foreign partners or competitors. Ever increasing struggle with foreign companies and efforts to conquer domestic market imposes better preparations to domestic companies and this is where competitive intelligence makes an irreplaceable part.

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REFORM OF QUANGOS IN KOREA

Abstract: After the 1997 financial crisis, Korea clearly showed its determination to pursue globalization both in business sector and in public sector. The Kim Dae-Jung government clearly stated to follow global management revolution, so called New Public Management (NPM) in terms of public sector reforms. The government very actively sought privatization, contracting-out, competition, downsizing, and custom-orientedness. This paper is to review and evaluate reforms of quangos which have been pursued during last five years in Korea, and bring up future tasks and issues.

Key words: public sector reform, quango, globalization, Korea

1. Introduction

Globalization is sometimes advocated to enhance human freedom and to increase economic opportunity, while at the same time it is criticized as imposing a set of common global standards and even constituting a kind of 'empire.' Without getting certain evidence about its impacts for countries and individuals, however, we are inclined to follow the current trend of globalization. This is especially true for countries like Korea whose economy mainly depends upon exports. In addition, Korea was bailed out by the IMF at the end of 1997. Thus Korea could not choose but pursue globalization. While the Korean government had previously by-and-large deflected longstanding demands of its principal trading partners, the U.S. in particular, for reform and the opening of its markets, it clearly showed its determination to pursue globalization after the 1997 financial crisis. The worst economic crisis, ironically, provided relatively favorable circumstances for the government to take reform measures. A wide variety of people were willing to suffer pains accompanied by reforms to overcome the pending crisis. The government swiftly implemented radical reform measures which embraced market principles, transparency, drastic restructuring, and liberalization of trade and foreign investment, all crucial to establishing the Korean economy as part of the

global marketplace. Korea is considered as casting its lot with globalization arguably to a greater extent than any other Asian country in those days.¹

The Kim Dae-Jung government took reform measures not only in business sectors but also in public sectors. The new government launched public sector reform measures even before official inauguration of the president-elect. Public sector reforms had been sought at least for four reasons. First, the public sector needed to improve its own efficiency, simply because it had been considered as impeding national competitiveness more than the private sector did. According to «World Competitiveness Yearbook 1997», published by IMD (Institute for Management Development), Korean government sector was ranked 33rd, while overall ranking was 27th. Second, a first, peaceful power shift within 50 years from the ruling party to the opposition camp also ignited a reform. It was natural that new ruling party members tend to look upon existing government systems and public servants with distrust. It may be safe to bet that they also wanted to gain a firm foothold early by bashing old bureaucrats and by differentiating themselves from previous leaders. In particular, it was the New Administration's interest to attack the old regime and reinforce the reform initiative, since doing so, it could insulate itself from responsibility for the currency crisis. Third, the government needed to keep up with reforms in public sector in order to gain public support and legitimacy in the midst of implementing painful reforms in the economy as a whole.² Fourth, the public sector needed to reform its relationship with private sector and citizens.

In terms of public sector reforms, the Kim Dae-Jung government clearly stated to follow global management revolution, so called New Public Management (NPM), as has been explained by Lee Kye-Sik in 2002, who is a leading scholar and chief director in Government Reform Office, Ministry of Planning and Budget. NPM concept covers all types of public sector reform. It promotes performance appraisal and efficiency; the use of quasi-markets and of contracting out to foster competition, a style of management emphasizing monetary incentives and autonomy to manage, and customer-oriented practices.³

This wave of managerial reform began from United Kingdom in 1980s and then swept much of the world from the Westminster nations-Australia, Canada, and New Zealand to Brazil, from Portugal to Sweden, certainly including Korea.⁴ To achieve such basic goals as to produce more goods and services for lower taxes, the Government benchmarked so many diverse reform measures from developed countries, especially Westminsterian ones, and applied

¹ S. S. Kim: *Korea's Globalization*, Cambridge University Press, Cambridge, 2000.

² S. H. Jwa: *A New Paradigm for Korea's Economic Development*, Palgrave, London, 2001.

³ K. S. Lee: "Achievements and Future Tasks of Public Sector Reform", *Korea Focus*, 10 (5), 2002.

⁴ D. Kettl: "The Global Revolution in Public Management: Driving Themes, Missing Links", *Journal of Policy Analysis and Management*, 16 (1), 1997.

these measures among the whole public sector, including central government, local governments, and quangos.

Among the whole public sector, reforms of quangos are specially noteworthy for the following reasons. First, various forms of hybrid-type organizations including quangos have proliferated in recent years, due to the emergence of NPM concept. NPM concept, with its emphasis on delegation, disaggregation and contracting-out into the private sector led to the transfer of functions from traditional governmental bodies to a new range of quasi -autonomous task-specific bodies. There have been growing concerns and debates on the alternative modes of delivering public services around the globe. Second, the role and legitimacy of parastate institutions differ from one country to another. This implies different reform issues for different countries. For example, both UK and USA are more worried about the responsibility because of lack of appropriate control schemes. However, Korea is more concerned with managerial autonomy because of too much control mechanisms. Although much of the literature on NPM concept stresses the global nature of the reforms, on the whole the quangos debate has suffered from a lack of comparative analysis.⁵ Third, while the government sectors have been targets of reform in every Government since 1980, quangos were the target for the first time in the Kim Dae-Jung government. Fourth, while several papers have already evaluated the reforms of government sectors, few papers have assessed those of the quangos.⁶

The purpose of this paper is to review and evaluate reforms of quangos which have been pursued during last 5 years in Korea, and bring up future tasks and issues. For this purpose, section 2 discusses the reasons why reforms are needed in quangos. Section 3 analyzes reform measures, achievements, and future tasks. And section 4 discusses concluding remarks.

2. Why to reform quangos?

Quasi-autonomous non-governmental organizations (quangos) refer to the hybrid organizations that are created by governments to operate ,at arm's length' under the guidance of appointees. However, the list of associated acronyms for organizations which spend public money and fulfill a public function, but exist with some degree of independence from elected politicians, is many: NDPBs(Non Departmental Public Bodies), NGOs(Non Governmental Organizations), QAOs (Quasi-Autonomous Organizations), including QUANGOS. Similar terms also include ,intermediate organization' or ,third sector'.

⁵ C. Greve, M. Flinders, S. Thiel: "Quangos-What's in a Name? Defending Quangos from Comparative Perspective", *Governance*, 12, (2), 1999.

⁶ S. S. Kim: *Korea's Globalization*, Cambridge University Press, Cambridge, 2000.

Quangos have developed as an alternative system in public service delivery to increase efficiency in the circumstance of fiscal restraint.⁷ Quangos are quasi yet independent from politicized and bureaucratized rules and procedures that often hinder organizational effectiveness. Quangos as quasi-private bodies are considered easier to introduce private sector management techniques which often lead to significant cost savings. Thus the creation of quangos follows an historical pendulum from pro-quangos in 1960 to anti-quangos in the late 1970, and again to pro-quangos with tidal wave of NPM.

However, quangos have continued to grow until economic crisis of 1997 and have faced reform pressure for several reasons in Korea.

First, quangos have been criticized for their low level of efficiency. A public-choice perspective proposes that quangos as quasi-public or monopolies breed inefficiencies and do not have incentives to reduce cost, while a competitive marketplace produces goods and services efficiently.⁸ A principal agent theory suggests agency problems causing low efficiency. Principal agent theorists have recognized that the separation of ownership and control common in most corporations creates conflicts of interest between an agent and a principal. These conflicts (agency problems) arise because agents have the opportunity to use the resources of the organization in ways that benefit themselves personally but decrease the wealth of the principals. Examples of this type of opportunistic behavior by quangos include drawing excessive compensation, consuming an excessive amount of perks, and shirking of their responsibilities. More specifically, if a person have worked for 25 years in a major state-owned enterprise and retire, he or she could receive 154 million Korean won as retirement allowance which is more than two times higher to those of government officials with same period of working years. In reality, the Board of Audit and Inspections (1998) issued a report on its investigation of state-owned firms which showed that many have been suffering from poor operations due to mismanagement. This agency problem is both ubiquitous and potentially very serious, especially in the case of the public corporation operating in a multiple layer of principal-agent relations. The managers are themselves agents (employees) of the board of directors, who are in turn agents of the owners (ministry), who are again agents of the owners (legislative), who are too agents of the owners (citizens). In this multiple principal-agent relation, each agent can enjoy benefits from quangos, and all together result in high cost for the country.

⁷ M. V. Flinders: "Setting the scene: quangos in context", in: M. V. Flinders, M. J. Smith, ed.: *Quangos, Accountability and Reform: The Politics of Quasi-Government*. St. Martins Press, New York, 1999.

⁸ K. S. Lee: "Achievements and Future Tasks of Public Sector Reform", *Korea Focus*, 10, (5), 2002.

Second, even with this kind of criticism quangos are considered to have grown beyond the optimal level, because the central government had a tendency to create quangos as way of solving the problems of «big size of government».. Under the global trend of ,small government', the central government could respond to expanding demand for public service without increasing government size.⁹ At its will, it could mobilize various resources to achieve policy goals such as financial, personnel, informational, physical, and organizational resources of quangos. This is very significant advantage for the central government because quangos do not face public scrutiny or control by other ministry or agency within government as much as each ministry does.

For the central government quangos are also very useful place for human resource management. Although a career government official is guaranteed to work until his retirement age by law, he tends to retire earlier, especially when higher level of government official is considered. After retirement, he could get a job in quangos, with leveling up his grade and also with higher level of salary, retirement allowance, and perks. This type of earlier retirement provides a position for lower level officials to be promoted, and in turn opportunity to increase morale for all government officials.

The political party, especially ruling one, may enjoy political advantages from quangos, because they allow politicians to use resources to fit with the political cycle.¹⁰ For example, they offer valuable resources for uses in territorial politics such as attracting plants and investment projects. They can also provide a wide range of positions to loyal servants of the ruling party. The process by which high level government officials and politician retire to senior management positions in quangos, is called *nakhasan insa* (parachute personnel) like *amakudar* (decent from heaven) in Japan. There had been wide consensus that this process is one of the main factors to decrease efficiency of quangos, and in turn should be the very target to be dismantled. Notwithstanding these criticisms, providing benefits to governments and politicians, quangos can acquire resources and support for their survival even when it is obvious that they should be eliminated. For example, a political strongman, a person very close to the president, after he became a manager, may exercise a decisive role to enlarge quangos or to make them survive even under the peril of liquidation. An ex-ministry bureaucrat may become a main window for quangos to keep some program, while an ex-bureaucrat from Board of Audit and Inspection may lessen degree of intensity of audit. Likewise, because each stakeholder can enjoy some benefits from them, the number of quangos has continued to grow substantially. This is also the main reason why the Korean government is generally regarded

⁹ H. Seidman: "The Quasi World of the Federal Government", *The Brookings Review*, 1988.

¹⁰ C. Hood, G. F. Schuppert: *Para-government Organizations in the Provision of Public Service: Three Organizations*; H. K. Anheier, W. Siebel, ed.: *The Third Sector: Comparative Studies of Nonprofit Organizations*, Walter de Gruyter, Berlin, 1990.

as a big government despite that it is in appearance a small government in terms of the amount of budget or the number of public servants.

Third, as each ministry may enjoy many benefits from quangos, it has competitively tried to create them. Thus, there are some overlaps in functions among central government, local government, and quangos. For example, Small and Medium Size Business Administration is present at ministry level, but there is also a division of small business on each local government level, and there is Small Business Corporation as quango. They all have the same role: to implement policy for promoting small and medium size businesses. There are also overlaps between quangos, as is in the Export-Import Bank of Korea (EXIM) and Korea Export Insurance Corporation (KEIC). Both quangos have with very similar function, such as financial support for export-oriented company. But EXIM belongs to the Ministry of Finance and Economy, while KEIC to the Ministry of Commerce, Industry, and Energy. These overlaps must result in waste of budget and personnel.

Fourth, despite this kind of harsh criticisms, quangos have escaped reform. While the central government has been the major agenda for reform all the time, quangos had never been included as a target of reforms. The only exception were state-owned enterprises (SOEs), which had considered their privatization possibilities since 1980s.

For all these reasons, many reform experts suggested that quangos should be the main target of public sector reforms. According to a Korean Development Institute survey on the public sector reform, which was made among economic experts and citizens in 1998 (Table 1), more than a half of respondents indicated that priority should be given to the reform of quangos taking into account that, by definition, quangos include SOEs, all government sponsored research institutes and all other para-state organizations. Privatization of SOEs has been supported by 16,8% of respondents, reform of government sponsored research institutes got 6,1% votes from the respondents, and the reform of other para-state institutions has been supported by 28,7% of respondents.

Table 1. The most urgent areas for reform in the public sector

Privatization of SOEs	Reform of government sponsored research institutes	Various quangos reform	Government reorganization	Reform of Local governments
16.8	6.1	28.7	21.6	12.7
Reform of local offices	Contract-out of government function	Reform street - level bureaucracy	others	Sum
1.9	7.2	4.7	0.3	100

Source: KDI, Economic experts and citizens survey about the public sector reform, 1998,

3. What is to be reformed in quangos?

The Kim Dae-jung government applied various reform measures in quangos. This article notes only a major part of the reform: first, identification and clasification of quangos; second, privatization of SOEs; third, governance reform; fourth, management reform.

3.1. Identification and clasification of quangos

Table 2. Summary figure for quangos in Korea

		No. of institutions	No. of employees	'97 Year Budget (government support)	'98 Year Budget (government support)
quangos	Government-sponsored Institutes	100	42.180	13,902.715 (4,822.022)	14,395.257 (5,188.068)
	state-reinvested enterprises	13	64.275	36,993.582 (2,284.666)	45,116.180 (2,805.184)
	state-reinvested enterprises	10	22.371	1,701.663 (0)	1,822.947 (0)
	state-capitalized enterprises	19	137.846	51,903.840 (67.202)	54,387.740 (57.405)
	public fund management institutes	11	5.072	2,652.131 (217.754)	3,126.351 (253.282)
	government-support institutions	86	12.605	4,450.413 (837.880)	3,791.887 (794.652)
	Subsidiaries sponsored-invested capitalized	121	36.246	8,224.429 (9.290)	8,376.225 (11.654)
sub sum		360	320.595	119,828.773 (8,238.814)	131,013.587 (9,110.235)
state funkcion entrusted corps		83	16.954	5,996.508 (12.757)	5,886.601 (3.845)
government supported association		108	48.022	5,593.473 (276.195)	6,233.138 (339.778)
Total sum		551	385.571	131,018.754 (8,527.766)	143,113.326 (9,453.858)

Source: Presidential Transition Committee(1998), Current Conditions of Quangos in Korea

On the basis of this information, thus, the Kim Dae-Jung government took various reform measures such as privatization, contract out, reduction of budget and personnel, governance and organization restructuring.

3.2. Privatization

A globalized reform approach, NPM, strongly recommends privatization because it is believed that partial and incremental reform cannot provide

enough satisfaction and productivity.¹¹ The Kim Dae-Jung government very actively drove forward privatization. Previous governments have tried to reform SOEs too because of their poor performance and gross mismanagement of state assets. Before the Kim Dae-Jung government, the Korean governments had endeavored privatization of SOEs five times (1968, 1980, 1987, 1993, 1996), producing poor achievements in a general sense. The first privatization effort had been taken from 1968 until 1979, with goal to promote business sector and restructure troubled corporations. During this period, 12 corporations were privatized, mainly including transportation-related corporatoin. The second phase lasted from 1980 to 1986. Major targets of privatization were financial institutions such as «Hanil Bank», «Cho Heung Bank» etc. However, worrying about economic concentration problem in «Chaebol», government hold power to intervene in internal management of financial institutions, and this is considered to be a remote cause for 1997 financial crisis. The third phase of SOEs privatization began in 1987 and continued to 1992. The government's privatization policy has been subject to several major changes between 1987 and 1992. In various occasions, the government announced plans to privatize several SOEs but frequently revised its privatization plan. With the exception of KSE, no SOE designated for privatization was sold to the private sector based on the original plan. Divestiture plans were delayed in numerous occasions and for those that were sold to the private sector the government retained control rights in all but KSE.

The fourth phase took place under the Kim Young Sam government. The 1993 Privatization and Reform of SOE Plan called for the divestiture of shares in 68 enterprises and restructuring of 10 SOEs through mergers and sell-offs. The original plan announced in October 22, 1993 called for divestitures in six State Invested Enterprises (KEPCO, KTC, NCB, TGC, NTC, and SMEB) and 51 subsidiaries of SIEs. However, for the fear of increasing economic concentration through the sale of large SOEs to Chaebols, whom were supposedly only viable purchasers of large SOEs in Korea, the government delayed the original plan. Instead, the government made new SOE Management Efficiency and Privatization Promotion Plan sought to concentrate on the reform of corporate governance structure, annulled its previous SOE privatization plans that were based on the transfer of control and cash-flow rights to the private sector.

However, the Kim Dae-Jung government had moved aggressively to privatize some of SOEs and to contract out other services.¹² Since the announcement of the privatization plan in July, 1998, a total of 26 parent SOEs were examined within the context of privatization. The principle was

¹¹ C. Hood: "Exploring Variations in Public Management Reform of the 1980", *Public Administration*, 1995.

¹² S. H. Jwa: *A New Paradigm for Korea's Economic Development*, Palgrave, London, 2001.

that those with no compelling reason to remain in the public sector were to be privatized. The types of activities that SOE is engaged in were examined. It has also been reviewed whether there were justifiable reasons to continue to keep the SOE concerned under state control. Applying this test, 11 SOEs, including their 21 subsidiaries, were identified for privatization. These SOEs were engaged primarily in commercial activities, and no justifiable reasons were found to keep them under state control. Out of these 11 SOEs subject to privatization plans, five SOEs and their 21 subsidiaries were selected as corporations to be privatized immediately, and 6 SOEs as corporations to be privatized gradually. So, eight among 11 parent to-be-privatized SOEs were fully privatized by the end of 2002, including National Textbook Co., Korea Technology Banking, «Daehan» Oil Pipeline Corp., POSCO (Steell), KT (Telecommunication), KT&G (Tobacco) etc. In addition to the parent SOEs, 66 subsidiaries of SOEs have been fully privatized among 77 subsidiaries planned-to-be-privatized. The total number of privatized SOEs, including both parent and subsidiaries, since 1998 are thus 74. Three parent SOEs, KOGAS (Gas), KEPCO (Electricity), and KDHC{ District Heating), are still in the process of privatization.

There are several reasons for the government to achieve just relative success in privatizing quangos. First, reform initiators hold such an assumption that without the threat of bankruptcy and/or takeover, the incentive structure facing SOB managers may differ drastically from the one facing their private sector counterparts. Hence, unless SOE managers' incentive mechanisms are fundamentally changed to imitate those in the private sector, long-term performance of SOEs will not change. Thus they seemed to believe that, all around the world, privatization has become the only viable option to reform SOE sector. So, they have set up such guiding principle that SOE's engaged primarily in commercial activities, with no justifiable reason to remain under state control, should be privatized.

Second factor relates to concentration issue. Many people have accused the government's privatization policy of selling state-owned firms to chaebol groups not to be a wise move. It has been argued that the government's all-out efforts to restructure state firms by selling them off to the business conglomerates is contradictory. Namely, the large-scale SOEs have been built up with taxpayers' money and handing them over to chaebol groups was considered as morally unacceptable. In the previous governments the privatization authorities attempted to rationalize delays in privatization programs for concerns over this kind of widespread anti-chaebol attitude, worrying that privatization of SOEs will increase economic concentration in chaebols and for the need to protect and promote small and medium size firms.

The third reason for the delay in the aforementioned privatization plan is due to the lackluster performance of the Korea's stock market. The KSE

composite index, which peaked in 1989, has plummeted by 40 percent ever since. At peak time, the government did not sell off their share. For the fear of further worsening of the market conditions, the government has avoided launching large scale public offerings of SOE shares. In order to solve these issues, the Kim Dae-jung government took diverse ways to make sell off. First, the government utilized international financial markets to reduce the adverse impact of public offerings on the domestic stock market. Second, the shares of SOEs can be sold in both international or domestic stock markets in several trenches to avoid the collapse of the Korean financial products. A considerable amount of Korea Telecom, POSCO, and Korea Electric Power Corporation stakes have been sold to foreign investors through the issues of depository receipts (DR). The successful issuance of DRs in international financial markets contributed to the rise of the international confidence in the Korean economy.¹³

Privatization authorities are also important for the success. Korea is famous for its achievements in economic development within short period of time through government-initiated development projects. In managing the economy, government had utilized various forms of macroeconomic and micro-economic intervention tools. SOEs are certainly a part of these tools. It is, thus, not surprising to see the government being particularly resistant to the devolution of its regulatory power away from central ministries. This meant that it was hard for the government to pursue more aggressive form of privatization. The monopolization of privatization policy making among selected government officials allowed them to shape the privatization course best suited to their interest.

The Kim Dae-Jung government made several institutional arrangements for continuous effort for privatization such as creating Ministry of Planning and Budget (MPB). Several teams in the MPB worked on the formulation of the initial privatization plan. Shortly after the announcement of the first phase of privatization plan in July, 1998, the Privatization Steering Committee and task force teams were created, to coordinate the overall privatization program and make important decisions. The committee consists of a minister, vice-ministers, related high level government officials, and civilian experts and others. The minister of the MPB becomes the chairman of the committee, and the vice-minister of the Ministry of Finance and Economy becomes the vice-chair of the committee. Vice-Ministers of related ministries also participate in the committee. Although this type of committee existed in the previous government, it is noteworthy that the chairman came from MPB which has no quangos under its territory, and has no incentive to resist the privatization.

There are opposite views about the result and speed of privatization. While ones argue the speed is too slow, the others criticize the government that it has

¹³ *Op. cit.*

been selling out its shares hastily, without fully considering negative impacts such as the possibility of market dilution, leaking national wealth, and losing publicness. Unlike expectation, privatization did not drop the value of stock market. This may result from introducing diverse way of sell-off for quangos. But after the financial crisis in 1997, Korean securities were much undervalued, and provided high incentive for foreign investors. They bought huge portion of SOEs stocks cheaply, and provoked many people to criticize privatization as a mean of leaking national wealth to overseas. For example, a government plan to sell 25% of its stake in Korea Gas Corp. (KOGAS) has been practically abandoned due to difficulty in settling on a sale price. «Enron International», which was one of the strongest candidates to take over KOGAS, seems to have given up its bid to buy the firm due to the discrepancy between Seoul's asking price and what «Enron» was willing to pay. KOGAS is going ahead with negotiations with three other overseas firms, but experts say there is little hope that a deal will be struck.

3.3. Governance reforms

Not all public entities can be privatized and should not be privatized. Rather quangos are said to have combined the best features of both public and private organizations, and their number have increased dramatically worldwide. Thus, as we have already seen in the SOE Management Efficiency and Privatization Promotion Plan announced in November of 1996, in the case of SOEs not to be able to be privatized, the reform of corporate governance structure is needed. The basic principles of governance structure reform are to hire an appropriate manager, to give greater autonomy to the management and to enhance the management's accountability.

First, there had been wide consensus that creating of *Nakhasan Insa*, parachute personnel, has been all the time a major problem for management of quangos. The fact that inappropriate candidates were named to executive positions or audit positions at quangos, implies why government firms have been unable to implement better business structures. „Restructuring” is little but an empty chant when non-expert-parachutes are put on top positions from above by those in the inner circle of power. Thus many people argue parachute personnel should be the very target to be dismantled. The government sought to depoliticize the SOE - government relationship and make the management more accountable for their performance. The government introduced a „human resources pool system” in order to widen possible pool for CEO and the „CEO Recommendation Committee” to ensure selection of capable chief executive officers (CEOs).

There are still criticisms about parachute personnel practices. An editorial in *ChosunIlbo* (May 10, 2000) says; „the government on the one hand talks about a ‚human resource pool’ for state corporations, a ‚CEO recommendation

committee,' an ,open hiring system' and other nice sounding fancy rhetoric, but now the general public can see for itself how it all has only served to legitimize the same old parachute appointment practices." In addition, although the government argues that ,CEO Recommendation Committee' is composed of neutral and independent members, some people criticize that the process geared toward selecting CEOs and outside board directors is inherently biased as the latter are selected by each ministry. Thus, it is a disillusion to suggest that outside directors will act as a buffer in preventing or limiting the ministerial intervention.¹⁴ Even with these criticisms, however, there also exists some promising progress. After introducing new system in 1999, the proportions of bureaucrats and politicians on CEO positions in quangos have been decreasing and inner promotion sharply increased from 5.6% of Kim Young Sam government to 59.03% of Kim Dae-Jung government.

Table 3. Major career of retired quangos' executives

Major Career	Jun Du Hwan Government (1980-86)	Rho Tae Woo Government (1987-1992)	Kim Young Sam Government (109.1-1997)	Kim Dae-Jung Government (1998-2001.11)
Sum	95(100%)	100(100%)	89(100%)	83(100%)
Military	46(48.5)	38(38,0)	11(12.4)	5(6.02)
Bureaucrats	27(28.5)	44(44,0)	43(48.3)	16(19.28)
Politicians	4(4.2)	7(7.0)	19(21.3)	8(9.64)
Businessmen	5(5.3)	3(3.0)	3(3.4)	
Lawyer	1(1.1)	1(1.0)	1(1.1)	1(3.20)
Inner promotion	6(6.3)	5(5.0)	5(5.6)	49(59.03)
Outside specialists	6(6,3)	2(2.0)	6(6.7)	4(4.82)

Izvor: Kim, Byong Seob et al. 2002.

Although a parachute personnel appears in most of quangos, however, new system like ,CEO recommendation committee' is only introduced in SOEs. Government-sponsored institutions and government-supported institutions did not introduce new system, and produced relatively higher level of parachute personnel than SOEs did. As we can see in Table 4, the proportion of government officials and politicians together is around 27%, but it rises to 67%, 43%, and 51%, respectively in government- sponsored institutions, government-supported institutions, and state function entrusted corporations. Therefore it is recommended to introduce new personnel system, and in reality the government did it during term of President Kim Dae-Jung.

¹⁴ S. S. Kim, ed.: *Korea's Globalization*, Cambridge University Press, Cambridge, 2000.

Table 4. Major career for quangos' executives by type

Types of Quangos	Inner promotion	Outside specialist	Competent ministry Official	Other ministry Official	politician	Sum
SOEs	52 (56,52%)	15 (16,30%)	12 (13,04%)	8 (8,7%)	5 (5,43%)	92 (100%)
Government-sponsored institute	29 (25,44%)	6 (5,26%)	48 (42,11%)	14 (12,28%)	15 (13,16%)	114 (100%)
Government-supported insiitute	9 (39,13%)	4 (17,39%)	3 (13,04%)	3 (13,04%)	4 (17,39%)	23 (100%)
State function entrusted corps	12 (25,00%)	10 (20,83%)	17 (35,42%)	4 (8,33%)	4 (8,33%)	48 (100%)

Source: Kim, Byong Seob et al. 2002,

Another way to depoliticize the relationship between the state and individual SOE would be possible through empowering boards of directors (BoDs), consisting mainly of outsiders, to take more policy decisions in place of supervising ministries. The task of monitoring the performance of SOEs would also fall upon the BoDs. However, it is unlikely that the boards will act as major policy making institutions. In other words, although most of quangos introduced outside board of director system following U.S. where their role in corporate decision making process became very active since the early 1980's, their role seems to be limited in the Korean context. An outside member of board cannot pay full attention to the job due to the part-time nature of his appointment; cannot play a decisive role due to lack of information about corporation's operations; may not want to fight with CEOs due to Confucian face-saving culture or co-optation.

Second, the Kim Dae-Jung government emphasised that more autonomy should be given to CEOs in quangos to run their corporations. The only way to improve government performance, they argued, was to change the incentives of government managers by subjecting them to market forces. To make managers manage in an efficient way, on the other hand, it was necessary to give them great freedom in solving administrative problems, just as it has been the case in private sector. However, the current corporate governance structure still leaves a room for ad-hoc ministerial interventions, either through a direct policy channel or indirectly through influencing BoDs as the state remains a majority owner. Moreover there are stilt policy audits and numerous reporting requirements by Board of Audit, National Assembly, as well as a competent ministry. There is also a special controversy when control about internal reform is considered. Ministry of Planning and Budget (MPB), as an organization

which is leading the public sector reform, on the one hand advocates managerial autonomy for CEOs of quangos, and on the other hand sends specific guideline for management (for example, the amount of retirement allowance, customer charter etc.) and then evaluates degree of achievements. MPB seems to be afraid of not achieving any reforms without top-down control.

Third, to enhance the management's accountability the government introduced performance evaluation and reward system. That is, each ministry is to be required to enter into a contract with the CEOs of the SOEs under its supervision. The CEOs are to be given greater autonomy over such matters as personnel and organization. The contract with the CEO may be renewed only upon finding of satisfactory performance. Thus performance evaluation is very important. However, performance contracts or management performance evaluation systems employed in the Korean SOE sector, which was aimed at linking SOE corporate performance to the salary structure, did not differentiate between well-performing SOEs and below-average performers mainly due to the equity concerns and therefore made little difference to long-term performance of SOEs.

4. Management reform

The Kim Dae-Jung government had tried to benchmark many management tools and techniques from developed countries without paying concern on feasibility and background culture. The following list shows only part of reform measures, which are generally in conformity with the Westminsterian approach to the public sector reform. Among those various management reforms, we discuss here only downsizing:

- each quango is to be restructured to run its "core" business activities;
- privatizing government-owned enterprises and consolidating daughter companies;
- introducing market principles into the management of quangos;
- shortening the mandatory retirement ages of public servants and lessening their job security;
- introducing management by objectives (MBO) and performance related bonuses;
- expanding an open and contract-based personnel system;
- tightening performance management and creating incentives for budget savings;
- enacting customer charters for government-owned enterprises.

A basic guiding principle for management reform is to streamline and slim quangos. Activities which are deemed to be better performed by the private sector are to be privatized or contracted out. Quangos are to be restructured as to

redirect their resources to the performance of their „core” business activities. To this end, they are required to divest, and sell the assets used for activities unrelated to their respective „core” business focus. They and their remaining subsidiaries are to be restructured and streamlined through merger or consolidation where deemed necessary to avoid duplicity and redundancy. And then, the quangos were required to downsize. According to Table 5, the government had a plan to reduce by around 20% or 142,359 of total employees in the public sector. This number was quite large, considering the period of downsizing was only four years. Downsizing was successful mainly due to economic crisis. Noteworthy is the fact that the proportion of reduction of employment in quangos is greater than that in government sector. It has been planned that in the government sector 18% or 82,125 government officials among 453,528 should be fired, while 24% or 60,234 quango employees among total of 248,091 were to lose job. In practice, 82.8% of the reduction plan in government sector has been fulfilled, compared to quangos where 94.4% reduction plan has already been achieved.

Table 5. Downsize, Plan and Result, by group

	Full quota	Total size	1998.	1999.	2000.		Plan for 2001.	Result./ plan
					Plan	Result		
Sum of Government sector	453.528	82.125 (18,1%)	44.154	59.000	12.000	9.000	11.000	82,8%
Central government	161.855	25.955 (16%)	9.084	17.000	5.000	2.000	4.000	73,2%
Local government	291.673	56.170 (19,3%)	35.070	42.000	7.000	7.000	7.000	87,2%
Sum of Quangos	248.091	60.234 (24,2%)	29.578	48.000	11.000	8.900	1.000	94,4%
Sponsored and entrusted	63.173	16.470 (26,1%)	9.947	16.000	2.000	2.200	1.000	95,8%
Sponsored research institute	18.503	2.530 (13,6%)	3.099					
SOEs	143.063	35.689 (24,9%)	13.378	32.000	9.000	6.700		93,9%
Subsidiary of SOEs	23.352	5.545 (23,4%)	3.154					
Sum	701.619	142.359 (20,3%)	73.830	107.000	23.000	17.900	12.000	87,7%

Source: Kim, Byong Seob(2001)

Another problem is related to rhetoric or symbolic politics. Several quangos appear to have been implementing government-mandated restructuring only keeping in mind the meeting of targets, rather than the initiation of substantive change. As we can see in Table 5, quangos have been able to streamline their

workforce by 24%. A closer look at the figures reveal, however, that restructuring has in large part been only cosmetic. Korea Land Corp. (ROLAND), which is under the Ministry of Construction and Transportation (MOCT), for instance, reported that it has trimmed the number of employees by 800 since 1998, but a substantial number of the workers who were laid off particularly those in higher positions, have been hired on by KOLAND subsidiaries. Another case is that the Korea Tobacco & Ginseng Corporation has reduced regular employees by ten percent, but has also been giving large retirement pensions and promised these employees either re-employment a year later or employment for their children.

Although the main purpose of downsizing is to reduce cost, increase productivity, and increase value for stock, it was found that downsizing could not achieve those goals in many cases. A company needs to pay extra money to early retirement, and also transition cost. In order to increase productivity an organization has to select useless or less useful employee. Because quangos had to meet the deadline and the reduction proportion, however, they chose rather easier way to reduce the number of employed personnel. That is they select target number for reduction, on the base of age regardless of ability and performance. This results in losing organizational knowledge and increasing social welfare cost. This is quite opposite direction for Korea to enter into aged society very fast, A quango also chooses a strategy not to hire new personnel at all, which results in lack of young new blood. This altogether implies that while quangos reform, especially downsizing management follows the global trend, its implementation seems to be very typical Korean style.

5. Conclusion

It has been considered that the Kim Dae-Jung government has achieved relative success in the public sector reform. The administration has succeeded in downsizing a significant percentage of its staff, SOEs privatisation has been successfully launched and the government appears to be making adopting of an open hiring system. In addition, unlike the previous government where public sector reforms failed partly because they lacked in proper visions or long-term blueprints, the Kim Dae-Jung government held clear vision and blueprint, that is, certainly global paradigm of public management: New Public Management. The existence of visions, regardless of whether right or wrong, could minimize patchworks, stopgaps, trial and errors, and distortions in the painful reform processes which are vulnerable to resistance and oppositions. However, vision does not guarantee success in implementation of reform, or total aspect of reform. The government tried to reform too many things within very short period, with monolithic standard regardless of local conditions. Reforming the reform pro-

cess is another major task for the government to introduce global standard to local context.

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ECONOMIC AND LEGAL ASPECTS OF PROPRIETARY TRANSFORMATION OF PUBLIC ENTERPRISES IN SERBIA

Abstract: *The proprietary transformation, with privatization as just one of the possible forms, represents the transition aspect that due to possible side effects attracts the most of public attention as a rule. However, this circumstance does not affect the importance of other transition aspects, such as structural, organizational, status-related and managing transformation of firms. Only when they act together with proprietary transformation can the necessary conditions for successful business activities of firms be created.*

The importance of proprietary transformation is especially emphasized in case of public enterprises, first because of the amount and character of state-owned capital in these enterprises, but also because of the importance that these enterprises have for normal working conditions of other firms.

The current system of regulations that determine the field of proprietary transformation of public enterprises in Serbia is based on several legal acts, which were being passed in the course of a long period. Consequently, there is the outstanding incompatibility of solutions, which is the result of various approaches to regulations within this extremely important field. On the other hand, objective circumstances related to the nature and sources of assets from which the public enterprises capital emerged are not regulated completely and satisfactorily. All this gives us basis to conclude that it is necessary to consider once again the goal of transformation before we approach the implementation of proprietary transformation of public enterprises. Then in accordance with the attitudes taken, we should determine the models and procedures that would allow those goals to be fully achieved.

Key words: *proprietary transformation, privatization, state-owned property, public enterprises, public interest, restructuring.*

1. Introductory notes

Adjusting of firms in Serbia to market economic conditions, both organizationally and functionally has been an almost unavoidable topic of many scientific and expert papers for a long time. Actually, ever since the Law on enterprises and Law on socially owned capital were passed in 1988 until today, these issues have been part of public appearances of almost all important persons at the domestic scene. However, it is exactly the number of such appearances and the abundance of attitudes that show that the level of neither political nor expert consensus has been reached, which could lead to such solutions that might be considered decisive for further activities.

During the period when these issues were considered, one of the main features was the effort to make one segment of the overall changes that were to be made in the field of regulations dominant over the others. In this way, the need to analyze other segments was quite diminished, even made marginal. The importance of proprietary transformation was emphasized to that effect, or privatization as one of its forms. Such a decision was supported at the legislative level, but there is no doubt that the political events that marked the domestic political scene also made significant contribution. All that created unrealistic expectations of the domestic firms, or in other words of their management, that it was sufficient to make adequate changes of proprietary relations, which would then create the conditions for successful business activities of those firms that were consistent in their changes.

However, the system of regulations regarding these issues failed to distinguish the firms according to the type of their organization, and even their economic activities. Namely, there were persistent efforts to include all domestic firms in the general business practice regulations. The result was the habit to propose the same solutions for both the socially owned firms and the state-owned firms, neglecting at that the specific features of not only the proprietary relations in them but also the characteristics and the importance of their activities.

On the other hand, there were special regulations covering certain activities because of their character. Special manner for conducting the activities of these firms was determined as well as their special status, which was particularly supported by the specific features of proprietary relations in these firms. The most outstanding example of this is the example of public enterprises.

The public enterprises are rather significant for the overall functioning of domestic economy, particularly because of the economic and natural potential they are in charge of and a large number of employees. This is why every transformation, especially proprietary, implicitly requires special attention to be paid and particular responsibility to be taken regarding the suggested solutions, particularly those solutions that would be implemented.

The specific activities on transformation of public enterprises have failed to take place so far because of the importance such a transformation requires. This

is why nothing more has been done than to turn socially owned property into state-owned property and to make adequate organizational changes. This fact influences also the attitudes on further proprietary transformation of other firms influenced by the transformation of public enterprises, and makes the subject of transformation of these companies additionally topical in all its forms.

Considering this, parallel to the efforts to find adequate solutions for proprietary transformation of public enterprises and other firms in Serbia, proper attention should be paid to structural, organizational, status-related and management forms of transformation. Every form of transformation has its field of manifestation and the specific measures characterizing it. Only when they become intertwined and interdependent and when the importance and specific contribution of particular aspects of transformation of firms is taken into account will the conditions be created for more successful business practice of every company.

However, under the conditions of evident lack of solutions regarding the system of regulations concerning proprietary transformation, and non-existence of general social consensus regarding its implementation, the proprietary transformation, and in particular privatization as one of its forms, is carried out neither according to the required scope or schedule and least of all effectively. It is not conceptually set to be in the function of maintaining and improvement of economic activities, but as a goal sufficient to itself. Other aspects of transformation (structural, organizational, status-related and management) were considerably made marginal because of that and unjustifiably pushed aside. Bearing this in mind, it is necessary in the forthcoming period to find solutions concerning character and scope of changing regulations in the field of business practice. These solutions should provide for the improvement of business practice of domestic companies, including public enterprises, starting from the main commitments, primarily regarding harmonization with the European Union regulations and appropriate taking over of international legal standards, but also taking into account the domestic conditions of work and business practice.

2. The notion of public enterprise

The specific position of public enterprises if compared with other forms of status-related organization of firms in the domestic law can be traced back to the regulations of Law on Enterprises of 1966 and Associated Labour Act of 1976 all the way to the Laws of Enterprises of 1988 and 1996. The regulations regarding the special position of public enterprises were supplemented by some solutions in the Republic laws – the Law on public enterprises (1990) and Law on public enterprises and performing activities of general interest (2000). There are also some solutions in the special Republic laws, which offer regulations regarding conditions to perform certain business activities. Some public enterprises were

also founded in order to run business practice in accordance with such regulations.

Following the analysis of the above-mentioned regulations and practice of public enterprises organization so far, it can be concluded that special characteristics of public enterprises in comparison with other firms within the legal system result from the elements based on which the notion of public enterprises has been determined. Depending on the regulations based on which they were determined so far, these elements were attached various influence on determining the notion of public enterprises. During some periods, greater importance was given to the business activities, and during some other periods the importance was given to the character of ownership of the instruments of labour in the public enterprise. However, generally speaking, the following elements had dominant influence on determining the notion of public enterprise:

- Performance of activities of public (general) interest, which most frequently reflects in the fact that the public enterprise business activities are the assumption and unchangeable working condition for other enterprises and public administration authorities in certain area (regardless of whether these activities are itemized);
- Establishing of public enterprises by government bodies both at the level of the Republic (Province) and the level of local community;
- Business practice using state-owned assets.

These three elements (performing activities of public interest, participation of public authorities in the procedure of establishing public enterprises and business practice using state-owned assets) are also the main criteria to differentiate public enterprises from other forms of organization of firms in Serbia. Legal consequences of such a notion of public enterprises, besides defining their status, are contained also in special rights of the founders, or government bodies against public enterprises concerning protection of general (public) interest contained in regular and continuous performance of activities for which the particular public enterprise was established.

On the other hand, although the elements for determining the notion of public enterprise are contained within general regulations and leave no particular options for various interpretations, we must also note the fact that the Republic regulations in this field allow the possibility to establish public enterprise with other form of ownership of the instruments of labour. The Law on Enterprises¹ from 1990 was quite clear to that effect: pursuant to Article 2 of this Law, public enterprises could conduct business with the state-owned, socially owned and private assets as well as with other forms of property. Article 3 of the Law on Public Enterprises and performance of activities of general interest² is a slight aberration from this attitude, at least from formal and legal regulation

¹ Official Gazette of Republic of Serbia, no. 6/1990

² Official Gazette of Republic of Serbia, no. 25/2000

point of view. This provision, under the influence of Article 401 of the Law on Enterprises (1996),³ determines that a public enterprise can be founded by the state only, or the local community, and that the majority of capital in the enterprises established in such a manner must be state-owned. This solution does not exclude the possibility for other enterprises, parts of enterprises or entrepreneurs to perform the activities of general interest, but they would not have the legal status of the public enterprise, although they hold the same position as the public enterprises.

3. Mandatory character of proprietary transformation of public enterprises

The issue of mandatory character of proprietary transformation can be approached from many aspects. It is necessary to consider the following:

- First, the mandatory character of proprietary transformation as an act or as a process;
- Second, its comprehensiveness, considering the nature of proprietary relations;
- Third, the scope of transformation in relation to the available capital of a certain company; and
- Fourth, time limit for proprietary transformation, or determining the time for the completion of the whole procedure.

Before the analysis of possible answers to the above questions, of course, from the point of view of proprietary transformation of public enterprises, it is necessary to point out that in its nature this issue is neither organizational and status-related, nor business-related and functional. It is, primarily, constitutional and legal issue.

We shall start here from the principle of constitutionality as the basic principle of contemporary judicial systems, which also guarantees legal security to the citizens of any state to realize their constitutionally determined rights but also presents a ground for responsibility concerning obligations established by it. The answers to the questions regarding the proprietary transformation of public enterprises would then be quite different from those expected under the current political situation in Serbia.

This is especially supported by quite clear and unambiguous provisions of Articles 55 and 56, and especially Article 66 of the current Constitution of the Republic of Serbia (1990).⁴ Namely, Article 55 of the Constitution determines the principle according to which "the economic and social system of a state is based on free operation of companies with all forms of ownership at a uniform market of goods, work and capital." Defining the stated principle in more details,

³ Official Gazette of Republic of Serbia, no. 29/1996

⁴ Official Gazette of the Republic of Serbia, no. 1/1990.

paragraph 1 of Article 56 of the Constitution determines the principle according to which “socially owned, state-owned, private and cooperative forms of ownership are guaranteed.” Paragraph 2 of the same Article determines that “all forms of ownership are entitled to equal legal protection.” Finally, paragraph 2 of Article 66 of the Constitution determines a principle according to which “the enterprises and other organizations are free to organize ... and they guarantee for their responsibilities in juridical relations by the assets at their disposal.”

The above quoted provisions of the current Constitution of the Republic of Serbia do not leave much space for freedom and arbitrariness of interpretation, at least concerning the issues that are analyzed in this paper, which might give them different meaning than that resulting from the known and acknowledged methods of legal interpretation so far.

It is quite a different question if we are satisfied with the meaning of these constitutional provisions and legal consequences resulting from them. If such an interpretation is not satisfactory for the interest of the majority of legally relevant subjects in the country, then the way to overcome such a situation is quite clear. This means to make amendments to the Constitution or the amendments to those provisions for which there is a coordinated attitude on the need to amend such a constitutional provision. Anything other than that would mean further discrediting of the legal system of the country and allow such a degree of voluntarism that would seriously question the basic legal security of citizens and firms. Considering all this, it can be concluded with full certainty that the majority of provisions of the current Law on privatization are not validly founded in the Constitution.

On the other hand, the rule should be honoured that only the Constitutional Court is authorized to make competent decisions on the constitutionality of legal documents, including the regulations covering proprietary transformation. Accordingly, as far as it can be seen from the announced decisions of the Constitutional Court of Serbia, it did not take a stand toward the constitutionality of the Law on privatization. This means that there are not conditions to declare this law unconstitutional overall or partially. However, the fact is, at least according to publicly expressed claims, that there is an initiative for evaluation of constitutionality of this law. Non-acting upon such an initiative represents also a specific form of obstruction of the principle of constitutionality.

By such a conduct, the Constitutional Court of Serbia actually obstructs its main function of the guardian and guarantor of constitutionality. On that occasion none of the reasons, and the least those in the domain of political appropriateness evaluation, can excuse the Constitutional Court of Serbia for non-performing its main function. In this way the Constitutional Court of Serbia added to its competence not only the interpretation and protection of the constitutional system, but also its creation, which naturally belongs to representative bodies only (either constitution-making or law-making).

The issue of obligatoriness of proprietary transformation of public enterprises can also be approached from the aspect of solutions that exist in other firms. The following fact can be noticed within that context: public enterprises, as a form of organization through which the work of public interest is performed and state property, as a specific collective form of property, are not the characteristic feature of legal system in Serbia only, but are known to almost all contemporary legal systems.

To support the above stated claim, we shall quote only two examples in the paper that are illustrative enough and based on them the misconceptions and tactlessness of the domestic lawmakers can be clearly noted.

First, we can quote a regulation by the European Union, which in the form of the Directive of the internal electric energy market (Directive 96/92 dated December 12, 1996)⁵ determines the obligations of the European Union member-countries regarding coordination of their regulations and measures of energetic policy with the provisions of this Directive. At several places in the Directive (See Article 2, Paragraph 2 and 3; Article 7, Paragraph 1; Article 10, Paragraph 1 and 2; Article 15, Paragraph 1 and 2; Article 22, etc.), as well as in its introductory notes (See provisions 5, 9, 10, 13, 16, 17, and other), there is a solution according to which from the aspect of regulation of European Union member-countries the supply of electric energy may be established as a public obligation that would be carried out by public enterprises of a particular member-country. Moreover, this Directive creates also a presumption of right for the existence of power supply enterprises within the European Union regardless of the system of ownership or the legal form according to which the enterprises operate (See Article 15, Paragraph 2 of the Directive). In other words, even the European Union regulations, with which the domestic regulations are to be coordinated do not include the obligation of full and time-limited proprietary transformation of enterprises with the majority of state-owned capital or fully-state owned capital as an imperative (this is based on Article 16, in the sense of Article 3, Paragraph 6 of the Constitutional Charter of State Union of Serbia and Montenegro, which determine certain obligations for

The other example comes from Hungary, where the regulations and especially the transitional experience are often quoted as an example to be followed by the law-making and executive bodies of Serbia. Moreover, a considerable number of domestic experts participated in the practical training in this country, so that the quoted solutions in this field existing in Hungary should not be new, at least not for those experts.

In Hungary, the main regulation determining standard framework and privatization procedure is Law XXXIX from 1995⁶ on the sale of property of state-

⁵ Directive 96/92/EC of the European Parliament and the Council of December 19, 1996, o.j.l.ol 7, 30.1.1997. p. 0020-0029)

⁶ Law XXXIX dated May 09, 1995, on the sale of property of state-owned companies (Official Gazette of Hungary, no. 50/1995).

owned companies, which was adopted by Hungarian Parliament at its session of May 09, 1995. This law started from the following goals:

- To improve the efficiency of firm operation;
- to stimulate changes in the structure of firm operation;
- to improve the firm operation organization;
- to develop the domestic capital market;
- to support domestic entrepreneurs;
- to keep the existing and to open create new jobs;
- to allow for workers to acquire property;
- to maintain and improve business capabilities of economic societies and other legally determined goals.

It determined the models and procedures of privatization. Leaving aside the other aspects of privatization in Hungary, the special attention should be paid to Article 7 of the above quoted Law. Namely, paragraph 1 of Article 7 of the Law on the sales of state-owned enterprises determines the rule according to which the property that was legally determined as state-owned capital to be the subject of privatization “may remain in state ownership permanently, if the property or the society through which it functions are state public enterprises.” In addition to this principled provision, paragraph 3 of the same Article determines the rule according to which “the government share in societies remaining in the permanent state ownership cannot be lower than the share providing 50% + 1 of votes”. In addition to this, for the societies that remain in permanent state ownership, the proportions of social roles as well as the bodies through which they fulfill their shareholders’ rights are determined by the Annex to this Law.

Naturally, the stated comparative solutions are not obliging for us to do the same. The domestic legislators are free to pass the regulations in accordance with the considered national interest and to protect that interest as much as possible while all comparative advantages should be emphasized at that. This is indisputable. After all, we have not asked either the European Union or Hungary when we introduced and developed the concept of associated labour and worker self-management. However, at least for the sake of respectability, the explanation of the current solutions referring to “the contemporary solutions of other successful countries” should be avoided or referring to the regulations and practice of the European Union as prerequisites for Serbia getting included in the flows of European economic integrations. Such an attitude is the result of the fact that these regulations, as above quoted, regulate privatization in quite a different manner, at least in the field of proprietary transformation of public enterprises.

4. Special conditions and the procedure of privatization of public enterprises

Generally speaking, the issue of proprietary transformation, especially the transformation of public enterprises taking into account their role in economy, should be regulated by standards in such a manner as not to leave the space for any dilemmas about the goals that should be achieved, or procedures and models that are in function of such a set goals. Let us for a moment set aside the fact contained in the realistic doubt on the constitutionality of the valid regulations on privatization and focus our attention to the analysis of legal provisions on proprietary transformation. It can clearly be observed that there are certain specific features that make the proprietary transformation of public enterprises special, if compared with the general regulations for privatization of other firms in our country. This specific feature manifests in several important segments, which would be independently worked out for easy reference.

4.1. Restitution of state ownership over instruments of labour of public enterprises

The question of defining and determining the scope and structure of state ownership is not given particular attention within the concept of proprietary relations with dominant state ownership over instruments of labour. Accordingly, the provisions of Article 56 of the Constitution of the Republic of Serbia seem discordant, which among other things guarantee the right of state ownership without determining the legal bases for establishing such proprietary relations. It is true that the Article 59 of the Constitution of the Republic of Serbia determines that “proprietary rights and obligations over the assets in social and state ownership, as well as the conditions under which these assets can be transformed into other proprietary forms are regulated by laws”. However, this formulation undoubtedly makes one conclude that this constitutional provision defines legal bases for transformation of the already established proprietary relations of the state ownership into other proprietary forms, but not the conditions under which the state ownership can be established.

This understatement of the Constitution of the Republic of Serbia concerning the conditions and procedures of establishing state ownership was in a way overcome by the Law on Public Enterprises from 1990. According to the provision of paragraph 1 of Article 4 of this Law, it is determined that the state ownership in an enterprise can be established in one of the following manners:

- by determining natural resources and goods in common use that are owned by the state;
- by determining other resources with which the enterprise operates and which are in state ownership;

⁷ Official Gazette of the Republic of Serbia, no. 37/1991

⁸ Official Gazette of the Republic of Serbia, no. 38/1991

- by determining the resources owned by the state as the share of the state invested in the development of enterprise.

What gives the specific feature to the above quoted provision is the fact that it creates a basis for the special laws to determine the resources that would become state property according to one of the quoted bases. In this way, this *de iure* legal provision is given *de facto* constitutional-legal character.

Under the influence of this provision of the Law on Public Enterprises from 1990, there were a number of subsequently passed laws in the Republic, primarily in the course of 1991, by which the public enterprises were established at the level of administrative agencies of the Republic. They determine that the resources by which these enterprises were established are state-owned. Accordingly, we can quote, among others, the following provisions:

- paragraph 1 of Article 4 of the Law on establishing public enterprise for the research, production, processing and sale of oil and natural gas;⁷
- paragraph 1 of Article 14 of the Law on radio-communication systems;⁸
- paragraph 2 of Article 11 of the Law on railway;⁹
- paragraph 1 of Article 9 of the Law on electric power industry;¹⁰
- paragraph 1 of Article 11 of the Law on forests;¹¹
- paragraph 2 of Article 81 of the Law on waters;¹² and
- paragraph 1 of Article 22 of the Law on Radio-television.¹³

The main characteristic of all these laws is that according to the above quoted provisions the resources with which certain public enterprises were established were proclaimed as state-owned resources, so that they initially started their operation as the enterprises with state-owned capital.

4.2. Transformation of state property in public enterprises

One of the main characteristics of the Republic regulations regarding the conditions of establishing and operation of public enterprises is contained in the fact that these regulations, although determining that the overall resources of public enterprises are initially state-owned, do not consider this condition permanent. On the contrary, once established public enterprises with state-owned resources are put into continuous process of proprietary transformation.

This law thus determines the framework for privatization of firms (in this concrete case the Republic public enterprises) and they must observe these regulations.

⁹ Official Gazette of the Republic of Serbia, no. 38/1991

¹⁰ Official Gazette of the Republic of Serbia, no. 45/1991

¹¹ Official Gazette of the Republic of Serbia, no. 46/1991

¹² Official Gazette of the Republic of Serbia, no. 46/1991

¹³ Official Gazette of the Republic of Serbia, no. 48/1991

The first framework refers to the specifics of proprietary transformation depending on the type of resources over which the state ownership was established. Three main solutions may be seen to that effect. According to the first one, which was applied in case of Public Enterprise NIS (Oil Industry of Serbia), Public Enterprise Srbijasume (forests) and water-supply public enterprises, all resources are state-owned and can be proprietary transformed under the same conditions. The second solution was applied in case of Electric Power-supply public enterprise (EPS), Railways and PTT, according to which the sale of the flats that make part of the balance of these enterprises on the day of their establishment may be carried out in accordance with the regulations for sale or purchasing of flats. Finally, in case of Radio Television of Serbia, the rule was determined according to which the resources at the disposal of this public enterprise can be transformed into other forms of property without limitation, excluding the resources that in accordance with the law serve to perform the activities for which the enterprise was established, and which are separately regulated by the by-law on that public enterprise.

The second framework is determined by the scope of privatization. It has been done by determining the percentage up to which the state capital in public enterprises may be proprietary transformed. In all analyzed cases, this percentage cannot exceed 49% of state capital, providing that depending on the attitude regarding the resources included in the calculation of state-owned capital subject to transformation the flats are excluded from the capital, in cases where this is provided for. In case of RTV Serbia, this includes other resources not in the function of the main activities of this enterprise. In this way, the majority participation of state-owned capital in the resources of public enterprises is provided and based on this the protection of public interest contained in regular and continuous performance of activities for which the public enterprises have been established.

The third framework of proprietary transformation of public enterprises is established on the fact that the proprietary transformation procedure will be carried out based on the restructuring program of managing bodies of public enterprises with the consent of the Government of the Republic of Serbia. It is interesting that in case of certain public enterprises, such as EPS and NIS, in addition to proprietary transformation of state-owned capital, the legislator emphasizes especially the necessity of organized transformation of these enterprises.

4.3. General conditions of proprietary transformation of state property

The current Republic Law on privatization¹⁴ defines as subject of privatization the socially owned capital or state-owned capital in firms or other legal entities, if it is not otherwise provided for by the regulations. Referring to this,

¹⁴ Official Gazette of the Republic of Serbia, no. 38/2001

there is also the provision according to which the property, a part or several parts of property belonging to the subject of privatization may be sold in the course of privatization procedure.

From this legislator's approach and in accordance with the concrete subject of analysis in this paper, three main principles of privatization can be deduced:

The first principle is that the legislator treats the socially owned and state owned capital in the same way. The result of this is the solution according to which in the field of proprietary relations only the right of property will exist as an expression of private and proprietary relations.

The second principle is contained in the attitude that the provisions of this law refer to all organizational forms in which firms can operate. There is not any distinction made depending on the nature of business activities of the particular firm, or the importance and influence of these activities to working and business conditions of other firms.

Finally, starting from the reference regulation according to which the special regulations can otherwise determine the subject of privatization, we have the third principle as a result, according to which every different regulation of the subject of privatization represents an exception to the rule and therefore should be interpreted restrictively.

Considering all this, it can be pointed out in the form of a general attitude that for public enterprises also there is a general system of proprietary transformation established, which boils down to privatization, if it is not otherwise regulated by some special regulations.

On that occasion, the field of exception to this rule is not limited regarding either content (the need for special coordination with the Law on privatization) or time (determining the moment from which the validity of special regulations is acknowledged). The validity of provisions of separate Republic laws resulting from all this, according to which the existing public enterprises in the Republic have been established and operate as firms, has not been put in question. In this context, they have the character of *lex specialis* regulations. Accordingly, the subject of privatization of state-owned capital in public enterprises is limited in content by the provisions of these laws of the structure of state-owned capital, and in scope by the percentage up to which that capital may be transformed proprietarily, and privatized.

In particular, cases of the existing public enterprises, the percentage of "free" state-owned capital, which is likely to be proprietary transformed, cannot exceed 49% of the total capital of these public enterprises. On that occasion, the percentage of state-owned capital that can be privatized should be put into relation against the total value of capital of public enterprise. The legal consequence of such an approach is that proprietary transformation of state-owned capital does not have to be realized in the same percentage for every part of property of that enterprise. In principle, the solution is possible according to which certain parts

of property, even the parts of public enterprise would be completely privatized, on one condition only – that the value of such privatized state-owned capital does not exceed 49% of the total value of state-owned capital of that public enterprise.

For the sake of more precise determining the subject of proprietary transformation of public enterprises, it is necessary to quote the legal provision according to which the subject of privatization cannot include the natural wealth and goods in common use, as well as goods of common concern. The fact that the majority of public enterprises in performance of their registered business activities use *de facto* both the natural wealth (mineral raw materials, water resources, forests, etc.) and the goods in common use (roads, railway and PTT facilities, etc.) is not important for determining the subject of privatization of these public enterprises. These objects, as well as the goods of common concern, cannot be subject of privatization. The right to use and exploit them can be effectuated on some other legal basis, but not in the course of privatization procedure of public enterprises.

Usually the procedure of proprietary transformation of public enterprises in the part of capital that can be privatized (up to 49% of the total value of state-owned capital) is almost identical to the procedure of privatization of other firms. This refers to both the initiative, preparation of the procedure, choice of privatization model and carrying out the procedure in accordance with the chosen model of privatization. A certain exception to this rule is the provision according to which the Government of the Republic of Serbia is authorized to approve the privatization of concrete subject of privatization with the majority of state-owned capital at the suggestion of a relevant ministry for privatization. In the spirit of this provision, the attitude of the Government of the Republic of Serbia concerning the consent or refusal of consent concerning the initiative for privatization represents a constitutive element for carrying out further procedure of privatization of the concrete public enterprise.

The particularity of conditions of proprietary transformation of public enterprises can be considered also by the analysis of time limits by which the process of privatization should be completed. Paragraph 1 of Article 14 of the Law on privatization is indicative to this effect, according to which the subjects of privatization with socially owned capital are obliged to carry out the procedure of privatization within four years from the date of this law becoming effective at the latest, which specifically means by July 07, 2005, at the latest. As it can be seen from the quoted legal provision, the time limit for privatization procedure is established only for those firms that run business with socially owned capital. By *a contrario* interpretation of this provision, it can be concluded that the legislator has not established a time limit for privatization of those firms that run business with the majority of state-owned capital.

What makes the position of public enterprises specific in relation to the time limits for the completion of privatization of state-owned capital is the circumstance that this procedure has not to be completed within the time limit established for privatization of socially owned capital even for the first part (up to 49% of total value of state-owned capital). In view of considerable participation of the Government of the Republic of Serbia in the procedure of privatization of firms with the majority of state-owned capital and referring to the consent for the initiative for their privatization, it can be expected with good reason that the framework of the possibly given consent will also include the time limits by which the privatization procedure must be completed.

It is necessary to emphasize once again two realistically indisputable facts. First, the Government of the Republic of Serbia is not obliged to give consent for privatization on any ground for any subject of privatization with the majority of state-owned capital. It is sovereign in its right to give consent or refuse to give consent to the initiative for privatization of the subject with the majority of state-owned capital. Second, possible consent to the initiative for privatization of the subject with the majority of state-owned capital can refer only to the part of that capital that cannot exceed 49% of total value of state-owned capital in that public enterprise.

Finally, what is important from the aspect of analysis in this paper is the fact that in the course of validity of the Law on privatization so far (it became effective on July 07, 2001), the procedure for proprietary transformation of any public enterprise (in the sense of privatization of state-owned capital in that enterprise) has not been officially initiated. It is obvious that neither the valid legal solutions in this field, but also the system environment in which these enterprises ran business, were inspirational for the decision to be made to begin the process of proprietary transformation and give consent for that transformation.

5. Restructuring in the course of proprietary transformation

In order to provide regulations for carrying out the privatization of domestic firms, the legislator provided realization of these assumptions on two bases.

First, the Privatization agency and interested buyers are given the right to initiate the procedure of privatization if the subject of privatization does not do this itself, therefore, in case the subject of privatization is not ready to initiate the carrying out of privatization process.

Second, there is the procedure of restructuring of the subject of privatization, if the Agency estimates that the subject of privatization cannot be sold according to one of the models provided for by the law prior to restructuring, therefore, in case when the objective assumptions for successful carrying out of privatization procedure are not fulfilled.

Because not one procedure of proprietary transformation for any of the Republic public enterprises has not been initiated and consequently not carried out, there is a need to consider the possibilities existing within the segment of regulations regarding the conditions and the procedure of restructuring of the subject of privatization.

First of all, the procedure of restructuring according to the Law on privatization and the Statutes of the procedure and the manner of restructuring firms and other legal entities¹⁵, is connected with the sale of an enterprise and is conditioned by making a decision on restructuring. This decision will be made in the following cases especially:

- when it is impossible to carry out the privatization procedure of an enterprise in its existing status or organizational form;
- when it is impossible to carry out the procedure of privatization with the existing structure of capital;
- when there are not potential buyers within a reasonable period;
- when the firm's liabilities exceed the total value of assets reduced for the amount of losses of the current and previous years.

The decision on restructuring has a constitutive effect. Actually, from the day when it was made, it is considered that the privatization process has begun. Related to this, the Privatization agency can decide to carry out the firm's restructuring on its own or to send a request to the competent body of the subject of privatization to make and submit the restructuring program to the Privatization agency.

Determining restructuring as organizational – status-related and material and financial changes in the enterprise that make it interesting for domestic and foreign legal and physical persons concerning business to become the owners of its capital or property, the above mentioned regulations in this field provide for the following restructuring models:

a) status-related and organizational changes include:

- merging of dependent firms within a joint firm by take-over or new establishment;
- dividing a firm into several legal subjects;
- selling of parts of a firm;
- transfer of property or part of property to other legal entities;
- changing the form of a firm, or changing a form of dependent firms;
- changing internal organization of a firm by closing unprofitable business departments;
- discontinuance of work of unprofitable activities of a firm;

¹⁵ Official Gazette of the Republic of Serbia, no. 1/2002

- b) **settlement of debtor-creditor relations** includes:
- deferred payment or rescheduling of debts of a part of company with the consent of the majority of creditors;
 - transfer of liabilities from one dependent to the other dependent firm within the joint firms, with the consent of the majority of creditors;
 - writing off the capital sum, adherent interests or other claims, in full or in part, with the consent of the majority of creditors;
 - conversion of financial claims by the creditors with the majority of state-owned capital into the capital of that company;
- c) **other forms of restructuring** include:
- measures for the increase of firm's capital;
 - measures for the decrease or increase of the number of employees;
 - other measures referring to the particular company, which enable the sale of its capital.

In addition to the regulations on proprietary transformation, i.e. privatization, the provisions of the laws according to which these firms have been established and in accordance with which they operate as firms also refer to the need to make a restructuring program. The terms are then less relevant (restructuring, or proprietary transformation) in relation to the function and the goal set for this program. Disregarding certain differences in defining these functions and goals, they can be reduced to the orientation that the restructuring program would make optimum business efficiency of a public enterprise and accordingly additionally recognize the goals of its establishment. Such an orientation results from the fact that public enterprises were initially established as enterprises that incorporate various but technically and technologically intertwined activities within one legal entity. Such a solution under the condition of technical and technological complex business systems that exist in the majority of such enterprises had to be corrected necessarily from the very beginning due to the requirement to find the appropriate organizational and status-related forms that would not be a limiting factor to perform the registered business activities of a particular public enterprise.

In addition to the quoted domestic regulations, the need to make adequate programs of restructuring is substantiated also by the provisions of certain foreign regulations, which regulate the framework and conditions for business practice of domestic firms at foreign markets, or in this particular case the markets of the European Union member-countries. An example of these regulations is the previously quoted Directive of the European Union on the internal electric power-supply market. In accordance with the provisions of this Directive, the rules suggesting the internal organization of electric power supply enterprises and mutual relations of these enterprises with other companies have been stated in several articles (par. 1, 5 and 6 of Article 7; par. 2 of Article 10; Article 13;

par 2 and 3 of Article 14; par. 1 and 2 of Article 15; Article 22, etc.). These rules should be incorporated in the respective national regulations of the member-countries. Similar provisions exist in the law on the European Union determining the internal market of natural gas.

Considering that Serbia is not the member of the European Union and that it has not signed the agreement to join it, it can be concluded that these regulations are not legally binding for us. However, the need to get included in the processes of European integration, and even more the business operations with the European Union member-countries, refer to the necessity of appropriate harmonization of domestic regulations with the regulations of the European Union. Accordingly, the solutions from the European Union should be accepted by and adjusted to domestic regulations by making public enterprises restructuring programs.

In this way, parallel to the program of proprietary transformation that is conditioned by many factors, the conditions would be provided for the appropriate organizational, status-related and managing transformation, for which at the moment there are not any special obstacles and pending questions. This would, in accordance with the provisions of domestic regulations on restructuring process create more favourable conditions for proprietary transformation of the part of capital in public enterprises that is subject to privatization. Further delay in making the decision and implementing the organizational, status-related and structural changes in public enterprises can reversely make the idea of privatization of these enterprises absurd in the near future, referring to any part of capital of these enterprises.

6. Conclusion

From the time of the first regulations determining the models and procedures of proprietary transformation (Law on socially owned capital from 1988), it attracts considerable attention not only of legal but also of a wider social public. However, the lack of political consensus regarding the goals of proprietary transformation on one hand, and the indisputable cases of social injustice resulting from it on the other hand influenced the carriers of political power to often change their attitude on the opportuneness of implementing certain models, by which the whole process of proprietary transformation was periodically seriously questioned. The consequence of this was that from the time when first regulations on proprietary transformation were passed until today several legal bases according to which it should have been carried out were changed. All this influenced the creation of the feeling of legal insecurity in this field, where that security was *conditio sine qua non* of the successfulness of the whole project.

Such a condition of legal settlement of proprietary transformation issue interpolated to the case of proprietary transformation of public enterprises. This

was additionally contributed by the incomplete attitudes on criteria for determining the notion of public enterprise, as well as the process of origination and proprietary transformation of state-owned property of instruments of labour with which the majority of public enterprises runs their business practice.

Considering the complex of regulations valid in the field of proprietary transformation of public enterprises, it can be stated that there are two systems of proprietary transformation of the state-owned capital. The first one refers to the part of state-owned capital not exceeding 49% of the total state-owned capital of the public enterprise, that are subject to proprietary transformation according to the regulations effective for proprietary transformation of socially owned capital. In this case, the explicit consent of the Government of the Republic of Serbia is required and a time limit by which the process must be completed is not established. The second one refers to the part of state-owned capital amounting to at least 51% of the total state-owned capital of the public enterprise, which according to the valid regulations cannot be subject to proprietary transformation in the sense of its privatization. It represents the main form of protecting public interest contained in regular and continuous performance of activities for which these enterprises were established.

However, regardless of the model of proprietary transformation of public enterprises, and even the system according to which the part of state-owned capital can be privatized, it is necessary to point out that the privatization of public enterprises must respect the conditions under which the capital of these enterprises originated.

This does not refer to legal basis according to which the by-then socially owned property was turned into state-owned property. This refers primarily to the circumstances under which the capital now in public enterprises originated. It is undoubted that the participation of a wider social community through general and special investment funds, government loans, and even direct budget investment, considerably and even predominantly influenced the structure and amount of that capital. Naturally, an interesting situation should be included, which is not considerable in scope but in its legal consequences. Namely, the users of public enterprises services have constructed and transferred to public enterprises some of the facilities that are now in property of public enterprises, since such a transfer was a condition to use the services provided by the particular enterprise. Finally, it is necessary to point to the fact that the construction of certain facilities that are now in property of public enterprises was carried out by the assets provided from the price of products and services of other public enterprises, which were collected from end-users and purposefully directed to the construction of these facilities.

In brief, the state-owned capital in public enterprises has not originated based on a single state investment in the property of a public enterprise, and

especially not as a result of a successful work and business practice of a public enterprise with the capital that the state invested in that enterprise.

Then it can be concluded that there are too many pending questions to be answered so that the procedure of proprietary transformation of public enterprises could successfully be carried out. Accordingly, before the proprietary transformation of public enterprises it is necessary to consider once again the goals of that transformation (which cannot be contained only in the inflow of a certain amount of finances into always-empty state budget), as well as objective circumstances that influence the achievement of these goals. Then in accordance with these attitudes, it should determine the models and procedures according to which these goals will be achieved optimally, without bringing into question the general or special legitimate interests of other subjects in the country. The role of the domestic science at that, as well as the role of business practice in public enterprises are considerably important and represent the irreplaceable condition for the success of this extremely important and responsible job.

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GLOBAL BRANDS IN DEMAND MANAGEMENT

Abstract: *The capability to manage demand is the characteristic of a very few companies extremely large in size and power. In addition to their size and power, the companies capable of demand management are also characterized by huge international management and marketing experience, innovative quality, capability to predict and create new jobs, products, brands, markets as well as the needs and desires of consumers. The companies make demand management operative by the instruments of international marketing, where managing global brand holds the key position.*

The guiding principle of the company's strategy created in accordance with the consumers is that "the consumer values, the consumer chooses." Choosing the brand is more beneficial for the consumer than choosing the product.

Key words: *global consumer, global brand, global market, demand management.*

1. Consumers at the global market

Under the conditions of world market globalization, only the companies that primarily create and consequently satisfy the needs of the world consumer can be considered capable to manage global business activities.¹ It is therefore justified to measure the skill of managing global business activities by the successfulness of company's business practice in the global environment with the consumer as a core, or in other words by the successfulness in demand management. The companies make the demand management operative through global marketing strategy, which is based on the strategy of positioning a product by the brand.

It is necessary to meet the requirements of global consumers better than the competition, which becomes increasingly hard when the competition acquires global character as well. The representatives of global competition are the companies earning the majority of income in the foreign markets, which have internationally well-known brand name(s) and business system as a whole, and

¹ The unknown author says: "There are three types of companies: those that set in motion, those that observe from aside and those that are surprised at what has happened," According to: Ph. Kotler, *Upravljanje marketingom I*, p. 68.

as such shape the contemporary business activities and determine the process of world market globalization. The most successful in global business management are those leading companies that demonstrate the behaviour characteristic for a global competitor.²

Consequently, the consumers of global environment demonstrate the similar needs for products and services on one hand, and specific requirements for them on the other hand. The cause of imbalance between the needs and requirements of global consumers lies in the intensifying of innovative quality and the need for competitive differentiation, necessary today but also characteristic for companies that create the needs of global consumers, i.e. leaders. Therefore, the ever-increasing number of products with internationally well-known brand names that are sold by global sales channels and that are followed by global promotion contributes to the creation of similar consumer needs regardless of where they live. The researches showed that 1990s were the beginning of the 'rule' of products with internationally established brands.³

On the other hand, creating global marketing strategy becomes more difficult under the conditions when the consumers value the same product variously. Various valuing of the same products by the consumers is influenced by the behaviour of every individual as a consumer. The consumer's behaviour when choosing is determined by both the personality of each individual and the environment that defines the framework for demonstration of such a behaviour. The products valued as of high quality in the developed countries are valued as luxury products in less developed countries. The products that are usually used in the developed countries are used depending on the habits of consumers in less developed countries. For instance, in less developed countries the consumers are not used to fast food products. They use fast food products between meals, since they have not acquired a habit to consider it in a different manner or have the sufficiently high purchasing power to pay for the meal as much as the traditional 'home-cook meal' would cost. At the target markets also, where the living standard is higher, contemporary sale forms dominate the purchase of all kinds of products: periodic purchase of food products, purchase of consumer durables exchanging the old ones. At less developed target markets the traditional sale form still exist, especially regarding the food products: it is a daily purchase of food products. The most developed sale forms may be found in large cities and the majority of them are the part of retail system of internationally known companies. The environment therefore determines the various behaviour of consumers in purchasing durable and non-durable consumer goods, or in other words, the consumers behave variously depending on the degree of the development of social and cultural environment and economy itself.

² V. Milanović-Golubović, *Posledice globalizacije poslovanja leaderske grupe konkurenata*, doctoral thesis, Faculty of Economics, Beograd, 2002.

³ K. Ohmae, "Putting Global Logic First", *Harvard Business Review*, I/II, 1995.

In addition to the working and living environment, the cause of various valuing of the same product by the consumers lies in the existence of various brands of the same manufacturer, which has qualified the habit for primary determinant of consumer's brand choice. The habit is, among other things, a part of culture of a nation or society. Culture in general, as well as the culture of purchase and choice, is not the category with which an individual or the society are born, but the category which is acquired and which is possible to influence. The influence on culture change is more intensive in societies where traditional culture is dominant. Traditional culture is harder to shape since the process of its development is long and since it has already been adopted. However, the internationalization of less and less ethnic-oriented life style of consumers leads to life styles of various cultures growing closer and to overcoming of traditional consumer habits regarding choice and valuing.

This growing closer of life styles of various cultures creates the various liking of consumers in the new cycle due to intertwining of elements of various cultures and shopping behaviour models. This does not standardize the consumers' liking but the market-accepted innovation is enriched by product variant for several likings. The effect on the consumer is demonstrated through changes of shopping models and types of demand, which stimulate the traditional choice criteria to disappear. The changes of shopping models and types of demand, which stimulate the traditional choice criteria to disappear, proceed at various speeds, so it can also be said that shopping culture changes at various speed depending on the social and cultural determinant of the environment. In this way the consumers change shopping habits, create new sets of values and beliefs, form the contemporary cult of values, change the model of their behaviour prior to and after shopping, develop consumer's consciousness of comprehending products and brands.⁴

It follows that the consumer's choice between several various brands within the same product category is determined by his personality and life style. It is therefore justified to ask how to create differentiated global marketing strategy the target of which would be the consumers' loyalty when the companies do business under the conditions of global competition, strengthening of global brands and global consumers' needs. The answer is in the consumer's attitude towards the brand, or the value the consumer assigns to the product brand. Therefore, the value the consumer assigns to the brand represents the basis to create successful international marketing strategy of a company. The value assigned to the brand product by the consumer is the consequence of the benefit he has by brand choice and then the product.

⁴ V. Milanović-Golubović: *Op. cit.*

2. Benefits for consumers choosing a global brand

When a consumer decides to choose a brand, he benefits more than when he decides to choose product primarily disregarding the brand. The benefits for choosing a brand and not a product are value for the money, confidence in the quality, easier planning of expenditure, easier choice in shopping, satisfaction of the right choice, shopping experience and trade culture.

The consumer gets the full value for the money when he chooses high-quality product brand where emphasize is on the value got by the choice and not on the price. The existence of global segments is particularly demonstrated at the market of personal consumer goods, which is the reflection of consumer's status and which, as such, enables the change of strategy of high and unique prices.⁵ Therefore, the premium value for the consumer who chooses specialized products does not necessarily base on premium quality, but has a premium price.

The consumer gets higher value for the same amount of money when he chooses the product with the same quality as that of the competition, but has lower price and higher level of service. The research has shown that higher value for the same amount of money is got by choosing the brands of the most famous and the most successful chains of discount stores, super markets and hyper markets for food products, such as *Wal Mart*, *K Mart*, *J. Sainsbury*, *Carrefour*, *Promades*, that successfully differentiate from the manufacturers of daily and periodical consumption.⁶

The permanent quality, regardless of its level in this context, is the reason to have confidence in quality. Permanent relation of quality and price makes it easier for the consumer to plan expenditure for further shopping. Permanent quality and permanent quality-price relation builds the brand image, so the choice in shopping is made easier if it is done by choosing the brand and then the product. The satisfaction of right choice is the consequence of feeling that 'the shopping was well done' and money spent "intelligently" or the feeling of prestige if the brand choice is done from that aspect. The feeling of shopping well done should appear in consumer's mind while he is still in the store, intensify when he passes the store and culminate when he uses the product, whose world known brand raises the value of choice made and general culture of choice/shopping. This is why the relation between the entrance of a consumer into the store and his choice of brand in it is the relation of primary task and target of the company.

The level of consumer services and impressions with which the consumer leaves the store is the company's contribution to the construction or maintaining brand consumer's loyalty. The consumer services can be directed by quantity and structure adjustments at every foreign market, in any facility or by the consumer type. Computerized system for giving information to consumers and

⁵ *Annual Report and Accounts*, "The Body Shop", London, 1998, [www. Benetton.com](http://www.Benetton.com)

⁶ *Annual Report and Financial Statement*, Sainsbury, London, 1993; *Carrefour*, Carrefour, Paris, 2000.

receiving information from them enables differentiated and adjusted set package of offered services. Such a communication system determines the limits of promotion and communication with customers. High level of services is the consequence of first-class relationship between the seller and the customer before, in the course of and after the choice has been made, the consequence that creates the customer's impression. The impression of the customer when leaving the shop can be compared with the impression that he should have after returning from the picnic. Therefore, the ambient of the shop becomes the lowest but primary level of communication of the consumer with the brand, which is the result of research of business practice of *Mc Donald's*, *Benetton*, *W.H. Smith*, *Tesco*.⁷

Communication between the customer and the brand through the ambient of the shop is done by the system of exhibiting the products at the place of selling and by internal communication climate created by interior design of selling place. Communication via shopping ambient is directed at customers who have already entered the shop, regardless of whether they have purchased or not. Those customers who have made a purchase leave the shop with the impression of a purchase well done and intelligently spent money, and those who have not made a purchase leave with the impression of personal experience of trading in highly positioned ambient of the shop. In order to make it possible for the large number of customers to get into contact with the brand in the shop, it is necessary to enable the customer to communicate with the brand locally and globally.

The customers communicate with the brand locally within the shops in the role of stationary company media. Company's shops create communication atmosphere within themselves, which is the result of the harmony of strategy of exterior shop design and window shop arrangement. The communication atmosphere is created by exhibited collections of products in the role of marketing objects. The consumers get visual satisfaction, which intensifies the brand perception, and the satisfaction of choice well done, if the purchase was accomplished.

Company creates and carries out communication of the customer with the brand globally by the strategy of corporate communication, which emphasizes the role of the leader. Using media marketing, the company does not communicate over the real expression of the product, but over the dimmed reality expressed as things and events that at first sight have nothing in common with the products. The family portrait of every company should not be made by the products it sells but by the symbols associating of its products and their identity. Colours, shapes and symbols led by the company's name and slogan are given the task to remind the consumers in a game-like fashion of the corporate identity of

⁷ *About Benetton*, Benetton, Milano, 2000; *Annual Review and Summary Financial Statement*, Tesco, London, 2000. *McDonalds in UK*, Mc Donalds, London, 2000. *W.H. Smith Group*, W. H. Smith, London, 2000.

the company and enable them to communicate closely with the company brand. "Brand and slogan of the company are the embodied expressions of its mission. Slogan is brand power's 'leash'."⁸

Using global communication strategy, the company creates communication atmosphere between the global public or global consumers and global brand. The satisfaction of right choice leads to consumer's satisfaction, which together with the experience in shopping aspires to consumers' loyalty to the brand and company. Consumers' loyalty, as an expression of brand power, makes vital contribution to further development of branded business.

3. Consumers' loyalty to world known brands

The company can achieve the loyalty of the existing and acquire the loyalty of the new consumers, only if:

- it acknowledges consumers,
- it has product brands they want,
- it knows the way the consumers like best to get the desired brand, and
- it knows the way to reach its consumers easily, or lead its consumers to their brands.

The loyalty of the consumers to the world known brands is measured by the invariable value they can get for their money, possibility to choose, quality, services and communication climate. Therefore, it can be said that demand management is actually managing of brands chosen by the consumers and based on which they value their choice.

3.1. Brand types

Company's strategy created in accordance with the consumers is carried out by the exploitation of the power of their own, (other) independent and common brands until reaching the most favourable advantage in business.⁹ Therefore, the brand management is actually the management of one or more mixed brands consisting of generic, production, and trade or combined brands.

Generic brands are worn by unmarked products. Unmarked products are manufactured by nationally oriented manufacturers using simple technologies, and they are sold at lower prices than the products having nationally marketed manufacturer's brand. For instance, French hypermarket chain Carrefour has introduced a variant of generic brand, marking the products as "*Produits libres*",

⁸ The statement of Mr. Luciano Benetton, one of the founders and owners of the Benetton company in "How Brand Power Works", Milan, 1996.

⁹ V. Milanović, *Komparativne strategije razvoja trgovinske marke u razvijenim tržišnim uslovima*, Master's Thesis, Faculty of Economics, Beograd, 1993.

and the British chain Tesco as “Tesco Economy”, appealing to lower prices.¹⁰ The development of generic brands by the above-mentioned companies was the initial strategy of brand development within its evolving path. Generic brands have less importance in the international marketing practice and international business practice.

Production or producer’s brand is the category by which production company acquires certain advantages that can be systematized in the following way:

- differentiation of the product with the production brand in comparison with the similar competition products;
- easier placement of branded products at the world market;
- building one’s own image;
- easier promotion and more liberal determination of prices;
- more market control;
- easier launching of new products;
- loyalty of consumers.

Trademark is developed by the trading company, which has the advantages of its own brand expressed as follows:

- easier trading;
- easier identification, manipulation and ordering of goods;
- more flexibility in purchase price policy and supplier’s choice;
- freedom to combine marketing instruments;
- more options to establish constant (high) quality;
- easier policy of prices, distribution and promotion;
- more loyalty by the consumers;
- linking consumers to trademarks and not the manufacturers (products);
- more interest by the employed personnel to place their own goods under their own brand;
- stronger image.

If manufacturing and trading company together develop a brand for a part of the assortment in various variants, then we have a mixed brand, or combined brand.

3.2. Different positions of companies in brand management

Manufacturing companies that have their own nationally known brand manage their own products either by innovating and developing products under the existing production brand or manufacturing products for a known trademark. Therefore, one part of capacities is put in service of a powerful trading company, waving the identity over the product. By manufacturing for a known trademark,

¹⁰ *Annual Review and Summary Financial Statement*, Tesco, London, 2000; *Carrefour*, Carrefour, Paris, 2000.

although they also have a nationally known product brand, the manufacturers get the advantages that surpass the benefits of independent arrangement. The relationship between the manufacturing and trading company becomes more than a cooperation, which is shown by the research of business practice of *Marks & Spencer* and its manufacturers, among which there are manufacturers with which this company cooperates for more than a century.¹¹

Trading companies that have developed their own nationally known brand or several brands within the assortment, manage their articles produced by nationally oriented manufacturers, the identity of whom may or may not be shown at the products. It could be said that C Market Company (Serbia) is the domestic example of a trading company with the easily recognizable letter “C” and the slogan that says “The alphabet of good services”. Thousands of nationally characterized manufacturers work for their assortment, and their identification can be seen on the majority of articles. The pioneer in developing their own trade mark in domestic economy was *Jugoeksport* company (then *YES - Yugoeksportsistem*), which is the unique example of a company managing the assortment of well known brands “My Way” and “My Home”, the manufacturing of which is conditioned by the anonymity of manufacturers and identification of trading company.

The companies that do not develop their own trademark for the complete assortment manage the brands of nationally known manufacturers for the part of the assortment that they do not cover by trademark, and they can offer the same products under the brands of various production companies. This means that the companies that do not develop their own trademark for the complete assortment manage the mixture of their own and manufacturers’ brands. The research of business practice of the chain of supermarkets such as *Sainsbury*, *Tesco*, *Safeway*, *Kroger*, prove the practical application of this thesis, since these companies develop and offer their own trademark for a part of the assortment, but also the production brands for the part of the assortment for which they do not develop their own trademark.¹²

The complexity of managing a mixture of brands increases if the various brands are present to mark the same product category, which leads to the real “war” of brands. The vertical competition within the product category and within the shop is also intensified to that effect, since the trademarks are sold at lower prices than the manufacturers’ brands. The power of trademarks is not only relative but also absolute, which is shown by the example of the Great Britain. Namely, the goods with trademarks participate with over 30% in the

¹¹ *Company Facts 2000*, Marks & Spencer, London, 2001; *International Retailer*, Marks & Spencer, London, 2000.

¹² V. Milanović-Golubović, *Posledice globalizacije, poslovanja liderske grupe konkurenata*, doctoral thesis, Faculty of Economics, Beograd, 2002.

sales scope of British supermarkets in 1990s, and with over 50% at the beginning of the 21st century.¹³

The intensified horizontal competition within the product category is caused by the increasing number of brands, which tend to meet the requirements of a larger segment of world market. The companies such as *Proctor & Gamble*, *Sears Roebuck*, *Burton Group*, develop more brand names within the same product category, which causes competition within their own assortment, but also the horizontal competition – competition among companies that are at the same level in trading.

By developing their own trademark, the world known trading companies manage one or a small number of brand names, which are manufactured by manufacturers of national or international character according to a leading technology. Trading companies with their own renowned brands include top manufacturer brands in the specific products category, if they are not capable of developing a powerful brand name or the brand name to which the consumers would express particular preference and loyalty.

The manufacturers with the known brand manage only their own brands if they refuse to manufacture for a world known trademark, or if the known trading company refuses the placement of the product with the world known production brand. This consequently results in intensification of competition and loss of a part of consumers. The international practice is rich with examples such as companies *Proctor & Gamble*, *Coca-Cola*, *Mars*, *Migros*. In the situation when, for instance, Swiss cooperative *Migros* refused to sell *Coca-Cola* beverages in their stores, it renounced a part of market participation to the competitive trading company which took the placement of *Coca-Cola* beverages in their stores. In addition, if the manufacturer refuses to manufacture for a known trademark, he will have a vertical rival at his own market and will suffer loss of a part of market where trademark products participate. Therefore, the cooperation of companies *Proctor & Gamble* and discount stores *Wall Mart* on the development, production and sales of new brand of washing powder represents the most recent example of cooperation between a powerful manufacturer and powerful trading company in the field of consumers' goods, by which the "war" of brands is avoided. The companies are rare that unite production and trading activities within their own organization or find it by various forms of virtual organizations or networks, enabling in this way to avoid the conflict of various interests of manufacturers and traders in identification of a product. This is shown by the research of business practice of companies such as *McDonald's*, *Benetton*, *Laura Ashley*, and *Toys R US*.¹⁴

¹³ S. Burt, "The strategic role of retail brands in British grocery retailing", *European Journal of Marketing*, 2000; *Toys 'R US in UK*, *Toys R US*, London, 2000; *Toys 'R US*, *Toys 'R US*, SAD, 2001; www.lauraashley.com

¹⁴ *Annual Report*, *Laura Ashley*, London, 2000; *Benetton Group*, *Benetton*, Milan, 2000; *McDonalds in UK*, *Mc Donald's*, London, 2000.

4. Brand strategies within the global marketing strategy

4.1. How to manage brands efficiently?

Managing a brand or a mixture of brands and not a product is one of the conditions to meet the requirements of global consumers more quickly and efficiently than the competition. To manage the brand means to create the offer of brands that would contribute most to the profitability of a company. The developed information technology contributes to the efficient brand management, since it is capable of offering timely information on the requirements to fill in the stocks and assortments in the required quantities, at the required place and in right time in the expected form and shape. In case the required brand cannot be found in the expected store, then the close competitive brand would be chosen at the nearest store, except in the case of an expressive consumer's loyalty.

4.2. Brand and assortment strategies

Management of global brands is based on the management of assortment under the identified brand, whereas the company can offer the following at the global market:

- wide assortment for the world market;
- limited assortment lines for a target segment of global type;
- specialized assortment of one group of goods or products, and
- narrow specialized assortment for narrow market segments at the world market.¹⁵

The research of business practice of world known companies showed that companies such as *Proctor & Gamble* and *Unilever* offer global brands of wide assortment for the world market. Companies such as *Benetton* and *The Body Shop* offer unique assortment under one brand name for global segments of the world market. Companies such as *Toys R US*, *Ikea*, *Laura Ashley* and *Levis* offer unique assortment of specialized products under one brand name, but the products that belong to one group of goods. Companies such as *Rolls Royce* and *Rolex* offer unique assortment of narrow specialized products under one brand name for a very narrow segment of world market.

In accordance with the above-mentioned offered dimensions of the assortment, the global consumer can choose among the products that have:

- a unique identification by one brand name, which can be the same as company's name, but it does necessarily have to be the same;
- an individual identification choosing among several brand names;

¹⁵ V. Milanović-Golubović, *Posledice globalizacije poslovanja leaderske grupe konkurenata*, Doctoral thesis, Faculty of Economics, Beograd, 2002.

- an identification by combination of names of company and product brand names.¹⁶

The identification of the offer by unique and familiar brand, such as *Sony*, *Levis*, *Nike*, *Philips*, *Laura Ashley*, *Ikea*, *Benetton*, *St Michael*, *Marks & Spencer*, is offered to the world consumer by the companies of the same name. Companies that offer several brand names are *Sears Roebuck*, *Nestle*, and *Procter & Gamble*. Car companies add the model name to the company name. *Mc Donald's* company adds the product brand name to the company name.

Taking into account that the needs and requests of consumers are dynamic category, company is not in a situation to keep the offer static. A globally oriented company would make the necessary adjustments of the offer to variable conditions and requirements of the consumers by creating their needs and requirements. Therefore, it does not wait for the consumer to create its offer, but creates ahead the needs of consumers, using strategy of extending or narrowing brands when introducing new products or categories. In this way, the company becomes capable to manage the brands according to assortment dimensions.

Using the strategy of extending the brand assortment in width, the company gives the existing brand names to new, modified or by then unlabeled lines of assortment for all foreign markets, particular markets or stores. By the strategy of extending the brand assortment, the company gives the existing brand names to the extended or modified existing line of the assortment; introducing new or modified products under the existing brand for all foreign markets, particular markets or stores. By the strategy of extending the brand assortment in density, the existing brand name is given to the new or modified types of products. In case of strategy narrowing, there is the reduction of the assortment covered by the brand in all its dimensions, especially in width.

4.3. Brand and qualitative-price strategies

A company can offer to consumers a price and quality level for the whole assortment under the brand name or more price and quality levels that can be under various brand names.

Various brand names for various price and quality levels of the same products are the privilege of the manufacturing leading companies. Manufacturing companies are more capable of developing more brand names for various product variants within the product or various products within the line, which means that they develop strategy of various brand names covering the assortment in width, depth and density. For instance, *Seiko* company develops one brand name for expensive watches, the other for inexpensive watches; company *Proctor &*

¹⁶ *Op. cit.*

Gamble develops two various brand names for the same product: ‘Tide’ and ‘Ariel’.

Trading companies develop with difficulty several brand names within the same product category, and accordingly offer to consumers several brand names for the same product. Every brand would have a small share in the market, due to expressed competitiveness. Several brand names must be supported by intensive promotion in order to link their reputation to the reputation of the company, which is the privilege of the powerful worldly known trading companies. Therefore, trading companies usually cover all price and quality levels by a unique brand name, very often identical to the company name. Using the strategy of brand name extension, the company makes it possible for the consumers to choose the existing renowned brands when purchasing:

- new products within the new company business activities;
- new lines of products within the existing company business activities, and
- new products within the existing line of products with or without a new name added.

Considering that global companies do business at the world market according to the premise “Think globally, act locally”, or in other words “Apply standardization as much as possible, and adjust as much as necessary”, they can be quite prepared for the situations that require offer adjustments. Adjustments are made easier by the fact that certain modifications can be made on all marketing instruments, except the brand name. Accordingly, the adjustment of the assortment to the consumer under the known name of the existing renowned brand would be achieved by the company in the following manner:

- by adding variant products to the main product or product models;
- adding certain substances to the main product;
- modifying products by varying materials for the same product;
- adding other products of the same category,
- extending the brand to the products of other groups of goods;
- extending the brand to the products within the same group of goods;
- using the same products for various purposes.

Adding the variant of the product to the main product form or product models under the existing brand name is used by *McDonald’s* and *Electrolux*. *Electrolux* Company manufactures 120 models of refrigerators in 1500 variants, which they adjust particularly for South Europe or particularly for the North Europe. *Nestle* company adds rice to their chocolates instead of hazel-nuts for the Japanese market. *McDonald’s* adds veal instead of pork to hamburgers in the Arabian countries. *Toys* Company sells porcelain or wooden dolls, adjusting them to the target market. *Coca-Cola* offers various tastes of non-alcoholic beverages and brands them differently – *Coca-Cola*, *Sprite*, *Fanta*. *Swatch* uses

Swatch brand name for various products. *Procter & Gamble* has only one product for one brand – *Camay*. *Marks & Spencer* offers bacon to be eaten raw or cooked, which means that the same product can be used variously.

Companies do not have to place a product under a unique or modified brand at the whole market, or to all segments of target market, which means that the consumer can expect the products to which the brand was extended:

- at the whole target market (strategy of global brand extension);
- at certain foreign markets (strategy of regional brand extension);
- within global segments (strategy of global segmentation);
- within specific target segments (strategy of specialized segmentation).

4.4. New brand strategy

In the situation when the extension of the existing brand to new products is not an optimum strategy, the company would use a new brand strategy.

If the company decides to offer new brands to the global customer, it provides a choice of new products in a line for him, new categories of products or the existing products with new components. For instance, *Coca-Cola* takes over local brands in order to use the advantages in distribution.¹⁷

Company's new brand may act as bait in a situation when it is used to defend the jeopardized position by the price of the existing brand. New products, especially under the new brand names, are placed through one's own network so that the brand name would quickly become recognizable and the distribution could be controlled more.

Companies create new brands and link their image with the image of the institution by taking over new products and their brands and including them into the existing offer at the target foreign market. In this way new assortment is acquired through someone else's brands, which was not offered by the company by then, as well as new chances to conquer the markets where a local brand is already identifiable.

5. Conclusion

Consumers are becoming increasingly brand-oriented in shopping, using brands to evaluate the same product variously. The best product seller to that effect is the brand. By choosing the brand, the consumers get benefits beyond the product choice.

¹⁷ www.thecocacola.com; www.cokecce.com

The brand makes the competitive and market-related power of the company stronger. Based on brands, companies are positioned in consumers' minds and they differentiate their offer in comparison with the competition.

The brand represents a landmark for a consumer and the standard of evaluation of products based on the choice made. The satisfaction of right choice leads to consumer's satisfaction by gathering the shopping experience and aspires to loyalty of the consumer to both the brand and company.

Consumer's loyalty, as an expression of power brand, makes vital contribution to further brand business development. Company keeps loyalty of the existing consumers and acquires new consumers only if it knows them, if it has the brands they want and knows the way the consumers find most suitable to reach the desired brands.

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NEURAL NETWORKS AND GEOGRAPHIC INFORMATION SYSTEMS

Abstract: *The latest stage of development of information science has been marked by increasingly frequent interrelation of powerful tools and conceptual solutions that stimulate better communication, comprehension and management of complex manifestations and processes in real geographic space. Geographic information systems (GIS) together with artificial neural networks are applied to many areas of natural and social sciences in order to improve the processes of analysis, planning and decision-making.*

The process of neural network learning is most often based on updating of weighted connection coefficients, and sometimes on updating of input processing units only. When the network learning has been completed, connection weighted coefficients remain unchangeable. Only then can the network be used for the anticipated tasks. Used as a classifier of complex geographic and satellite gathered data, neural networks demonstrate many advantages over classic statistical classifiers.

Key words: *neural networks, geographic information systems, integration, classification, modeling, decision-making.*

1. Main characteristics of neural networks

Neural networks are the artificial intelligence method, structured after the human brain. Since they have appeared in science, there have been two approaches to the research of neural networks. First, biological approach, studies neural networks as simplified simulations of human brain and uses them to test hypotheses on human brain functions. Second approach treats neural networks as technological systems for complex information processing.¹ When speaking about neural networks in this paper, we primarily think of Artificial Neural Networks (ANN), because we mostly describe neural network models accomplished by computers. From the appearance of the first prototype of neu-

¹ F. Zahedi, *Intelligent Systems for Business, Expert Systems With Neural Networks*, Wodsworth Publishing Inc., 1993.

ral network in 1943² until today, 30 various models have been developed. One of the most often used models in natural sciences is the model of non-recursive back propagation feed-forward network, also known as Multi-Layer Perceptron (MLP) network. Its author was Paul Werbos in 1974, and later it was extended by Rumelhart, Hilton and Williams.

Neural networks (NN) are conceptually different from classic artificial intelligence systems. Artificial intelligence systems are based on module integration concept: knowledge bases, modules of deduction and adequate user interface. As for neural networks, several units (neurons) simultaneously process several data. Neurons are the main elements of data processing within a neural network, grouped in layers and connected into network so that the output of each neuron represents the input into one or more other neurons (Figure 1).

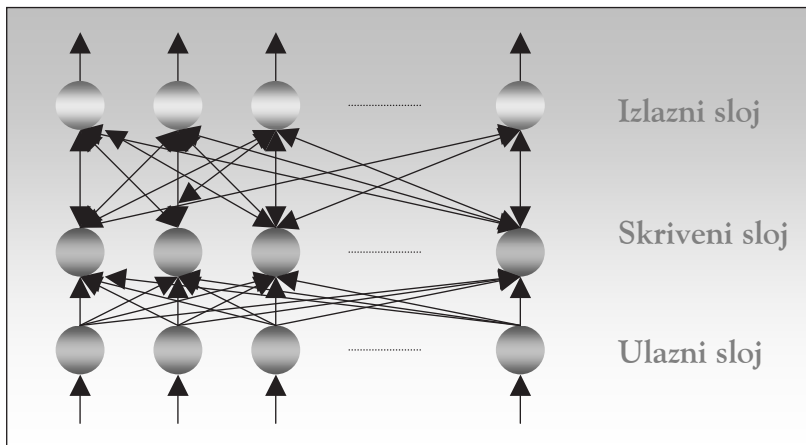


Figure 1. Three main neural layers

There are three main layers: input, output and one or more hidden layers. Input layer receives data from the environment and sends them to one or more hidden layers. Information are processed in the hidden layer(s) and sent to output layer neurons. Information then travel back through the network, and the weighted values of connections between neurons are adjusted according to the desired output. This process repeats within the network in as much iterations as necessary to achieve the desired output. This process is called the process of network learning, which also represents one of the important differences between classic computers and neural networks. While the former are programmed, NN are instructed or taught.

² W. C. McCulloch, W. Pitts, "A logical calculus of the ideas imminent in nervous activity", *Bulletin of Mathematical Biophysics*, 5, 1943, p. 115-133

2. Artificial neuron model

Artificial neuron (or shortly neuron) represents a simple processing element, which performs a relatively simple mathematical function. Figure 2 shows the graphic representation of a neuron.

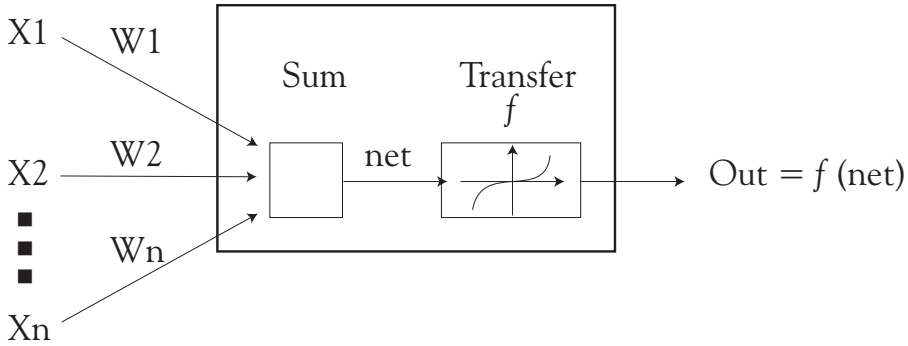


Figure 2. Neuron graphic representation.

When the input layer sends data into the first hidden layer, every neuron of the hidden layer receives input value from input layer, which is calculated according to the following formula:

$$I_j = \sum_i w_j x_i$$

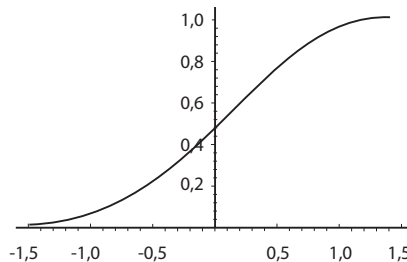
where w_{ji} represents weighted connection from neuron j to neuron i , and x_i output from neuron i . Neuron j of the hidden layer transmits its input according to the following formula:

$$y_j = f(I_j)$$

where f is transfer function.

The most often used transfer function in neural networks is sigmoid (or logistic) function:

$$y_j = \frac{1}{1 + e^{-g \cdot x_i}}$$



where g is function contribution calculated as $g = 1/T$, and T is *activation threshold*.

If there is more than one hidden layer, the above presented transfer function is used through all hidden layers until the output layer is reached.

3. Learning and training of back propagation network

According to the definition taken from Britannica Dictionary, learning is the modification of behaviour following upon and induced by interaction with the environment and as a result of experiences leading to the establishment of new patterns of response to external stimuli. Although this definition was written much before the appearance of neural networks, it can fully be applied to the process of their learning.

Basically, NN learning is the process by which the system acquires the values of weighted coefficients. Neural network learning process starts with giving random values of connection weighted coefficients. The data from training set are then periodically passed through neural network. The values at the network output are compared with the expected ones. If there is a difference between the obtained and expected data, modifications on links between neurons are made in order to reduce the difference of the instantaneous and desired output. Input-output set is again introduced to the network for further weight adjustment, since in the first few steps the network usually gives wrong results. After the weight adjustment for all input-output schemes in training set, the network learns to respond in the desired manner. Once the network learning has been completed, weighted coefficients remain unchanged. Network can then be used for the anticipated tasks.

The obtained network output of the input layer is compared with the expected (or desired) output and the mean square error is determined:

$$E = \frac{1}{2} \sum_k (d_k - x_k)^2$$

where d_k is the obtained output, x_k is the expected (or desired) network output, and k is the number of output neurons.

The learning process of neuron network is actually the process of minimizing the difference between the expected and obtained output, or in other words minimizing the upper error function, propagating it backwards through the network to the input layer. In the course of weighted coefficient adjustment (increasing or decreasing) process, every link within the network is corrected in order to achieve lower mean square error. Learning is discontinued only when the network is capable of giving a satisfactory accurate output.

Every neural network goes through three operative stages:

- 1) learning stage (training) – network learns on a training sample, weights are adjusted in order to minimize target functions, for instance root of the mean square error;
- 2) testing stage – network is tested on the testing sample while the weights are fixed;
- 3) operative stage – neural network is used in new cases with unknown results (weights are also fixed).

4. Analysis of spatial data using NN

One of the most widespread applications of neural networks is, by all means, the analysis of spatial data. There has been more than 10 years since Ritter first brought about the idea of integrating artificial neural networks and GIS (1988). Since then, great many researchers have been directed to the research of applicability of neural networks to the analysis of spatial data.³

The advantages of neural networks over classic methods are visible even where they are used as classifiers for complex geographical data, such as those acquired by satellites.

4.1. Processing satellite images

In the course of the past decade, there has been an increased interest in the application of neural networks to processing data obtained by satellites. Again, the non-recursive back-propagation feed-forward network has been compared with the traditional methods of satellite image processing.⁴ In 1991, Ryan developed a back-propagation network for coast outlining with Landstat-TM (Thematic Mapper) data. He showed that neural networks could be learned to differentiate ground areas from water areas using Power Spectral Ring data.⁵

Artificial neural networks have several advantages when used as classifiers of complex geographical and satellite-gathered data. They usually do not require any assumptions on data distribution and can be trained at a small sample (small

³ P. Gong, "Integrated analysis of spatial data form multiple sources: An overview", *Can. J. Remote Sensing*, no. 20, 1994, p. 349-359; D. Z. Sui, "Recent applications of neural networks for spatial data handling", *Can. J. Remote Sensing*, no. 20, 1994, 368- 380

⁴ P. M. Atkinson, A. R. Tattall, "Introduction: Neural networks in remote sensing", *Int. J. Remote Sensing*, no. 18, 1997, p. 699-709

⁵ P. Changuhui, X. Wen, "Recent Applications of Artificial Neural Networks in Forest Resource Management: An Overview, Environmental Decision Support Systems and Artificial Intelligence", *Technical Report WS -99-07*, AAAI Press, Menlo Park, CA, 1999, p. 15-22

set of data). They also do not require big preparations of data before they are used.

Artificial neural networks are mathematical model that in addition to its being widely applied for prediction and approximation found its place in the field of data classification. Various statistical models have often been used as an alternative to neural networks. As far as classification is concerned, the model alternative to neural network model is Gaussian maximum likelihood classifier – MLC.

Approximate function $\Pi_{(n,p)}$, which is used by classifiers and which maps the given input into the desired output, may be represented by the following formula:⁶

$$\mathfrak{R}^p \xrightarrow{\Gamma(n,p)} \Pi^q$$

where p is the number of attributes, q is a number of classes and n is the number of samples.

With statistical classifiers, such as MLC, to find this approximate function means to find the corresponding probability distribution function. Discriminant function, which divides p dimensional space R^p into independent regions, is defined based on it, one per each class of data. The problem with these classifiers is to find the corresponding distribution function for each class of data, since it is based on the corresponding starting assumptions. For instance, popular MLC implies Gaussian distribution for each class of data. In addition to this, minimum $10p$ do $100p$ of input vectors for each class is recommended, in order to be able to use Gaussian distribution.⁷ Figure 3 is obtained using ML classifiers.

On the other hand, multi-layer perceptron is used as an alternative to this method. It is one of the models of artificial neural networks, which does not require any pre-assumptions of data distribution and does not have a minimum number of data required for network learning. Multi-layer perceptron is a three-layer neural network shown in Figure 1. Each neuron of the hidden layer together with its weighted vector is responsible for generating separate hyper-planes inside p -dimensional space: R^p . The purpose of hyper-planes is to divide input data into classes.

The above Figure shows the hyper-planes marked A, B and C. Output layer neurons are responsible for the integration of one or more hyper-planes into q -l set of solutions and for generation of classification strategy (Figure 3). The result of using multi-layer perceptron as classifier is shown in Figure 5.

⁶ G. German, *Neural network classifiers for GIS data: improved search strategies*, GeoComputation, 1999.

⁷ K. V. Marcia, T. Kenet, J. M. Bibby, *Multivariate analysis*, Academic Press, London, England, 1979; P. H. Swain, S. M. Davis, *Remote Sensing: The Quantitative Approach*, Mc Graw Hill, 1978.

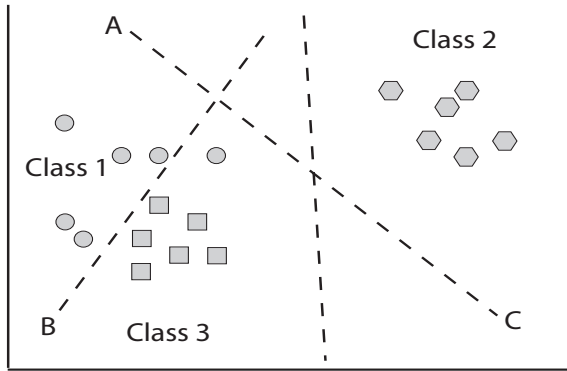


Figure 3. Integration of one or more hyper-planes.

Such an example is shown in Figures 4 and 5, where back propagation neural network turned out to be considerably better classifier than statistical classifiers based on Gaussian maximum likelihood. The problem of these statistical methodologies is in finding satisfactory probability density functions for each class of data, which might require certain assumptions and limitations of the data set.⁸

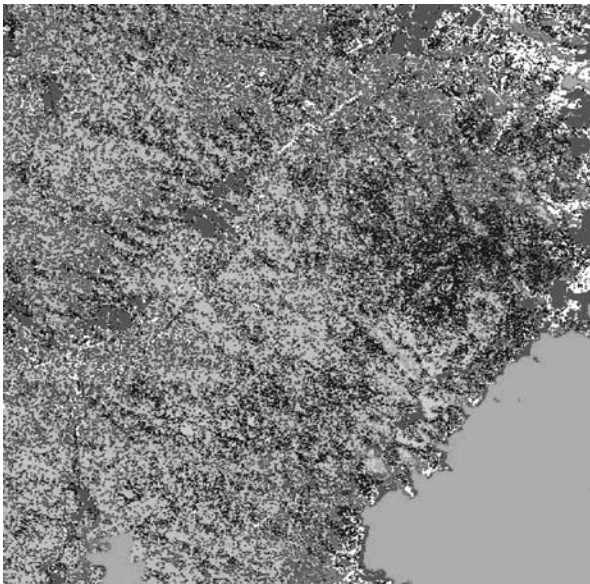


Figure 4. Classification of geographical data using statistical methods.

⁸ G. German, *Neural network classifiers for GIS data: improved search strategies*, 4th International Conference on GeoComputation, 25-28. 7. 1999, Mary Washington College Fredericksburg, Virginia, USA, acc. to: Mardia et al., 1979; Swain-Davis, 1978.



Figure 5. Classification of geographical data using NN.

Source of data: Kioloa area of New South Wales, Australian National University in Canberra

4.2. Geographical knowledge gathering mechanism

Neural networks, due to their capability to predict conduct of non-linear systems, are increasingly used as an alternative to classical statistical methods of geographical knowledge gathering. Traditionally, geography offers an important operative framework, language for organizing and key concepts for communication with the environment, or in other words with real world. GIS is comparatively new mechanism for gathering of geographical knowledge in five main elements. These are maps and globes, sets of geographical data, data model, process model and meta-data. These five elements combined with GIS software logic are the blocks that participate in the construction of intelligent geographical information system. The intelligent GIS enables digital compression of geographical knowledge. All the elements are the basis to gain many advantages, which are obtained using geographical information systems, such as the efficiency improvement, intelligent decision-making, scientifically established planning and auxiliary device for calculation, estimation and communication.

Analytical tasks and process modeling when planning regional development based on spatial and numerical data are more often done with the aid of GIS, neural networks and redundant databases (RDBMS). In the joint system consisting of these three elements, redundant databases and GIS serve as the input data source to neural networks. Neural networks then further identify the connection weight, for instance among population, or demographic characteristics

(status and resources), environmental conditions and the desired output that shows the quality of life in urban and rural environments.

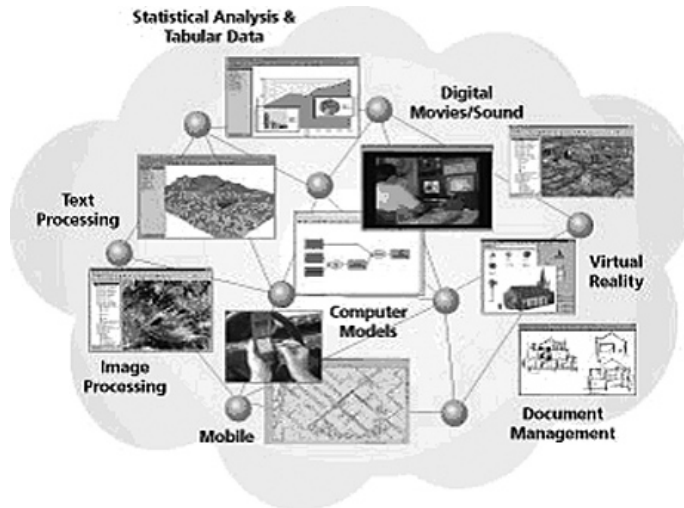


Figure 6. Integration and processing of digital multimedia data

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INFORMATION SYSTEM OF REVENUE AUTHORITIES IN SERBIA

Abstract: *Information System (IS) of the Revenue Authorities (RA) should support the functioning of public revenue system in Serbia in that it should include the public revenues such as taxes, dues, compensations, and other public revenues. The existing information system offers only a partial automation of the process of control, determining and collection of public revenues in Serbia. The development of new information system should provide for the complete modernization of business administration considering the efficient public revenue management and offering a better service to citizens.*

Key words: *public revenues, taxes, dues, compensations, contributions, new information and communication technologies, development of information systems.*

1. Introduction

The development of the existing information system of the Revenue Authorities in the Republic of Serbia started in 1991, by making the Preliminary study on the development of IS RA. At the beginning of 1993, the Program of development and construction of IS RA was prepared in order to provide conditions for efficient carrying out of policy in the field of public finances, as well as modernization of work of the then Public Revenue Administration of the Republic of Serbia. The Government of the Republic of Serbia then adopted the program titled "The Development Plan for Public Revenues Information System for 1994", based on which further activities were carried out in the construction of information system.¹

The information system of the Revenue Authorities was developed and implemented by Mihajlo Pupin Institute in Belgrade. Information system has been designed as a user-oriented system in the following environments:

¹ G. Ostojić, D. Djordjević, S. Pantić, *Razvoj informacionog sistema javnih prihoda u Republici Srbiji*, zbornik radova *Informacioni sistem organa i organa lokalne samouprave*, Beograd, 1996.

- Fox base + under Unix/Xenix operative system
- Fox pro (fully compatible with Fox base+) under Dos/Novell operative system.

Considering the homogeneity of work performed by territorial offices, all departments for determining and collecting of public revenues use the same program solution.² The program solution makes it possible to perform all system functions from any terminal if the access codes are known, or the passwords to access the set of functions or one of the system functions. Basic program entities have been made within the information system as follows:

- Determining public revenues
- Entry of the determined dues and payments
- Monitoring the collection
- Registering of system code records, and
- System maintenance.

Some of the IS functions provided for by the Preliminary design were not included in the computer data processing. These are the two very important system functions: fiscal analysis and financial audit.

This information system also did not include all but only some of the forms of public revenues. IS did not include some of the most generous public revenues: taxes and dues on salaries and other public revenues determined as deductions.

Some of the tax forms included by the system do not cover all taxpayers. This is for instance the case with tax on property, which does not include a considerable number of taxpayers. The reason for this is that the Revenue Authorities do not have updated records on the owners of property liable to taxation.

The program changes in the system were made by Mihajlo Pupin Institute as well. The problem is that the required changes in application are being implemented and introduced slowly.

The computer networking within the Revenue Authorities was not fully implemented due to the poor quality of telecommunication equipment, lack of finances, but also due to the technologically outdated computer equipment on which certain program solutions were made. Where the networking of computers with the computers of other organizational units was successfully established, Telnet service is used to access data. Such computer networking with the computers of other organizational units was made by modems using commuted or rented PTT lines. Within an organizational unit, the computers are connected into a local computer network.

According to the estimations made by the Agency for the development of information science and Internet of the Republic of Serbia, the construction of the Revenue Authorities network could cost up to 60 million dollars and could

² Group of authors: *Razvoj Informacionog sistema Republike uprave javnih prihoda u Srbiji*, preliminary study.

last over three years.³ This is why the Agency suggested to identify the existing resources and to connect the resource owners with the Revenue Authorities in order to enable their use. It has been established that Public enterprise PTT Serbia owns interurban network with 128 connected municipal centers, which is built for the transfer of identical data and only some 2% of it are in use.

2. Goals of the new IS

After an insight into the functioning of the existing IS, it has been determined that the Revenue Authorities cannot perform their functions well with the support of such a system and that the design and implementation of new information system is a necessary step to take. This is why the development of the new IS was defined as one of the strategic goals of the Revenue Authorities reform.

The main goal of the new IS in the field of the Revenue Authorities scope of work tends to achieve the establishing of accurate, updated, thorough and always-available tax records for the whole territory of Serbia. The other important goals result from this strategic goal:

- support to the Revenue Authorities officers in carrying out tax procedures;
- accurate records of tax debts with the schedule when they are due;
- good criteria to monitor and improve tax discipline;
- quality reporting to beneficiaries of public revenues;
- quality services for the taxpayers.

In order to achieve these goals, there are two very important records introduced within the IS:

- Taxpayer Identification Number intended for uniform identification of taxpayers for all tax forms at the whole territory of Serbia;
- Reference number, as a strictly controlled and unique record of payment of tax debts in payment operations.

The goal of the new information system is to provide information for all the employees of the Revenue Authorities, which they need in decision-making, planning, execution and control. The goals of new information system may be grouped as strategic and operative.

Starting from the global tasks of the Revenue Authorities, the strategic goals of new IS may be defined as follows:⁴

- information basis to determine and introduce fiscal policy instruments;

³ <http://www.arij.sr.gov.yu>, Agencija za razvoj informatike i Interneta

⁴ Raičević, B.: *Specialist post-graduate studies for the Republic public revenue administration personnel*, Beograd, 1995.

- information support to implement fiscal policy;
- efficient work of the Revenue Authorities and other bodies and organizations dealing with similar activities;
- efficient exchange of data with other information systems (statistic information system, geodesic information system, payment operations information system, information system of the Ministry of the Interior Affairs, social security information system, business banks information systems);
- data set required for decision-making outside the fiscal system (the budget, common insurance funds, and similar);
- design and implementation of organizational and technical solutions in order to provide continuity of IS functioning, fast and efficient adjustment to new requirements resulting from further development of fiscal system;
- invariability of current organizational requirements within the system and more narrow within the Revenue Authorities.

The operative goals of the IS are:⁵

- organization of computer data processing required for the IS functioning all over Serbia;
- support to the organizational structure of the Revenue Authorities;
- organization of computer processing of those fiscal system functions for which there are acceptable and efficient organizational and technical solutions;
- covering all taxpayers and all tax forms by computer processing;
- providing legality of work, especially in assessment, collection and control of taxes;
- providing timely actions by the Revenue Authorities regarding even charging of taxpayers and continuous inflow of public revenues;
- providing impartiality in tax policy enforcement (equity of all taxpayers within the system of determining and collecting of taxes);
- minimizing the possibilities for non-payment of taxes (due to exclusion of certain taxpayer groups or individual taxpayers);
- providing access to data on taxpayers and data on collected public revenues to the authorized personnel of the Revenue Authorities and other authorized government bodies, and data protection from unauthorized use or accidental destruction;
- storing data required for every-day work of the Revenue Authorities and permanent storing of archives on taxpayers and public revenues;
- continuous development of the IS starting from the requirements resulting from further development of public revenue system and trends in the development of new information science technologies;

⁵ Raičević, B.: *Specialist post-graduate studies for the Republic public revenue administration personnel*, Beograd, 1995.

-
- using standard methods and techniques in designing and development of information systems.

3. Main elements of the Revenue Authorities organization

The Revenue Authorities are organized as a unique administration for the whole territory of Serbia. Their territorial offices control, determine and collect public revenues. The internal organization of the Revenue Authorities is defined as hierarchy, whereas every level has its specific role in work realization. It is a three-level hierarchical organization. The following levels are determined:

- The level of headquarters as the highest hierarchical level in organization and management;
- The level of territorial branches in municipal centers or the level of territorial centers, as the second level in hierarchy vital to organization and management;
- The level of territorial branches in municipalities, as the lowest hierarchical level.

Detailed job distribution between certain organizational levels of public revenue service is determined in the following manner:

- determining and collection of public revenues are carried out at the level of territorial branches in municipalities;
- financial control, or tax inspection is allocated to the level of territorial centers and to the Revenue Authorities headquarters, as a part of control and analysis in tax policy enforcement;
- the highest hierarchical level, the Revenue Authorities headquarters, organizes the management, control, analysis and planning of tax policy enforcement as a whole; after the integrated IS has been made, the highest level should take over all work regarding the provision of data that are originally stored in other information systems and that are necessary for the functioning of IS.

Such a defined organizational structure of the Revenue Authorities and subordinated job distribution according to the appropriate hierarchical levels results in a strong vertical communication connection, considering the requirements to exchange data between hierarchical levels.

4. The Revenue Authorities information flows

From the point of view of information science, there is a clear need for both vertical and horizontal data exchange between various hierarchical levels of the Revenue Authorities. Namely, the successful control and analysis, which according to the above mentioned job distribution are allocated to two higher

levels, are not achievable without an efficient access to data that are originally gathered at the level of municipalities. On the other hand, it is necessary for the management role of the Revenue Authorities headquarters to enable the data flow towards the lower hierarchical levels. At the same time, certain legal solutions point to the need to exchange data between various territorial branches in municipalities. The suitable example for this is the total income of citizens, which can partially be earned in various municipal territories. This means that a citizen can have advance obligations distributed per various municipalities, while at the time of determining the total income tax he appears as a taxpayer in only his residential municipality. Therefore, during final determining of tax, all data on his partial incomes and paid taxes are required, which in this case are located in various municipalities.

Therefore, there is a need for information flow (data exchange flow) between the following organizational parts of the Revenue Authorities:

- from municipal to superior territorial center and vice versa;
- from municipality to the Revenue Authorities headquarters and vice versa;
- from territorial to the Revenue Authorities headquarters and vice versa;
- from one municipal center to the other;
- from one territorial center to the other.

The way in which the exchange of the said information flows would be provided depends on the regulations for work technology in the Revenue Authorities (procedures for information and document exchange), as well on the technical realization of data processing. It should be emphasized that there is already certain data exchange within the Revenue Authorities and it is carried out mainly electronically, not on-line however, but by memory medium such as a floppy disk. This means that floppy disks should be brought to a certain organizational part of the Revenue Authorities. These information flows may be efficiently carried out only within the integrated IS.

Therefore, the IS should enable both horizontal (between territorial branches in municipalities) and vertical (territorial branches in municipalities – territorial centers – the Revenue Authorities headquarters) data exchange.

5. The IS global structure

The main task of the information system is to make the work of the Revenue Authorities as efficient as possible. The condition for this is that the IS structure be adjusted to internal organization.

The information system can be organized as centralized or as distributed. The communication with taxpayers within the public revenue system is realized at the level of territorial branches in municipalities.

The main characteristic of the municipal level is the large-scale data processing. The data are loaded and updated, various inquiries are made for data, tax-paying decisions are issued, and so on. Accordingly, it is necessary at this level to provide short response time of the information system, or the high speed of data processing and forwarding. If the IS was centralized, the requests for processing from municipalities, for instance, would all flow into one central computer system. In that case, such a system should process hundreds and even thousands of simultaneous tasks. This refers to the conclusion that the centralized information system is not suitable for the nature and organization of work in the Revenue Authorities.

This means that classic centralized information system architecture, which includes one powerful computer with the data management system, data as well as application, and which should serve a large number of end-users, is practically unacceptable solution for the information system of the Revenue Authorities. The solution, therefore, should be sought in the distributed information system architecture, such as multi-layer client-server system architecture. In the case of the Revenue Authorities information system, where the data are simultaneously created and used at several locations far from each other, it is necessary to construct distributed information system (or the information system that supports the distributed data processing over distributed database). This would appropriately provide the support for information requirements of real system users, whose activities include wide geographical area.

The client-server data processing model is suggested for the Revenue Authorities information system, which includes the distributed data processing model, where the functions of one user program are distributed to at least two mutually communicating processes. These two processes of data processing are the client process that sends the message to server process demanding a certain service, and the server process that executes the required task and sends message to client process on the results (success or failure) of the executed task.

In practice, various client-server system architectures are realized. The simplest system is made of one client and one server while the more complex systems include several clients and several servers at the same time. If the task distribution is done at two levels, then it is two-layer architecture, so that (regardless of the number of clients and servers) there are only two layers: data base layer and client (user) layer.

Three-layer client-server system architecture is suggested as an optimum Revenue Authorities IS, the main elements of which are: data base server, application server and application client. Data base servers are the first layer, application servers are the second layer and application clients are the third layer of this architecture. The task distribution in this three-layer client-server system is as follows:

- data base server is in charge of the support to data processing management and data processing logics;
- application server is in charge of presentation logics support;
- application client is in charge of presentation management support.

Therefore, database management system, which supports parts or the whole information system database, should be contained in the data base server. The installed applications should be at application server. The program for management of user interface application should be installed at application client. In such a client-server model, the role of application server is double. It takes over the role of a client in relation to data base server, and the role of a server in relation to the application client. In such a client-server model, the program for user interface management should be simple to use, standardized and available for use at PCs of modest hardware possibilities. Today the role of such a program is undertaken by some of the known programs for access to Internet/Web servers. In addition, the computer of better hardware performances should be an application server in order to be able to serve a large number of application clients simultaneously.

In addition to standard activities for the design of information systems, the design of distributed information systems includes also the following tasks: the analysis of justifiability of distributed information system realization, identification of location types of distributed information system, shaping solutions of hardware-software configuration of distributed information system and design of information system distribution. In principle, the first three tasks are carried out within the strategy phase of life cycle methodology, while the design of information system distribution is carried out in the course of strategy, analysis and design of life cycle phases.

The analysis of justifiability of distributed information system should offer an answer to the questions if a real system needs to have distributed information system introduced and what the possibilities for its introduction were. This means to answer the questions if and within what time the organizational, financial, personnel and technical-technological prerequisites can be provided for its introduction and what effects are expected by its application.

The identification of location types of distributed information system is based on the idea of grouping the locations where mainly the same processes are performed, which enables the design procedures of database distribution and application to be generalized and made simpler.

Shaping the solutions of hardware-software configuration of distributed information system generally refers to defining system software configuration (operative systems, data base management systems, as well as program packages for exploitation and development of information system applications) and to shaping of preliminary design of hardware and communication infrastructure. This shaping should be made so that the distributed information system could

meet the following requirements for as long a period as possible: integrity, availability, reliability, performance at work, flexibility for maintenance and flexibility for upgrading of both architecture and information system. The following is required for the design of hardware-software configuration of distributed information system:⁶

- it should be specified for every location type if there are and how many computers that have the database server role and application server role;
- the name outline for database server and application server should be established for every location type, which will provide a uniform identification of servers and future local databases within the system, and
- mark the database servers, application servers and clients and name servers in accordance with the established name outline, for every location within the system according to the specification of configuration per location type.

The design of information system distribution is carried out in order to obtain the following documents:

- specification of application distribution per location types, which should contain a list of information system applications to be installed at that server for every location type and every anticipated application server at that location type;
- specification of data base distribution per location types and specific locations, which should contain database schemes implemented at that type of location or location for every location type and every specific location;
- specification of data replication in distributed database should define all replication copies and the manners of their updating for every location type and every specific location.

Further in the text we shall present the global distribution and location of hardware and software resources and in accordance with them the data organization per hierarchical levels of the Revenue Authorities.

There are two possible options of the distributed IS (Figure 1 and Figure 2). The first option (Figure 1) includes the IS organized in three levels, whereas computer resources, application software and relevant data are allocated to two higher levels in the Revenue Authorities organization hierarchy.

Here we have the following hardware, software and data distribution per the Revenue Authorities levels:

- at the level of the Revenue Authorities headquarters, central computer system is installed, which among other things, acts as a server in data exchange between certain territorial centers;

⁶ P. Morgin, I. Luković, M. Govedarica, *Principi projektovanja baza podataka*, Novi Sad, 2000.

- at the level of territorial centers, computer systems and appropriate application software are installed, as well as data bases on taxpayers that are registered in the municipality subordinate to the relevant territorial center;
- at the level of municipality centers, there is terminal equipment connected to computer systems of relevant territorial centers.

In the second option (Figure 2), the IS is also organized in three hierarchical levels. However, the difference, if compared with the first option, is that computer and software resources as well as data are distributed to all three levels of hierarchy of the Revenue Authorities:

- at the level of the Revenue Authorities headquarters, the computer system is installed that in addition to information-related work acts as a server also; as the server, it now covers considerably wider range of communication requests;
- at the level of territorial centers, computer systems are installed that in this variant in addition to information-related work act as servers in communication between subordinated municipalities;
- at the level of municipal centers, microcomputer systems are installed and the appropriate application software, as well as databases on taxpayers registered in the relevant municipality.

The differences between these two options appear in two lower levels, where the second option (Figure 2) accomplishes greater distribution of database, and at the same time, the level of municipal centers is made stronger by computer equipment. Based on the analysis of work and functions of the Revenue Authorities IS, current condition of the equipment (territorial branches in municipalities are already equipped with computers to a large extent) and investments made and required so far, it can be stated that the further development of the Revenue Authorities IS should be organized according to the second option (Figure 2). In other words, it should be organized as three-level hierarchy of data processing.

The large-scale data processing functions, which as a rule resulted from the work of the Revenue Authorities with taxpayers, have been carried out so far at the places where taxpayers were registered (municipal level). They have been computer executed at the level of municipality (application software is at the municipal level, as well as databases on taxpayers registered in the relevant municipality). The suggestion for the further development of the IS is to keep this solution.

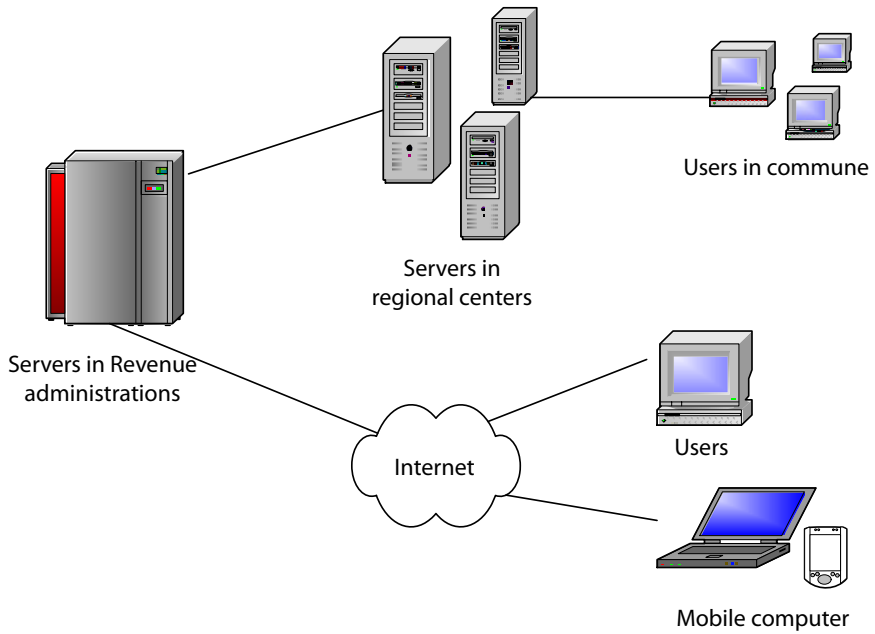


Figure 1. Distributed information system – first option

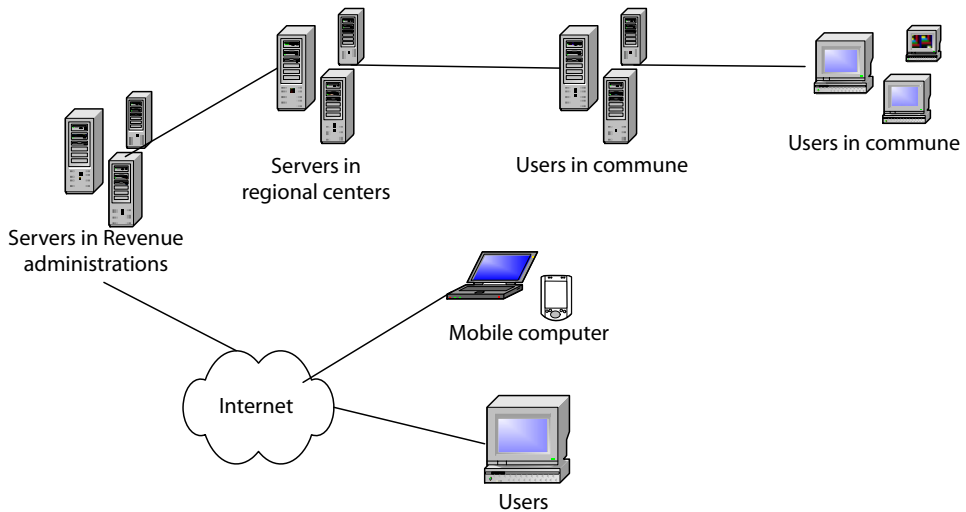


Figure 2. Distributed information system – second option

6. Main functions and subsystems of the new IS

Current practice is that the same software for tax calculation is used in mainly all municipalities at the territory of Serbia. This results in higher productivity and lowering of costs of development and maintenance of these systems, which is why the practice to use the same software for all municipalities should be kept further.

The calculation and collection of fiscal revenues that are carried out by the Revenue Authorities are characterized by the following features:

- large-scale data processing;
- large number of data that should be updated, reliable and accurate;
- large number of individual data accesses;
- large number of various data processing algorithms that are often repeated or continuously executed;
- large number of individual output documents;
- large-scale data exchange between organizational parts of the Revenue Authorities and between the Revenue Authorities and other bodies or organizations;
- large number of data for which reduction analyses should be made as well as relevant reports.

The next huge work to which the main functions of the appropriate IS correspond are seen within the scope of work of the Revenue Authorities:

- determination and collection of taxes,
- control of taxpayers
- monitoring of income state
- analysis of fiscal policy enforcement.

The IS is divided into subsystems during designing. The IS functions are grouped for the needs of design and implementation of the IS into the following subsystems:

- 'Determination and collection of public revenues' subsystem
- 'Fiscal analysis' subsystem
- 'Tax inspection' subsystem.

7. 'Determination and collection of public revenues' subsystem

The main aim of this subsystem is to provide information resources for everyday execution of the stated tasks, which are organizationally located in territorial branches for determination and collection of public revenues in municipalities. The characteristics of this subsystem are as follows:

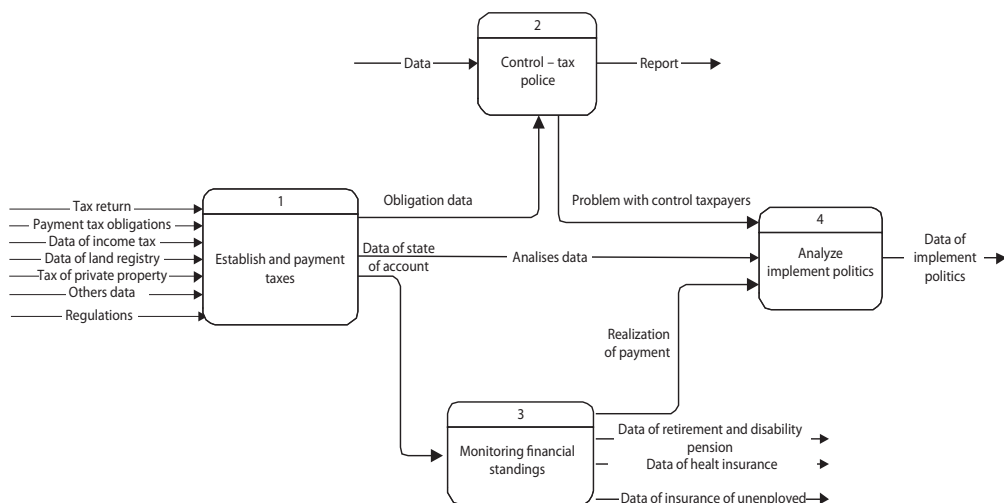


Figure 3. Main functions within the Revenue Authorities

- the subsystem function is the same in all territorial branches although they vary in their size (the number of employees, the overall number of taxpayers, types of taxes, total amount of taxes, and similar);
- the subsystem organization is functional and does not necessarily follow the specific territorial branch organization – the individual subsystem function is possible to use everywhere regardless of organizational location;
- from the data processing point of view, all functions within the subsystem are executed in municipal territorial branches, but communications with other territorial branches and higher levels of hierarchy are also possible;
- subsystem functions are organized for those forms of fiscal revenues as determined by the law and which are also within the scope of the Revenue Authorities competence;
- determination of public revenues (taxes, dues, compensations, local incomes and taxes) is carried out as either advance or annual obligations.

The main subsystem functions are taxpayers register, tax reports, determining tax amounts, processing of data on tax collection, reporting, auxiliary registers and external data.

7.1. Taxpayers register

The taxpayers register includes the records of all data on taxpayers relevant for tax-related work. Every taxpayer is covered by one set of data and has the

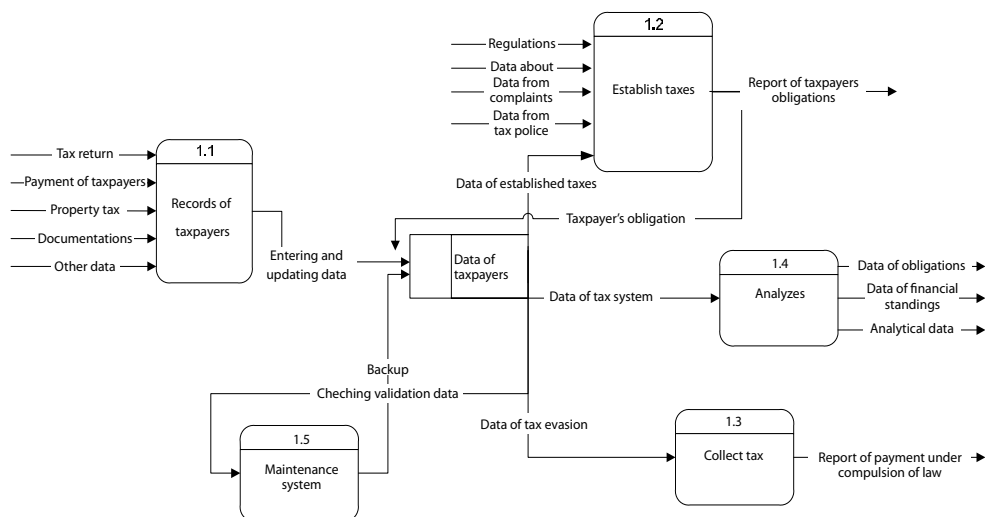


Figure 4. Main functions of 'Tax determination and collection' entity

identification number in this record. All bookkeeping data are related to this identification number everywhere in Serbia.

The functions of taxpayers register are the following:

- registration of taxpayers – entering of new taxpayers into the register and assigning them the identification number, filling in basic data on taxpayers (code number, name, address, business activity code and similar);
- records of other data on taxpayers – entry and updating of data on taxpayers: this part of the system should provide for the entry and changing of data on taxpayers, as well as keeping the history of data changes;
- records of separate business branches – records of opening, closing and all status-related changes of separate business branches of taxpayers; this part of the system should also provide for the keeping of history of these data changes.

The function of taxpayers register is very important part of the information system and it is important for the data provided by the register to be updated, accurate and available. In order to provide for this, it is necessary for taxpayers, as well as government bodies keeping the records of the part of these data, to be obliged to inform the Revenue Authorities on all changes of registered data.

7.2. Tax reports and other documents

This part of information system should support the process of receiving and processing of documents supplied to the Revenue Authorities by taxpayers. In one case, we have “true” tax reports filled in and brought by taxpayers and in

other case, there are documents used by the Revenue Authorities to determine tax obligations.

It is necessary to provide the mechanism to receive tax reports, to enter them into the information system, check their accuracy and completeness and their processing. Considering that tax reports, the sets of data they contain and the rules for checking of their accuracy and completeness subject to frequent changes, it is necessary to provide for the system that would accept as parameters the complete definition of the afore mentioned elements so that every new form or new rules of checking would not cause changes of program code. It was not the case with the system so far, which resulted in frequent changes and upgrading of programs and in unstable and unreliable program solutions.

Generally speaking, the function of tax reports is divided into the following business processes:

- receipt of tax reports and formal control
- entry of tax reports
- control of completeness and accuracy of reported data
- processing – making an entry of tax obligations, or issuing documents on the obligations.

Each of the above mentioned business processes is supported by particular program parts – modules, which are implemented as independent entities. New possibilities, such as for instance the receipt of reports by e-mail or Web interface, are easily included in the system.

7.3. Determining tax obligations

Determining tax obligations means the following: determining tax obligations and other obligations (compensations, taxes, local incomes) and determining social insurance taxes. This is done by:

- a taxpayer (self-taxation) when it is provided for by the law;
- the Revenue Authorities by issuing tax obligation document in certain cases.

The Revenue Authorities issue the documents on tax obligations in the following cases:

- when the law prescribes that the amount of taxes and other public revenues are determined by the Revenue Authorities;
- when it is determined during the control procedure that a taxpayer has contrary to law failed to submit tax report or his report contains wrong or incomplete data.

As for self-taxation, after processing of tax report and routine and formal control, the amount of calculated tax and other public revenues is entered into the database. In case when the Revenue Authorities determine taxes, it is neces-

sary to determine the amount of tax obligation based on the data from Revenue Authorities records and on data from tax report and other data obtained from taxpayers. In this case, the Revenue Authorities issue a document, which is handed over to the taxpayer. This part of the function for determining tax obligations is closely connected with the function of auxiliary registers and external data, since the elements for determination are obtained from the records kept at some other places (the Ministry of the Interior Affairs, geodesic institutions and other).

Determining the amount of public revenues that an individual is obliged to pay is carried out in various manners, according to various tax rates, whereas there are legally prescribed elements for calculation and payment for every type of tax and other public revenues. These main elements important for the information system, its design and functioning, are considered per certain tax forms.

7.4. Processing payment information

The data on taxes paid on the accounts of public revenues are obtained from banks and from the Administration for public payments. The important element of these data must be the reference number, which is filled in by the taxpayer when making a payment. New Law on Payment Operations provides for the obligation of filling in these data, with the mechanism to verify its accuracy. This is carried out in two ways:

- assigning the reference number in the documents by which the Revenue Authorities determine tax obligations, using printed orders for fund transfer;
- for self-taxation or in cases where taxes are paid as deductions, by prescribing the rules to form the reference number, by education of taxpayers or sending reference number lists to taxpayers.

In both cases, the information system must have data on the assigned reference numbers (to whom they were assigned, for which tax form and for what period).

The processing of data obtained from banks is automatic providing that all data (account number, reference number, payer's account and other) are correctly filled in by the taxpayer and correctly processed by payment operation agents. If the use of reference number is correctly prepared and carried out, the majority of these data would be processed automatically. Manual interventions would be carried out only for those data that were not consistent, where taxpayer has not filled in the reference number according to the instructions obtained by the Revenue Authorities.

7.5. Reporting

The reporting function includes all reports that originate based on accounting data, leaning also on the data from taxpayers register and outer data. According to their purpose, the reports are divided into the following categories: accounting reports, taxpayer service and elements for allocation of public revenues.

Accounting reports are intended for the everyday reporting in main units of the Revenue Authorities and these include status report, balance, account analytical card, accounting diary, report of payments (summary).

The taxpayer service includes the reports that are submitted or provided for consideration to taxpayer at his request or at the request of the Revenue Authorities and comprise the following: the report on tax debt, record of comparison, receipts and certificates.

The elements for allocation of public revenues based on tax form and territory offer information required for relocation of collected assets to their users – the budget of the Republic of Serbia or local budgets.

7.6. Auxiliary registers and external data

The IS environment is represented by external facilities with which the data should be exchanged. The subsystem exchanges data with the following external subjects:

- Taxpayers (legal and natural persons) through tax reports, tax documents and payment slips, status reports, reminder of payment;
- Social security organizations (retirement and disability insurance organization, health security organization and organization for insurance of unemployed persons) by reports of determined and collected taxes;
- Law-making and executive government institutions and organizations that establish the parameters of fiscal system, and based on the data obtained from the Revenue Authorities obtain required bases to create and execute fiscal policy;
- Geodesic institute by data on real estate that are kept at land registry, and present the elements to determine obligations (land registry income and real estate) for the needs of territorial municipal branches;
- Business banks by the reports on payments, allocation of public revenues and orders to block transfer-accounts; via data on taxpayers income (savings, transfer-accounts);
- Bureau of Statistics
- Other subjects related to the Revenue Authorities, which represent the data source, such as for instance delivery notes – notes on handed over documents obtained from the post.

Figure 5 shows the global flows of data between the IS and the environment, using UML diagrams of case uses.

8. 'Fiscal analysis' subsystem

Information aspect of fiscal analysis refers to gathering, keeping and analytical processing of aggregate data on the state and development of fiscal system, and their characteristics are such that they are carried out at the Revenue Authorities headquarters. Considering that it is provided for the computer data processing in Revenue Authorities operative work to be distributed and organized at territorial branches, the data required for fiscal analysis are obtained from distributed databases.

'Fiscal analysis' subsystem should provide for offering information on:⁷

- monitoring and analysis of fiscal system and suggesting fiscal policy;
- analysis of income of legal and natural persons and charging of taxpayers based on taxes and other forms of public revenues;
- monitoring the measures for the enforcement of the determined legal policy.

Subsystem functions cover all forms of public revenues, regardless of whether they are determined based on self-taxation, Revenue Authorities documents or as deductions, so the data sources based on which the aggregate database is formed are as follows:⁸

- data base of 'Determining and collection of data on public revenues' subsystem
- data base of 'Tax inspection' subsystem
- external sources of data (business banks, Customs administration, and other).

A citizen or a firm report their income, and pay their taxes through business banks. Business banks provide data on savings and transfer accounts. Geodesic administration offers land register data. Bureau of Statistics offers the data on income, and law-making and executive bodies provide elements of tax system. The system provides data on calculated and collected taxes for retired and disability insurance, health insurance and unemployment insurance to social security institutions.

In order to provide the required information, the subsystem performs the following functions: aggregation of data per types of public revenues and specific features of taxpayers, maintains the aggregate database, processes aggregate data

⁷ Raičević, B.: *Specialist post-graduate studies for the Republic public revenue administration personnel*, Beograd, 1995.

⁸ G. Ostojić, D. Djordjević, S. Pantić: *Razvoj informacionog sistema javnih prihoda u Republici Srbiji*, Beograd, 1996.

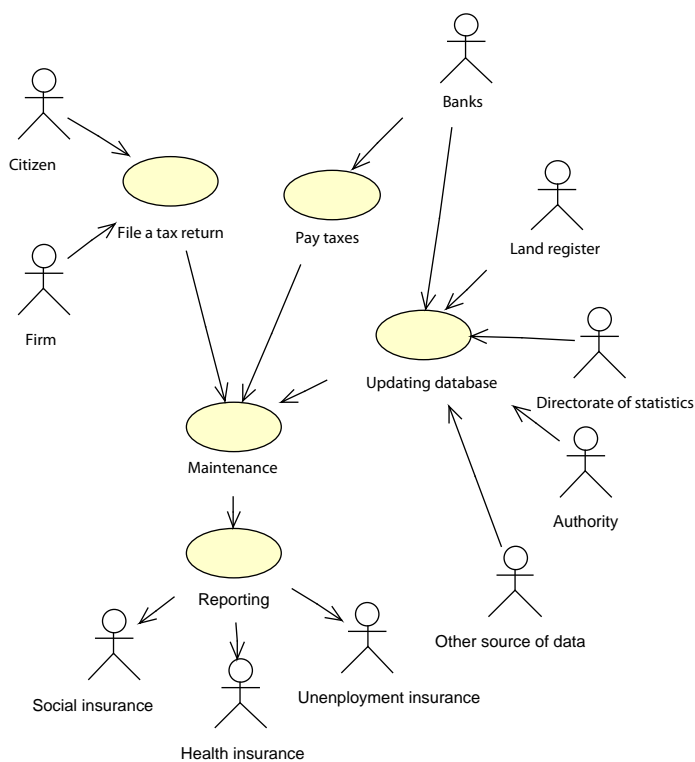


Figure 5. Global data flows between the Revenue Authorities information system and the environment

according to the defined requests and makes output reports. The output reports of the subsystem are printed reports and enquiries from database.

Since this subsystem should be organized as a system to support decision-making and as an access to data organization, it is necessary to use Data Warehouse. Data Warehouse represents a centralized database, which contains data of all Revenue Authorities organizational parts, as well as the external data in standard format. This database is used only for enquiries, while the operative databases are used for both enquiries and updating, whereas the updating is a critical operation as a rule. Data Warehouse should be used by the management for making specific business decisions. This database should contain aggregate data for the previous unit of time or even predictions for the forthcoming units of time. The content of this database is periodically extended by data from operative database, whereas all these aggregates depending on time are calculated again. The data from Data Warehouse are erased only after a long period, and in the meantime, new data are constantly added, which results in that the base

⁹ P. Mogin, I. Lukovic, M. Govedarica, *Principi projektovanja baza podataka*, Novi Sad, 2000.

is constantly extending so that such databases can be of several terra bites. The design procedure for Data Warehouse database includes the following:⁹

- the identification of user requests and the content analysis of operative database;
- logical designing;
- the designing of procedures for the extraction of operative data;
- physical design.

The procedure for the extraction of operative data includes conversion of operative data, initial loading of Data Warehouse database and updating of Data Warehouse database. It is necessary to determine the life cycle of data and the frequency of updating. The life cycle refers to the interval of time for keeping the data in the database, after which they could be erased because they became irrelevant for business decision-making. The frequency of updating shows the time interval between two content refreshments of Data Warehouse database with new data. Considering that one-month period represents the smallest time unit for the analysis of operative data for the requirements of financial analysis, this means that updating can be carried out on a monthly basis, or that there is no need for everyday updating of Data Warehouse database.

Data Warehouse database should be uniform for the whole system, which is why it is important to extract operative data from all distributed databases of the Revenue Authorities branches. Data Warehouse database updating is not carried out under the operative mode of operation, but in periods when the users cannot access it.

9. 'Tax inspection' subsystem

Tax inspection scope of work includes detection of criminal offences, violations and other unlawful activities in the field of public revenues, carrying out the prescribed procedures and determining the measures for which it is authorized by the law. Therefore, the tax inspection is authorized for the control of regularities of calculations and payments of taxes and other public revenues.

Based on the scope of work and tasks within the competence of tax inspection, we can define the following main subsystem functions:

- planning and preparation of taxpayers control
- direct control of taxpayers
- supervision of application of laws and other regulations in territorial branches.

¹⁰ G. Ostojić, D. Djordjević, S. Pantić, *Razvoj informacionog sistema javnih prihoda u Republici Srbiji*, Beograd, 1996.

9.1. Planning and preparation of control

This function includes the access to data from database of taxpayers in order to:¹⁰

- separate the set of taxpayers where, based on the set criteria, the control of recording, presenting and reporting the elements important to determine taxes for individual legal and natural persons should be performed;
- obtain data important for control by the tax inspector for a chosen set of taxpayers.

9.2. Direct control of taxpayers

This function should support the work of inspectors in the field. It requires the formation and keeping of database on the performed controls of taxpayers (based on the documents: records, first-instance decisions, second-instance decisions, minutes on goods seizures, etc.). The database on performed controls should include the following:

- records on the official acts performed and state determined during direct control of taxpayers;
- records on decisions made, which order the taxpayer to eliminate the violations of law or discrepancies in work;
- records of decisions resulting from second-instance procedures and monitoring their implementation;
- records on criminal charges and economic violations brought.

9.3. Supervision of application of laws and other regulations in territorial branches

This subsystem function should enable the efficient access to database of 'Determining and collection of public revenues' subsystem, since the database on taxpayers and their obligations and tax collection is located in territorial branches in municipalities. It is necessary to provide access to these data organizationally and technically for the needs of tax inspection activities performed in centers, or in the Revenue Authorities headquarters. This means that it is necessary to provide interconnection of the computers in the Revenue Authorities headquarters, computers in centers and computers in territorial branches. The supervision of application of laws and regulations in territorial branches should be organized on computers that are installed in the Revenue Authorities headquarters.

10. Conclusion

New information system should provide for the following:

- timely response by the Revenue authorities from the point of view of equal charge to taxpayers and continuous inflow of public revenues,
- fair implementation of tax policy (equity of all taxpayers when determining and collecting taxes), and
- minimizing the possibilities for tax evasion (due to omission of certain groups of taxpayers or individual taxpayers).

The new information system should also provide for the insight into the amount of money available for budget expenditure, as well as more quality of reporting to the users of public revenues. The new information system is a prerequisite for application of value added taxes and synthetic taxing of personal incomes, which is the strategic goal of the actual tax system reform.

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RESEARCHING THE CONCEPT AND DEVELOPMENT OF VIRTUAL UNIVERSITY ARCHITECTURE

Abstract: *The development of information science technologies has contributed to complex changes in the learning environment redefining completely the role of education. As a result, there are new educational institutions, which are called virtual universities. Planning and designing of such a virtual university is a complex task involving many various aspects of higher education. In order to make the analysis, design and improvement of conceptual model of virtual university easier and quicker, consider the information flows through the virtual university and assist in choice of the appropriate hardware and software products, this paper presents the original reference generic architecture of a virtual university, which is translated by the author as Generic Virtual University Reference Architecture and for the sake of consistency the abbreviation GVURA is accepted. The developed architecture should cover all the activities included in design, either directly or indirectly, or the improvements of virtual university, or in other words, it would provide for a set of standardized hardware and software tools required for the configuration of a virtual university. Once the methods are defined, the designer could be able to present his ideas to the generic model and choosing from tools library to construct a specific model of virtual university. In order to be able to set successful generic reference architecture of a virtual university, it is necessary to consider the modern concepts, perspectives and modalities of learning and teaching. It is then necessary to consider the concepts and applications of electronic teaching within which CAL system, E-learning, distance learning, learning environment, learning technologies are studied. It is also necessary to consider the case studies of successfully applied virtual university concepts, and finally, to study thoroughly the models and architecture of information systems, the latest information science technologies, software agent technologies and learning objects and overall system integration. This paper analyzes the conceptual Clyde model of virtual university as one of the most represented concept in this field.*

Key words: *distant learning, virtual university, learning environment, UML (Unified Modeling Language).*

1. Introduction

The revolutionary aspect of on-line distant education leads to the emerging of new learning methods that are more adjustable to students. Not only many traditional higher education institutions have started offering on-line versions of their subjects, courses and service support, but also new educational institutions calling themselves virtual universities started to emerge. This new type of educational institutions does not have a traditional sense of campus and classrooms, in other words, it does not have a physical representation in the form of buildings and fields, but exists only in cyberspace.

A large number of virtual universities have emerged after an increasing use of Web technologies for educational purposes. Virtual university, as a new paradigm of higher education, where not only the students but also the professors, administration staff and other personnel directly involved in higher education must take part in new practice where roles and missions of institutions are changed. Virtual university is faced with two main challenges: obtaining necessary resources for students, college and administration staff and acknowledgment of diplomas offered. Accordingly, the existing higher education institutions have better positions in providing necessary resources and marketing of their undergraduate programs.

A term virtual university is often used without paying much attention to its true meaning. Many people use this term to refer to on-line courses, or courses offered by the Internet. Some use this term to refer to on-line catalogues of courses, or electronic database of on-line courses. However, the term virtual university is defined as infrastructure transferring a learning experience to students and offering them services so that they could graduate on-line, while the members of university are provided with the educational resources and possibilities to perform their on-line researches effectively.

Virtual university is an alternative to traditional university. In many countries, the universities are part of social and state community. The society expects the university to educate more and more students while however, it does not provide enough finances for universities. The universities, therefore, can either lower the marginal costs of education or find the solution in new technologies. Virtual universities seem to be the solution to these problems. However, the costs cannot be lowered without the changes in the way of education; it should therefore pay attention to where it would be most adequate to change the style of education and what would be lost at that.

Planning and design of a virtual university (VU) or virtual campus is a complex task involving many various aspects of higher education. In order to build a successful distance learning academic environment, we have to consider and include into the plan various supports to services to students and members of colleges. The first step in planning and design analysis of Virtual University is to

study the existing concepts and models of virtual universities. One of the representative concepts is the conceptual Clyde model of virtual university.

2. Conceptual Clyde model of virtual university

Strathclyde University in Scotland developed a Clyde conceptual model of virtual university on which Clyde Virtual University (CVU) is based. CVU was established in 1995, as a first European virtual university, uniting five institutions of West Scotland – Glasgow, Strathclyde, Glasgow Caledonian and Peisly universities, as well as Glasgow School of Art. CVU is one joint venture formed with a purpose of development and transfer of Internet-established subject materials to students. Clyde conceptual model of virtual university is structured in three levels (Table 1). It consists of organizational level, infrastructure level and content level.

Table 1. *Conceptual Clyde model of virtual university*¹

Organizational level	Infrastructure level	Content level
Structure Copyright Quality assurance	Virtual campus Registration and payment Students service Evaluation mechanisms Discussion mechanisms Content transfer system Student supervision	Static HTML Dynamic HTML Learning environment Formative evaluation Collective evaluation

2.1. Organizational level

Structure. The first step in design planning of a virtual university is to consider the organizational structure of the future virtual university. According to this model, virtual universities may be roughly classified in three categories:

1. *Virtual front-end universities* emerge when the independent institutions create their own virtual universities separate from the main university Web server.
2. *Collaborative venture universities* include the cooperation between several existing universities in order to make a virtual university (the typical example is Clyde virtual university).

¹ Sclater, N.: *Migrating to the Virtual University: Issues and Strategies*, Centre for Educational Systems, University of Strathclyde, 1998.

3. *New institutions* created with the purpose of on-line education. Within these new institutions, there are two types of Web sites calling themselves virtual universities. These are:
 - a. *on-line clearing houses* – offering number of distance-learning courses of many various institutions, and
 - b. *commercial enterprises* – Web sites created for the requirements of worker prequalification; they do not offer, however, the accredited university courses.

Almost all universities today have their Web presentations at the Internet. In the majority of cases, these Web pages offer information to the academic staff and students who participate in and attend classes traditionally. Some institutions, such as the Michigan State University², have chosen to create virtual front-end university separate from their main University Web server. This provides an on-line access to distance-learning courses to those students who consider the traditional courses inaccessible. The universities such as the University of Phoenix³ from the USA and Britain's Open University already offer their primarily distance-learning courses.

Collaborative venture between the existing universities represents a model that combines marketing power with academic credibility. The capital is more easily accessible if several universities join their resources. *Clyde Virtual University*⁴ was one of the first such joint ventures. Joining of the staff from four universities in West Scotland attracted also the funds of the then national government in 1995. It currently provides on-line modules of traditional undergraduate courses accredited by the existing institutions. In 1997, *The Western Governors' University*⁵ was established as a non-profitable independent institution that gathers experts of academic institutions from 16 countries and offers new courses accredited by new organizations.

Completely new distance-learning institutions appeared as well. The *International University*⁶ is one of them. It is Internet-based organization, accredited by the *Commission of Institutions of Higher Education* from the *North Central Association of Colleges and Schools*. However, such credibility has been shattered by the appearance of programs known as "digital diplomas" issued by non-accredited organization.

There are several instances of institutions within one geographical area combining their distance learning with their associated organizational structures within one Web site. *California Virtual University*⁷, after the decision to leave

² Michigan State Virtual University, <http://vu.msu.edu>

³ University of Phoenix, <http://www.phoenix.edu>

⁴ Clyde Virtual University, <http://cvu.strath.ac.uk>

⁵ The Western Governors' University, <http://www.westgov.org>

⁶ The International University, <http://www.international.edu>

⁷ California Virtual University, <http://www.california.edu>

the coalition of state universities the *Western Governors' University*, contains links at 45 accredited colleges and universities in California that are currently offering distant-learning courses. The similar situation is with the *Virtual Open University of Finland*⁸, which lists the courses available by 19 Finish open universities. *Globewide Network Academy*⁹ clearing house lists over 15000 courses and programs worldwide.

Some commercial enterprises, such as *Price Waterhouse*¹⁰, have created their own *Web* sites in order to meet the requirements of company workers prequalification. Such virtual universities do not issue accredited higher-education courses; some universities, however, such as *British Aerospace Virtual University* are considering such options as well.

The issue of copyright. Regardless of the organizational structure of the virtual university, it is necessary to have a clear policy of copyright and property over material. This could be highly problematic when the organizational structure is collaborative venture, where the on-line courses are developed by several individuals coming from various institutions. Copyright mainly depends on the contracts that the employed person has concluded before writing the material. The institutions that directly pay an expert to write the material that would be used for distant learning may claim that they directly own such material and that they are entitled to render it to be used by other personnel in charge of distant-learning courses.

Marshall University has considered the issue if the university can reserve the rights over electronic course material, the development of which was directly financed by the University. They found out that the allowance of a few thousand dollars for the development of a new course by the member of the staff who would then leave the institution to work somewhere else would ultimately leave the University empty-pocketed and unable to show anything for their investment. The problem has been solved so that the author will reserve the ownership over his material and the right to sell it privately, while the University has the right to use any course version that it has financed and reserves the ownership over the number, title, description and educational program of the course. The course author is not obliged to share with the University any part of his earnings that has increased by private sale of the course material. The University also does not hold the exclusive rights to selling and licensing of any software created by their staff. Such policies will vary from institution to institution. They should be coordinated with the current policies of intellectual property of text-based materials and inventions and should be based on them.

For instance, at *Clyde Virtual University* a package was financed and developed by designers of two independent institutions. When the institution, which

⁸ Virtual Open University of Finland, <http://www.avoinyliopisto.fi>

⁹ Globewide Network Academy, <http://www.gnacademy.org>

¹⁰ Price Waterhouse Virtual University, <http://www.vu.pw.com>

contributed the most to the development of the package content, released the package at the market and took possession of all the profit, there was a real tension. The situation was resolved by the agreement to divide the profit so that 75% goes to the main institution, while 25% goes to the virtual university for its further development. It is up to the universities to decide based on their own intellectual property policies how to divide the profit. In order to avoid the possible conflict, it is recommended to sign the agreement before the work starts.

Various issues are to be dealt with considering the intellectual property. One of the issues is how a creative work by academic staff can be protected from copying, use and sale. Within a protected system, where the students are given the relevant information of only the course they attend, unauthorized access and copying of materials can be controlled to a certain extent. However, as soon as the texts or graphic representations are available on-line, they can be copied easily. In that case, the lecturers can rely on legal rather than on technical limitations.

Virtual universities must protect by copyright all their materials available on Web sites. They must own copyrights for all the materials they possess and transfer. The strict keeping of codes is recommended as well as presenting and listing of copyrights for every text, sound, graphic or film. In addition, VU must inform their personnel and students who download materials from the server on the restrictions regarding copyrights.

Quality assurance. The system must insure quality of the Internet-based courses. It is necessary to test and evaluate materials and methodology regularly and strictly. One system designed for testing of syllabus, environment and resources, learning and teaching, standards, management and support, is the basis to insure that the quality standards are constantly tested and confirmed. *California Virtual University* has made an Academic Plan¹¹, which defines the roles and responsibilities of every institution and explains in detail how to provide the quality of virtual courses.

Distant courses that attract a large number of students can make the process of quality assurance complicated. Where there is plenty of on-line material, the care should be taken of management configuration and types of control.

2.2. Infrastructure layer

Infrastructure layer is most often visible when you visit a virtual university site. All large Web sites require consistent and clear appearance. Many virtual universities use a metaphor of virtual campus in order to point to the highest level of navigation. Without the system of registration, mechanisms of evalua-

¹¹ <http://www.virtualu.ca.gov/Faculty/AcademicPlan/acplan-full.html>

tion, decision-making and similar, the virtual university would not be anything more than an ordinary document.

Registration and payment. Not all virtual universities have an organized system of virtual payment. All virtual universities should register their students and this requires a sort of registration form. Managing a large scope of registrations can present a problem if it is not planned adequately. The registration enables the students to register for the desired on-line or real time courses.

Student service. For students attending the virtual universities, the student services, especially the services of guidance and supervision, are one of the important factors requiring a special attention to be paid to their structure and organization.

Evaluation mechanisms. Evaluation is crucial in any educational system. Virtual universities should offer the mechanisms for testing student progress in learning. The level of material acquired is evaluated. Evaluation is usually a delayed two-directional communication process, where the faculty must clearly express what is expected from the student and what is the manner of evaluation. The students fill in and send the tests they received from the faculty. The traditional examination would be possible to transfer by Web only if the students were all in a computer room and under the traditional conditions of examination.

Discussion mechanisms. In traditional classrooms, the information between the professor and the students and between the students only are exchanged by sounds and looks. The communication goes either directly between the professor and the students or indirectly by means of various media, such as projectors, video and audio tapes. As far as distance learning is concerned, the information is transferred to distance, which means that the telecommunication technology must be used. The professors and students at various locations cannot hear or see each other directly face to face; in order to make the communication between them easier, they must use telecommunication media such as audio and video tapes, billboards, e-mail, fax, chat rooms, audio and video conferences, on-line applications on the Internet, etc.

At virtual university, the classrooms, the services to students and resources are turned into electronic lessons, discussions, processes and documents by asynchronous or synchronous transfer systems. Asynchronous transfer systems have the following advantages:

- *flexibility*, where the students can access materials at any time and any place;
- *time for thinking*, offers the possibility to the students to think of the ideas and check references;
- *arranged learning*, gives the possibility to students to integrate the ideas they discussed on the subject or at work, and

- asynchronous access *does not require high technology* and it is a better value because of off-line access.

Synchronous transfer system has the following advantages:

- *motivation*, where the focus is on the energy of the group;
- *tele-presentation of real time* when they are interacting;
- *good feedback* enables momentary replies, ideas and support, and
- regular meetings inspire students to keep familiar with the lectures and materials.

Synchronous transfer systems require relatively high range, sophisticated hardware and software and are usually much more expensive than asynchronous transfer systems. The choice of medium would depend on the kind of interaction between the professor and the students, between the students only, between the students and the administration (for instance, lectures, discussions, spontaneous discussions, informing, etc.) and if the interaction should take place in real time.

As for an on-line environment, the simplest mechanism for discussion is by e-mail, which does not represent the most perfect manner of communication. The main system of e-mail could be improved by adding mailing list of manager and mail archive. The systems such as *WWWBoard*¹² and *HyperNews*¹³ provide Web based alternative e-mail lists for asynchronous discussions. The more improved systems such as *Lotus Notes* and *FirstClass*¹⁴, which are not Web based, have wider application for asynchronous discussions. Synchronous discussions or real time discussions can be accomplished by *Internet Relay Chat*, *EWGIE*¹⁵ and other systems.

Content transfer system. The presentation of distance-learning course material is the most frequent topic in literature of distance learning. There is a large number of existing course material presentation technologies, which is chosen based on the budget, subject of presentation, lecturer's style and institutional infrastructure. The starting form of Web-based courses would look like a HTML page with an occasional image. If the course material is stored as something that is not HTML, then the mechanisms to generate Web pages in flight are required.

Student supervision. Supervision of student's progress is very important for both traditional and virtual universities. The evaluation results provide vital data, but supervision of student's progress in the course of the work can also offer useful information.

¹² <http://worldwidemart.com/scripts/wwwboard.shtml>

¹³ <http://www.hypernews.org/>

¹⁴ <http://softarc.com/>

¹⁵ <http://www.eit.com/ewgie/>

2.3. Content level

Web-based courses are the reason why virtual universities exist. Many virtual universities have developed from a simple collection of course materials. As the scope and number of courses increases, there is a need for some kind of structure. The content organization would largely depend on the type of institution. It is possible that various courses would be written and transferred in various manners within the same virtual university because the various authors would write and transfer the content.

The original form of Web-based courses looked like a collection of HTML pages with an occasional image. Such contents were easy to be made by the authors, but even the simplest static HTML presents a problem as far as the maintenance of the consistent Web site appearance is concerned.

Learning environment. Today's context of learning environment is rapidly changing. It is impossible to provide for the best individual learning environment, but it is possible to create a set of interactive learning components that are closely intertwined and able to meet various student requirements in an efficient manner. When designing the learning environment, the focus should be on learning and not on teaching. The student can best understand or learn only if the environment makes it possible for him to create on his own, to design, research or simulate.

Evaluation. Evaluation is a delayed two-directional communication process. One of the solutions for the evaluation of students is to design and transfer documented questions with multiple-choice answers. The integrated *Java Apleti* with evaluation mechanism enables various types of questions, including the questions that stimulate self-critical evaluation. In addition to formal communication, that tells about what is expected, informal communication channel should be open for those students who require explanations.

3. Framework for modeling of virtual university architecture

The analyzed existing concepts and models of virtual universities represent real models in practice and do not contain main postulations of virtual university architecture. The VU architecture is considered as a unique generic VU model based on which a designer should present his ideas and then choosing from the tools library he should construct a specific VU model. There is a need for the development of such a VU architecture that would:

- be generic, or that could be applied to the majority and potentially to all types of VU;
- possess open system architecture that is defined as integrated methodology, which imitates all stages of VU system life cycle from request specification, designing, implementation to the system maintenance;

- group complex activities into logic blocks and thus make the representation simpler;
- serve as a guide or framework according to which the universities could create their VU, or offer assistance at planning and analysis of VU, designing, choice of hardware and software products, considering of overall information flows at the VU.

Adhering to these main requirements that one reference architecture should meet, grouping all activities of virtual university and giving suggestions for their design and implementation, a generic reference virtual university architecture has been developed in this paper. For the sake of consistency, the author has named the suggested architecture Generic Virtual University Reference Architecture and accepted the English abbreviation GVURA, which would be used further in the text. The purpose of this architecture is to serve as a guide or a framework according to which colleges and universities could create their own virtual university.

GVURA modeling framework (Figure 1) is based on the view dimension and modeling dimension.

View dimension:

The view of administrative services includes:

- **The work of student service** [Admission (enrollment, catalogue, curriculum and syllabus, guidance, registration, informing, payment), supervision of students (evaluation, CV, financial support, arbitration, course materials, scholarships), monitoring the examinations, issuing reports, certificates and diplomas, administration personnel management].
- **The work of teaching department** [analysis and evaluation of applications and supervision of teaching staff, teaching (planning and organization of teaching, monitoring fulfillment and quality of teaching), monitoring scientific research, course materials].
- **The accounting work** [monitoring the subsystems of receipts and expenditures, human resources, forming main book and reporting (filling in entry orders, review of the count status card, diary and main book, balance status and success balance, reporting on taxes and dues and sending payment list to the bank)].

A view of student services:

- Depending on the way they would use the system, the students are divided into unidentified visitors, identified visitors and students.
- Distant students are allowed to review their files, examination results, library obligations, program of their courses, text-books, on-line ordering of books from the university library, taking part in social life, alumni organization, and so on.

- It is necessary to take into account the following services: using e-mail; real-time discussions by chatting; discussion forums; FAQ (Frequently Asked Questions) list; communication with experts; Groupware technology; self-evaluation option; assistance in learning (should offer a well-designed learning environment); momentary feedback information (from learning environment, professors, and others); Alumni organization (network of graduated students, program of scholarships, choice of carrier, etc.).

A view of the faculty:

- Designing hyper-media learning environment includes various theories and techniques, such as goal-oriented learning, managing hyper-media and student modeling.
- The staff:
 - *Authors* (write course content, are responsible for FAQ list, create topics, relations among them and group topic in virtual classrooms);
 - *Lecturers/professors/tutors* (teach by video-conference, supervise student progress, answer the questions, participate in discussions, evaluate, and other);
 - *Researchers* (gather information, statistical data, frequency of visits to certain topics, monitor student grades, etc.);
 - *Administrators* (manage the system, add users, erase, set the security measures, etc.).
- Copyright issue
- Quality assurance

A view of resources includes:

- **library** (on-line access to library catalogue and other services);
- **technical support** (framework to consider 'virtual capabilities');
- **technical infrastructure** (includes all necessary technology for course transfer and evaluation through virtual university, necessary for on-line studies and includes telecommunication systems, servers, networks and PCs for the personnel, student's computer, modem and line services).

Modeling dimension:

The level of request modeling – the most critical stage of a design goes through:

- **the stage of consideration** (of problems, possibilities, solutions, the field is agreed upon, the design is planned and presented)
- **the stage of investigation** (modeling of the current system, analysis of processes, problems, possibilities, system goals and limitations are determined, etc.)

- **the stage of defining** (the requests are modeled and priorities are set to the system requirements, prototypes are made, plan and field of design is modified).

The design level – describes the results of the requirement modes, or in other words, deals with physical or implementation-dependent aspects of the system:

- **the stage of configuration** (alternative solutions are identified, the possibility for their execution is analyzed and global system solution is suggested)
- **the stage of purchase** (identifies the appropriate hardware and software for the new system)
- **the stage of design and integration** (analyzes and distributes the data and processes, designs databases, user interface and presents the design).

The level of implementation goes through the following stages:

- **the stage of construction** (building and testing of networks, databases, new software packages and programs are installed and tested, etc.)
- **the stage of implementation** (supervision of system testing, preparation of the plan for system corrections and conversions, databases are installed, users are trained, transfer to the new system)
- **the stage of system support** (program maintenance, system recovery, technical support, system upgrading).

Figure 1 shows the original framework for generic reference architecture modeling for virtual university.

The view sections (columns) and the modeling level (rows) define blocks of reference architecture of virtual university. GVURA blocks do not exist as isolated. They must be synchronized in order to avoid inconsistencies and incompatibilities within a virtual system. The view of administrative services, student services, faculty and resources during the modeling stage would be considered and developed separately depending on the university requirements. However, these views must be coordinated and compatible so that the whole system would be successful.

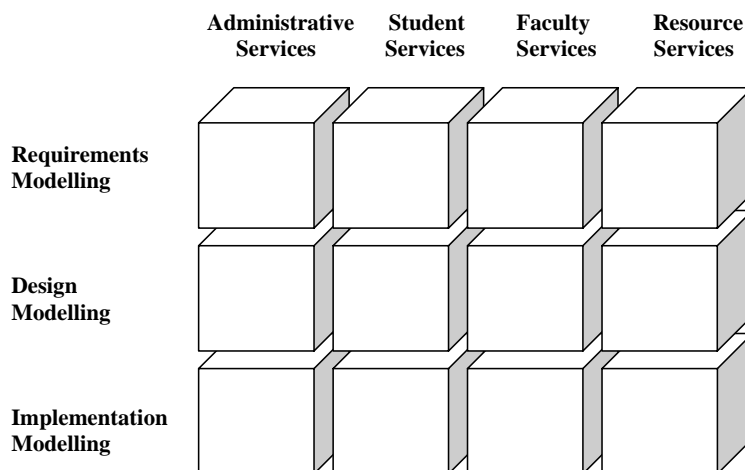


Figure 1. GVURA modeling framework¹⁶

4. GVURA component: Administrative services

Generic virtual university reference architecture provides for the virtual university designer to consider overall processes and activities of the virtual university and to adjust them to specific requirements. The designer's first step in the development of the virtual university is to consider the organizational structure, or in other words to define its own organizational structure of the virtual university that is to be designed. Such an organizational structure would influence the analysis of technical infrastructure, postulations of GVURA components and further steps in designing the virtual university. The categories of organizational structure of virtual universities are taken over from Clyde model of virtual university.

After considering the organizational structure of virtual university, there is an analysis and modeling of component requests of generic virtual university reference architecture. The virtual university cannot be successfully established unless the systems and services provided for distant learners are not at the thorough and content level. Web available administration student systems attract attention of an increasing number of organizations. These organizations offer self-servicing applications to students for higher education, using the Internet, Intranet and other technologies. They offer similar functional products but differ very much depending on the choice of technology.

¹⁶ A. Njeguš, *Istraživanje konceptata i razvoj generičke referentne arhitekture virtuelnog univerziteta*, FPS, Megatrend univerzitet primenjenih nauka, Beograd, 2003.

Under the administrative services, the students should have an access to crucial student information such as enrolment, files, accounts, financial support and grades, all under one interface. The students would be asked to give a signed statement not to give away their username and password to third persons. In this way, the possibilities for unauthorized access to information are minimized. The institutions should be aware of the limitations of some security protocols such as HTTP, which is widely used to limit the access to Web pages. The Administrative request for “real” signature would be replaced by on-line credit card payment. It was even suggested that the students could set their own learning goals and choose the evaluation methods but this requires the appropriate resources.

The organization of administrative services would depend on the organizational structure of virtual university. Namely, whether the administration would be designed separately from the administrative office of the main institution or whether the existing university information system with some additions would be used will depend a lot on the goal set by the university. It should be taken into account that the requirements, possibilities and goals of the development of a virtual university vary from university to university. The virtual university designers would select those processes and relations that are most suitable for their specific requirements and set goals.

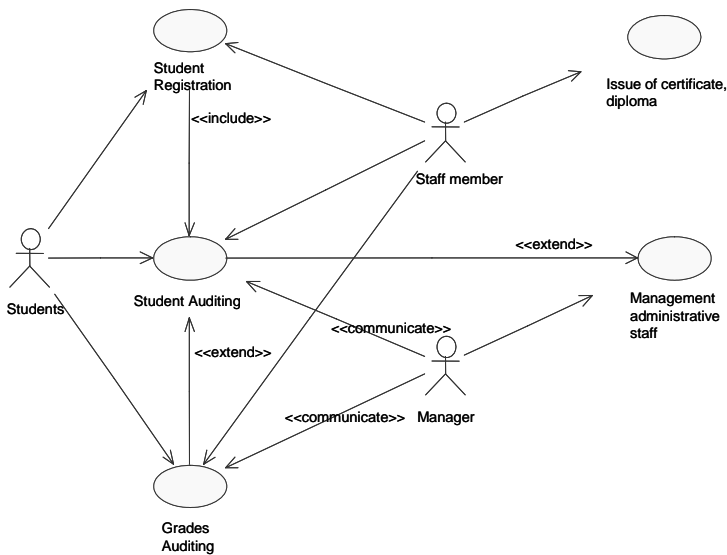


Figure 2. *Diagram of use cases of student service*

In order to increase the productivity of modeling, design and implementation of the virtual university model, shorten the time for development and improve the system quality, the administrative services have been presented

using UML (Unified Modeling Language). Figure 2 shows diagram of use cases of student service.

Figure 3 shows the dynamics of activities related to the admission of students.

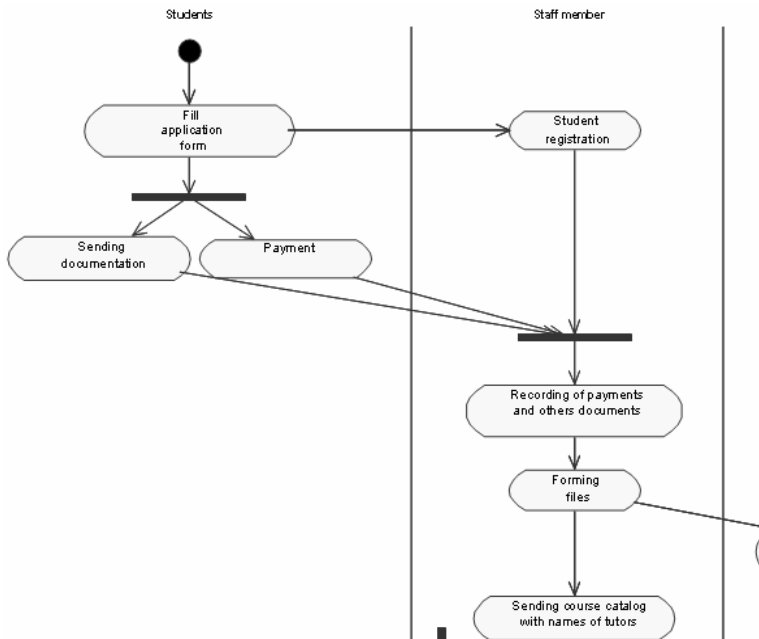


Figure 3. Diagram of activities related to the admission of students.

The developed conceptual model of student supervision is shown at Figure 4.

The following steps in the VU model development are:

- *diagram of sequences* – interaction diagrams that are used to describe dynamic aspect of the model;
- *diagram of classes* – a view of class domain is transformed into the scheme of relation database, and then into database;
- *Web system architecture* – three-row architecture is suggested;
- *Choice of appropriate infrastructure and integrated tools* – the suggestion for the server side is *Java servlet*, and for the client side *HTML* and *JavaScript*. The database can be implemented in *Microsoft SQL server*.

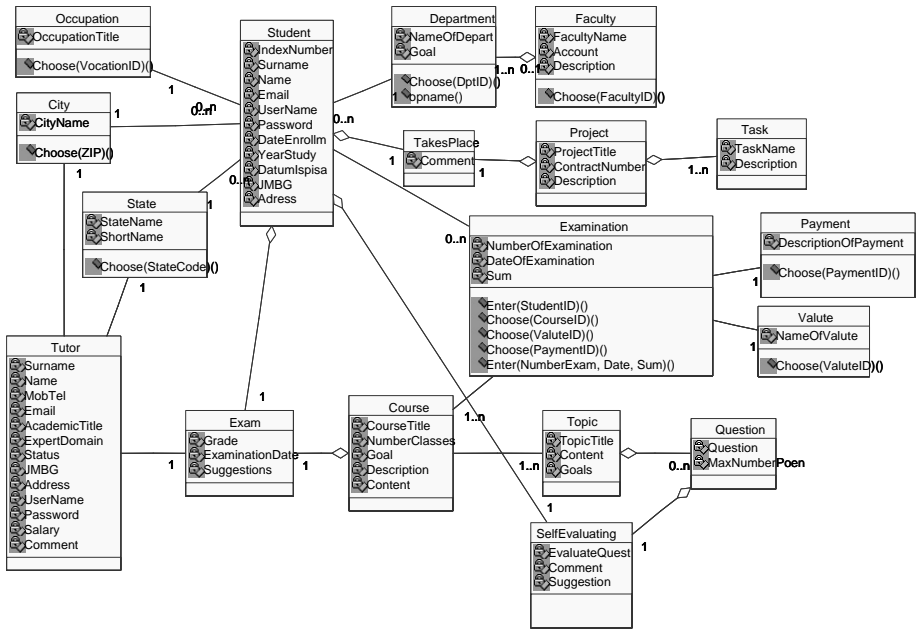


Figure 4. Conceptual model of student supervision

The suggested process of application development follows the generally known object principles. The process of application development is carried out in two simultaneous procedures, which take place iteratively and incrementally:

- the procedure dealing with application structure, which includes formal description of domain key abstractions and the description of their roles, features and relations;
- the procedure dealing with application conduct, which describes cases of use, expressed as interactions between the system and its actors.

The procedure dealing with application structure starts from text description of the domain and requirements from which a structural application model is made, or the model of object-oriented classes, and finally this structural model is transformed into the scheme of relation database (Figure 5).

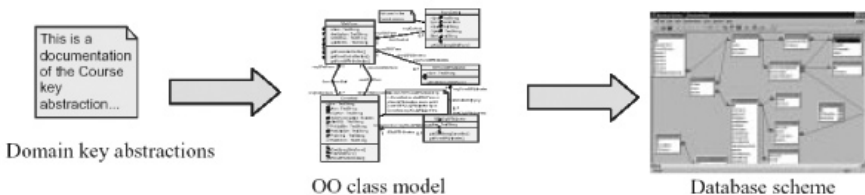


Figure 5. The process of application development by the procedure of application structure

The procedure dealing with application conduct starts from the functional requirements (Figure 6).

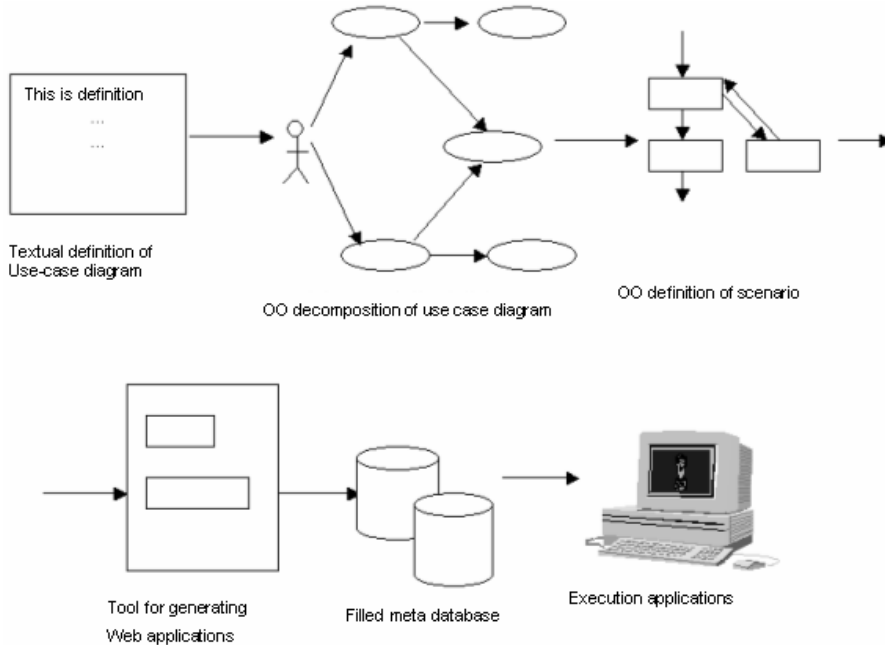


Figure 6. *Implementation of use cases*

Based on the text description of cases of use, formal UML model of use cases is made. After that, the scenarios that realized the stated cases of use are defined. Scenarios are determined by diagrams of condition that define the navigation through application. The structural user cases are usually defined by SQL enquiries, which access the base directly. Otherwise, the specific cases are defined through interaction diagrams, which join one transition at some condition diagram. In such a way, condition diagrams represent the navigational “skeleton” of the application, which is then filled with either SQL enquiries for structures or Java code for conduct cases. Diagrams of state are automatically transformed into the specification of application that is interpreted at server. Diagrams of interaction are transformed into Java code, which is incorporated into extender operation.

5. GVURA component: Faculty services

In any educational environment, the tutors and instructors have an important role in providing high quality education. At traditional universities, the faculty staff is interacting with the students in or out of the classroom, and this interaction may take many various forms: one versus many, one to one, face to

face, interaction in the course of work, interaction during seminars, examinations, and other. Each of these activities is critical element of instruction and must be included in the environment of the virtual university. The academic personnel will have to work more with the designers and technical personnel in charge of development and transfer of their courses. On-line courses are best designed if they are interactive and collaborative, and would therefore require a wider training.

Web based courses are the reason for the existence of virtual universities. Many VU have developed from a simple collection of course materials. As the scope and number of courses increases, there is a need for some kind of structure. Content organization would largely depend on the type of institution. There is a whole range of the existing technologies for presentation of course materials, which are chosen based on the budget, the topic that is presented, lecturer's style and institutional infrastructure. One of the key issues here is how to measure student's involvement. The theory of engagement and constructivism offer the effective teaching/learning methodologies.

5.1. *Virtual learning environment*

Virtual learning environment consists of the systems that enable the academic staff to create and run their on-line courses with the minimum of technical and designer expertise. In addition, the learning environment should provide the students with the tools and methods for motivation and efficient self-study. This basically means the application of adaptive techniques and learning through the ideology of stimulating student's work. The learning environment should also provide for the feedback and the feeling of success or praise just as the tutor would do personally. The design of virtual learning environment basically provides the following:

- working framework to present the content and structure of courses;
- patterns and systems for making course content as Web pages;
- tools such as e-mail, chat rooms, glossaries, and other;
- evaluation tools;
- support for course management.

Various commercial and other systems are available, each of various power. However, the question is how to develop the courses that are equally pedagogically good and virtually attractive. The balance should be made between putting a simple lecture on a Web site and one well designed, interactive, professional site on which a lot of time and money should be spent. The middle should be found between the two extremes. *Neptuno*¹⁷ laboratory has an interactive on-line learning manual, which runs the process of development of instructions

¹⁷ <http://www.adeit.uv.es/neptuno>

at the Internet. The manual offers software tools, HTML templates and well designed examples.

Creating the content is the process of knowledge generation and representation of structured knowledge. The tools for content creation support should provide for the following elements: possibility to define vocabulary and rules to express the knowledge structure and the methodology guided by the process of authorship. XML (*eXtensible Markup Language*) tool meets all these requirements. However, the need for various structure dimensions presents a problem.

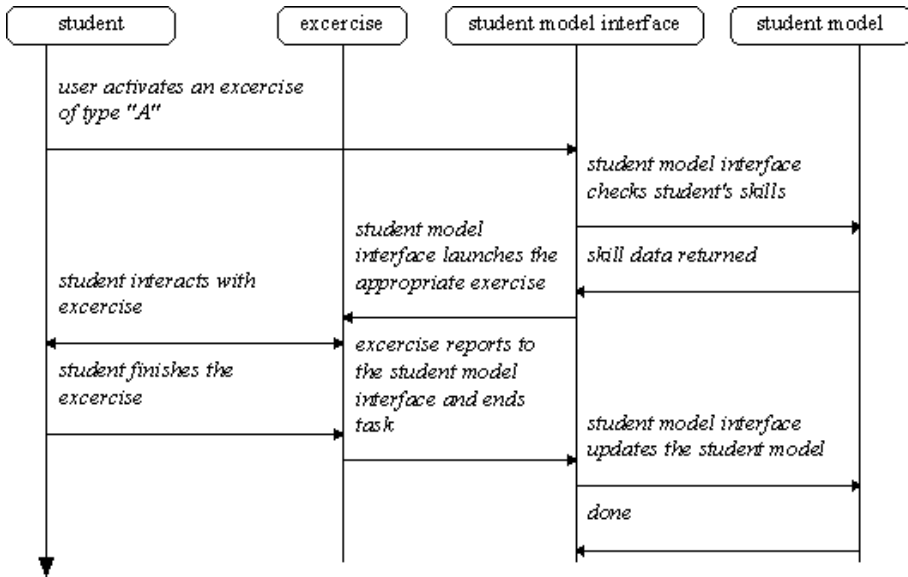
The course content is broken into so-called learning objects. From the aspect of learning, every learning object must have a certain role in the methodology of instructive designing. The requirement for every learning object should be that it could communicate with the learning system using standard methods, which do not depend on the system. The key points are:

- the whole content should be inside the learning object, for instance, multimedia files and other contents;
- the manner in which the student moves between the learning objects is controlled by the learning system;
- every learning object must contain the description in order to make it easy to find the real learning object for every work;
- there are not standards for determination of the learning object size.

The need to make the learning process easier leads to the development of the *Learning Content Management Systems* (LCMS). The components of one LCMS are authorship, data storage, interface and administrative tools. The learning materials are usually *Word* documents, *Power Point* presentations, *Flash* animations and other. LCMS can help gather the existing content into the component parts of one system, similar to Lego system of knowledge blocks. In this way, the appropriate knowledge blocks can be grouped as required.

The need for the model of student is obvious considering the fact that the goal of creation is a creative and adaptive learning environment with the elementary tutor possibilities. The structure of hyper-textual subjects as a natural starting point of student model is suggested. The subject, the abstract course is divided into cells, the smallest parts of knowledge identified by the user model. The cell refers to individual topics or virtual sections. Each cell is joined by the measure of topic knowledge, or the scalar representation of student knowledge evaluation. The basic knowledge graph version suggests with what subject it should previously be acquainted, before reaching the desired, chosen subject. Semantics of prerequisites provides for the analysis and guiding of goal-oriented learning. Graph of prerequisites contains the measure of understanding and comprehending, the function of scalar value based on the measure of certain topic knowledge and the structure of graph leading to the chosen cells. The measure of understanding provides for the analysis of user contextual knowledge condition for the majority of entities. By means of the understanding measure,

the automatic guiding system is possible to show the weak or strong fields of student's knowledge and, therefore, help the student to direct his efforts to certain fields. Student model updating is therefore based on the controlled exercises, which are defined by the student model interface (Figure 7). Student model interface precisely defines how and when the student model is updated. The status of student knowledge is changed depending on the correct answers in one student exercise. Correct answers increase the valuation of the degree of student knowledge depending on the difficulty of the exercise.



Result: student model is updated based on student's skills. Changes in the student model affect the appearance and behavior of the learning environment. Student model interface waits for the next exercise to be launched.

Figure 7. *Diagram of events when student performs his tasks*

The other critical aspect of faculty/student interaction is evaluation, which includes tests and examinations. VU should offer the mechanisms for testing of student learning progress, and these mechanisms should be integrated with the course content. The evaluation is the process where the intelligence, motivation, potentials, achievements, conduct, capabilities and a level of student knowledge are assessed. The analysis of types of learning has a considerable influence on the strategies and methods of evaluation. There are three various kinds of evaluation:

1. **diagnostic** – identifies weak and strong points;
2. **formal** – provides feedback to students;
3. **summary** – the performances are assessed at the end of the course or field learned.

The design and transfer of documented questions with multiple-choice answers is one of the solutions for student evaluation. Integrated *Java Apleti* with the evaluation mechanisms allows various types of questions, which include the questions that stimulate self-critical evaluation. Several available software packages are designed for electronic transfer of objective tests (for instance, *Question Mark*, *Examine*, *EQL Assessor*), within which the transfer of various types of questions is supported. When a student finishes the test, the results are evaluated automatically, quickly and consistently. The traditional examination would be possible to transfer by Web only if the students would pass the examination in a computer room under the traditional examination conditions.

6. Conclusion

The whole approach to GVURA development is highly abstract so that the users could define the starting models of their own, which meet their specific requirements for the development of virtual university and in this way, the architecture would be adjusted to the stated field of application.

The results of this work can be used in various environments:

- *when designing specialized models* (architecture can help the designers of such models at least for specifications and documentation, if not for the model implementation);
- *in adjustable tools of architecture component modeling* (where the user can easily generate his own inputs, processes, flows and outputs);
- *in realization of applications for various purposes*.

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NEW AGE MANIFEST

Essay on the book “Intercultural management” by Professor Mića Jovanović,
Megatrend University of Applied Sciences, 2003.

Rare are the books that unite the seriousness of the offered material and interesting reading. The book by Professor Mića Jovanović Božinov – “Intercultural Management” (Megatrend, Beograd, 2003) belongs to this rare category, appearing at the very threshold of new millennium, when everything was ready to extinguish Guttenberg’s galaxy on behalf of a virtual, impersonal, computerized world. However, the thoughts printed in the form of a book have expressed (un)expected toughness, which was visionary foreseen by Ray Bradbury in his cult book “Fahrenheit 451” – this is the temperature at which book paper burns. Every new book is a delight, especially one as communicative and understandable, such as “Intercultural management”, which addresses everyone, not only the professionals in management. At the same time, Professor Jovanović deals very seriously with the complex discipline of management at the beginning of 21st century, analyzing the current situation at the world global level, comparing bravely the advantages and disadvantages of globalization, as bravery today means to think differently from the “Big brother”. The conclusion is almost unexpected – the management we know faces its end in the new millennium. The author offers the vision of possible solutions for the future, an optimistic ‘day after tomorrow’, creating thus a new category – the manifest of the management for the 21st century, which we have just entered.

“Intercultural management” is assigned to those students who study management or some related discipline as a part of their curriculum. The book is divided in two parts. The first part consists of six chapters (Intercultural manifest of the management for the 21st century) and analyzes the conflicts and syntheses in close encounters of East-Asian (Confucian) and Western (Protestant) cultures. Nine chapters of the second part of the book (About management) represent a cross-section of lectures that the author held at several Universities and Business Schools abroad (London, Bradford, Tokyo, Seoul, Bologna, Munich, Fontainebleau), with very interesting case studies as illustrations.

“Intercultural management is a process of imposing, mixing, accepting and mutually preserving cultural values between various civilizations with a view of globalization of international business operations.”

At the beginning of the first part of the book, two different things may be observed in the introductory definition. First is a combination of “imposing” and “globalization”, which sounds familiar. The second is a fairer interpretation in which the definition of intercultural management can be observed as an ideal program for co-living and peaceful coexistence at planet Earth. As a philosophy of life, the international business both links and separates while it is carried out under the influence of individual cultures. Globally and locally, they are in constant interaction (“think locally, act globally” and vice versa). The newly created notion ‘GLOCAL’ (global-local) determines the new paradigm of conduct within the international business.

The skeleton of the culture of Japan and Asian-Pacific region is Confucianism (Confucius, Chinese philosopher and social reformer, 551 – 479 B.C.), the philosophy that advocates this-worldliness, as opposed to Western religion that advocates other-worldliness. The framework of Confucianism is represented by four main relations: father-son, teacher-student, husband-wife and ruler-subject relation. In these relations, “the subordinates” are obedient and faithful to “the superiors”, while “the superiors” are responsible to protect their “subordinates” in every respect. This creates a firmly intertwined hierarchy in which every member holds not only a certain position and responsibility, but also the security of permanently established relations.

Japanese companies also function in this way, where the employees are fully committed to work, firmly connected and completely loyal until the end of their lives. The essence of Japanese culture is in the system of interpersonal relations of powerful collectivism, as opposed to European and American individualism, which is the basis of the Western culture. This is also where the secret of business success of the Far East lies, which the West could not anticipate in any way. While the West values the cult of property, individuality, changing system of values, the East values firm connections of collectiveness in everything and unchanging system of values as old as civilization.

There are some other differences as well. The main characteristics of practical activities of the American management are:

1. short-term employment in one company;
2. individualism in decision-making;
3. individual responsibility;
4. fast progress at work;
5. direct control mechanisms;
6. specialized professional career;
7. selective care of the employees.

Japanese practice advocates the following:

1. life-long employment;
2. collective decision-making;

3. collective responsibility;
4. gradual progress at work;
5. indirect control;
6. unspecialized professional career;
7. care of all company's personnel within the context of their personality.

More interesting example of the differences between the West and the East is presented in one of the case studies. When some ten years ago Siegfried Hoehn, a strategy and investment director in Volkswagen, asked his advisor, Professor Sung-Jo-Park, why the Japanese always win in business negotiations with the Europeans, he was given the following answer: "In East Asia the best students graduating from faculties go to business, somewhat weaker students go to state administration, weak students stay at Universities to deal with science, while the weakest students become politicians. In Europe and America, the best students stay at universities making scientific career, somewhat weaker students acquire positions at state administration, weak ones become businessmen and the weakest engage in politics. Therefore, during business negotiations the brilliant Japanese students are on one side of the negotiating table face to face with the weak European students on the other side. Accordingly, the results are clear and expected."

During the very first meeting between the Japanese and the Americans at business negotiations, one can notice American obtrusiveness. Nonchalant arrogance would expose the stupidity of seeming superiority, as opposed to polite and modest Japanese partners, which does not show the weakness of the Japanese negotiators but only their traditional good manners.

These differences in culture and approach to business are possible to unite and synthesize by studying the intercultural management, approaching and integrating positive parts of both cultures in companies that according to William Ouchi would have the following characteristics:

1. long-term employment;
2. collective decision-making;
3. individual responsibility;
4. the system of gradual progress at work;
5. moderately specialized professional career;
6. indirect control mechanism;
7. care for all company's personnel, including their families.

In this way, it is possible to give equal opportunity to both the privileged and unprivileged, in the union of the contrasts.

Presenting theoretically and historically everything that management is made of (II part of the book, *About Management*), Mića Jovanović, PhD, deals in an interesting manner with the basics, practice and end-game of the discipline called management, intertwining science and creativity, theory and practice,

together with the interesting case studies and lucid comments and quotations such as this one:

“If some of you do not like to kiss people, I would kindly ask you to leave this lecture immediately, since I do not want anyone to leave here with the diploma, become a manager and ruin a company.” (Tome Peters, the author and consultant in the field of management).

While he analyzes the economic trends with the objective criticism of the American global plan (especially related to conquering the markets of the former socialist countries, i.e. macro-acquisition of all their relevant resources), as well as global communication network, the Internet, the author goes beyond the framework of just a management text-book, dealing with wider aspects of the possible future. The global communication network, the Internet, created to serve two most powerful intelligence agencies – CIA (Central Intelligence Agency) and super-secret NSA (National Security Agency), enabled a large number of people to acquire information, making the world ‘a global village’. At the same time, the ‘global village’ phenomenon jeopardizes the unique and special cultures, creating ‘excellent, new’ unicultural world, so that the Internet can be seen as ‘the murderer of cultures’.

Economic colonialism of the proportions not seen so far, supported by the military pressures and inciting of “low-intensity conflicts” world wide, deranges micro-economy of subordinated countries. Apart from disturbances of economic flows, the appearance of just one “international manager” (“Big Brother”, Regan, Clinton or Bush...) disturbs the functioning of traditional management. New world order does not care for small phenomena, small companies or business as such so far. What is the role of traditional managers within that order in new millennium in 21st century? The functions of middle-class managers are weak because of the wave of robotization and computerization, ‘top’ managers see themselves as leaders, visionaries, persons in power, but not as managers. The executive directors are slowly disappearing. The number of managers deteriorates, the content of work narrows, the career shortens.

Mića Jovanović, PhD, sees virtual organizations as a possible way out, which would not eliminated the human factor, but learning organizations also. Artificial intelligence will be entrusted with the collection, classification and processing of data, while the human mind would determine the appropriateness and use of information. Robo sapiens, but according to human measure. “Everyone his own manager”. What the managing elite knew is transferred to all the personnel. Everyone learns permanently. In 21st century, not only the privileged managing minority will have the new knowledge available, but also the wholeness of the only living company’s resource – all people in organization, individually, as a team or collectively.

Anticipating still the positive outcome, Mića Jovanović, PhD, gives hope to everyone in new millennium, approaching many topics, asking many questions,

answering to some of them and leaving the others to his readers to think about them. This book inspires thinking, it is interesting, informative, and you read it from the beginning to the end in one breath. This will do for the beginning.

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CULTURE OF COMMUNICATIONAL SEDUCTION OF PUBLIC

Essay on the book “Public Relations” by Professor Milivoje Pavlović
Megatrend University of Applied Sciences, Belgrade, 2004.

A University Professor, Head of the Department for communication and marketing of the Faculty for business studies of Megatrend University, a novelist and journalist by vocation, Milivoje Pavlović is known to the public by his engaged and interesting books in the field of culture, signs and heraldry for which he has often been rewarded. However, it is certain that by publishing a study titled “Public relations” (Megatrend University of Applied Sciences, Belgrade, 2004) he opens new space to contemporary analysis of theory and practice of this sub-discipline of communication science. Ever since 1923, when Edward L Burneys, PhD, wrote his first textbook and held his first course at the University of New York, the study of techniques and skills of functional creation of reality has been approached with special attention worldwide. In Serbia, long time has passed to understand that it is an important and influential profession, essentially different from journalism and marketing. It was as if the consciousness had great difficulty to fight its way up that the acquiring of strategic knowledge in creation of corporate, visual and harmonious accord with the environment would make us change the representations of personalities, phenomena or events. Several titles have been published in Serbia in recent years, both by foreign and domestic authors, but choosing the comparative study of physiological characteristics of communication and media channels of message diffusion, Pavlović offers a fresh, compact, successful synthesis of dominant paradigm, which results in transformation of conception of this increasingly popular field.

Making a modern conceptual approach to democratic exchange of opinions, which our political and journalist culture obviously lacks, Professor Pavlović speaks in favour of a radical break from the old, agitprop-like manner of propagation of ideas, values and goods. Determining by the very title the focus of his contemplations and angles of observation of problems of social and general-knowledge communication, he presents a number of topical theories, illustrating them thoroughly by a number of practical examples and situations in which a reader can find himself. Observing public opinion as a field of social life that is

most subject to social changes, the author uses deep psychology to reveal the conditions of social and economic prosperity, which functions within the models of new technologically multimedia order. Differing strategy from tactics, which is its dynamic and effective realization of changing social relations, popularly called “public jobs” and later on “public relations” (PR), Pavlović interprets PR as a discipline of management, circulation of ideas between an organization and the public, “more a dialogue than a monologue”, the feeling of corporate spirit and engagement of specialized agencies that carry out specific communication projects. Considering the basic idea, the book is thematically structured in several complex units: “Public relations as communication theory discipline”, Strategy and forms of public relations organizations”, “Corporate identity”, “Relations with media” and “Public relation ethics”, while special wealth is a number of standard enclosures supporting the presented hypotheses.

Because today there is more communication than ever, the book by Milivoje Pavlović analyses in detail the influence of public relations on the current social changes. The author studies the psychological structure of the public concisely, methodologically consistent, eruditely and scientifically scrupulous, the motives why the public participates in the processes of public decision-making, the role and sense of motivation, as well as various perception of the received messages. Starting from the attitude that the institutionalized relations at the beginning of a new millennium are not at the level of improvisation, he convincingly and systematically points to tracking paths of creation by which the relations among the citizens of a civil community are channeled into tolerant, culturally shaped patterns dominated by humanity and multiplicity. The division of public and private in social life suggests that there are two parallel flows, which by aggression and fear can lead to new revolutions and explosion threatening to lead to the end of civilization. By precise definitions of notions and certain aspects of public relations, which is emphasized in the review by academician Radovan Vuckovic, the author refreshes and extends the knowledge from many related disciplines, most of all from interpersonal and mass communication, business communication and persuasive communication, advertising and propaganda, as well as the science of multimedia.

This book is a small encyclopedia of basic journalistic knowledge, from the primary forms of expression, through genre theory to the appearance of new media, which gave swing to the process of people persuasion. The author is not satisfied with just registering the potentials and power of contemporary multimedia. Stepping further along the futuristic paths of uncertainty, in addition to analytic quality he also uses prognostic dimension, offering the vision of a society in 2010, people surrounded by computers who would become contemporary electronic shepherds and replace natural, social and genetic potentials. Paraphrasing a great Serbian poet, Laza Kostić, who said “in reality and in a dream...” he searches for the information twinkles, which would ennoble the world at the

crossroads of centuries. Since he has defined the main meta-position at the very beginning, the author continues showing the complex dialectics of historical development and improvement of public relations science, which only with the wealth of communication sub-systems becomes free from the restraints of political bureaucracy that have tended towards manipulation. "Communication is a dynamic process in which there are plenty of messages, actions or operations in constant flows directed towards a determined goal", reminds Pavlović, observing well the consequences of mass media explosion, which radically changed the traditional human habits. Offering his definition of public relations as "a set of managing and communication activities with the aim to create, maintain and improve good relations with the environment", he joins the wide planetary range of over 130 scientists who have already tried to determine this scientific field.

In the second chapter already, the author explains the levels of effective communication, public segmentation and identification of target public, chronologically and skillfully developing a thesis of evolution of thinking about these specific fields of the public. In addition to well-known cliché models of relations with media and winning publicity, considerable attention is paid to the relations with the employed people, important for the management of every organization, the relations with the consumers and local communities, sponsorship, while the segment on the importance and nature of lobbying is challenging for further study. The field of personal orientation is dominated by numerous theories of 'push' and 'attract' the public, which are given space as much as is sufficient to understand their primary goal. Explaining in more details the origin of stereotypes and prejudices, the author practically demonstrates the creation of opinions that are challenge for thousands of scientists who still study the modalities of influence on the human cognitive components. Interaction leads to powerful homogenization of masses, which chase the exclusiveness and easily fall into already set traps of uniformity and sensationalism under the influence of markets.

The existing configurations of power and domination survive thanks to fierce game between governments, mega-corporations and the public, so that a not at all accidental investment into the public relations science determines the outcome of the future of our culture and survival. Professor Milivoje Pavlović skillfully weaves seemingly simple and breezy story about the corporate identity by which "the companies, as well as any other man, nourish the image of themselves and strive to get impressed into the minds of other people as much permanently and painlessly as possible." He also reminds that such conceived systematic activities "constitute, make stronger or supplement the image of a political idea, party or personality." The name, signs and significance, brands, logotypes, mascots and logo-sheets, pictograms and personal marks are the titles of precisely explained notions and contents required by the people who plead to dedicate their lives to creative and inspirational job of corporate image creation. The philosophy of public relations is quite different from all previous ones,

claims the author, empirically proving how digitalization influences the changing of not only forms but also the contents of traditional types of communication. The value of the book is exactly in a number of examples from everyday life, taken over from world and domestic practice, which point to the procedures and explanations that guide readers to the projected goal. Articulation of ideas and initiatives finishes with the construction of induction model of generalization of attitudes based on general willingness and agreements between the manufacturers and consumers, who have the potential freedom to choose.

Almost a third of the book consists of the chapter on the relations with media, which is not surprising considering the fact that the author spent the majority of his life dealing with this field, but also the significance that media have on the perception of reality. Using the historical diachronic method, Pavlović carefully and methodically reconstructs the development of the most influential mass media, presenting their significance and power within the time and space in which they were active. Choosing the term 'media-sphere', he systematically explains the skills of news transfer from Guttenberg to the Internet, observing that the wealth of media techniques and genres at the same time threatens to diminish journalist freedom! The truth is more and more pushed back by its reflection (Baudrillard would say "virtual simulation"), which suppressing the facts and information offers merciless influence in which "media are the most powerful catalysts of economic flows and the most convincing messengers." Besides the incredible technological achievements which practically realized McLuhan's metaphor of the world as a "global village", its majesty the Word still has a central role within the relations of creating communication relations, which can be supported by many examples that influenced the development of civilization. "New and previously unknown forms of social and psychological perceptions appeared," observes Pavlović, concluding that the truth is more and more often the victim of TV journalism. The author's observations on the advertisements and advertisers are also interesting, as of their struggle for as bigger a piece of marketing cake as possible. Researching comparatively the situation in the leading European Union member-countries, he discreetly recommends the most acceptable model appropriate for fragile democracy as Serbia is in times of transition. Christopher Columbus needed a year to bring the news of the discovery of America, almost a year was needed for the news to travel from Kosovo Polje to Paris about the outcome of the famous battle, even interpreting wrongly the Serbian victory, while today the wars begin first on the CNN and other global networks and then in reality!

With the chapter titled "Public relations ethics" as a logical conclusion of the book structure, the author points to the complexity of interrelations between social consciousness and human practice. He observes many morals and unity of ethics, transformed through various societies and cultures, respecting at that contemporary standards and codices, noting that both the possible

over-regulation and inflation of regulation proportionally lead to limiting of human freedoms and silent return to covert forms of control. Contemporary management therefore must plead for strict respect of business ethics and rules of conduct. Otherwise, there would be distortion and manipulation, creation of information blockades and chaos that disables socialization. The instances of such activities in recent years can be seen in crises, especially in media wars that because of frightening technologies become planetary significant. In order to remain at the level of description, the author explains in detail the “principles of ethical power” of the leading theorists Kenneth Blanchard and Norman Pile with the main motto: “You do not have to believe to win!” The European Code of Professional Conduct in PR Practice, together with the Code of Professional Standards of PR Associations in the USA, the International Code of Advertising and the Munich declaration of rights and obligations of journalists, as well as Codes of Serbian associations, all make illustrative and practical documentation to support the previous hypotheses.

The value of Pavlović’s book, in addition to new original and critical survey of thoughts on dialectics of flourish of the public relations science, is in a simple mosaic-like style of writing. The spirit of a writer and journalist emanates from narrative flow of precise and well-articulated thoughts offering different perception and new prospective. Fine, topical and interesting examples that author used to illustrate his theoretical hypotheses, are always in the function of easier understanding of the content, spiritual refreshment that prepares us for new contextual layers of information to come. This is how it is possible to translate dull, sometimes tiring theoretical postulates into easy-flowing, dynamic and acceptable models of reality creation, together with the successful application in everyday communication. From the practical ideas, the author skillfully and responsibly derives the most important axiological assumptions important for the construction of developed theory of science creating the public relations.

Observing it as a whole, the new book by Professor Milivoje Pavlović represents a very successful communication theory inter-disciplinary analysis of the public relation system development, with a special survey of media and their influence on formation of the public judgment. It is a supplement to deepening of democratic relations not only in the sphere of PR, but also in the sphere of public communication, which accepts more and more the characteristics of global, political, economic and cultural super-system, so it is an unavoidable reading-piece for everyone who studies numerous crossroads creating the high-ways of the future. This is why it is intended to all readers interested in understanding the skills and techniques of the efficient changing of human beliefs, opinions, ideas, attitudes and conducts.

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33

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