

megatrend

# review

**The international  
review  
of applied  
economics**

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Megatrend  
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## THE BULGARIAN NATIONAL BANK IN A HISTORICAL PERSPECTIVE: SHAPING AN INSTITUTION, SEARCHING FOR A MONETARY STANDARD\*

**Abstract:** *The Bulgarian National Bank (BNB) was established in January 1879. It was among the first institutions of the freshly created Principality of Bulgaria – a virtually independent tributary of the Ottoman Empire that emerged from the 1877-1878 Russo-Turkish war. Initially, the BNB was deprived from the privilege of issuing banknotes. This right was granted to it in 1885, transforming the institution into one of the first ten proto-Central banks worldwide. The BNB has played a pivotal role throughout modern Bulgarian history. It is a key for understanding the philosophy of national economic development. The bank has mastered the capitalization of important segments of the economy and it shaped the fundamental relationship between the economy and the State. Moreover, the BNB has set important behavioral standards, thus molding the financial culture of the nation. It has also established patterns in the accountability and the transparency of the financial system. The National bank has been a first-order producer of economic data and (incidentally) of economic knowledge. The aim of this article is to outline a brief sketch of BNB historical development. The focal perspective is on its role in the choice and implementation of the monetary regime. BNB institutional arrangement is discussed, as well.*

**Key words:** *Bulgarian National Bank, monetary regime, institutional arrangement*

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## 1. The Bulgarian National Bank: Shaping an Institution

### 1.1. The “impossible institution”

By definition, a Bank of Issue tries to manage an unmanageable “original sin”: it receives a monopolistic privilege in exchange of services provided to the Government. Thus, having access to the credit of the bank and to its seignorage, the Government is provided with immediate solution to short-term emergency problems. The Bank, in turn, develops a specific dependence and a “financial Oedipus complex” vis-à-vis the State. The conflict of interest is inherent, its tackling being a matter of economic culture. Two key questions are addressed: How to deal with conventions? How to avoid violation of the frail balance?

The two sides are not symmetrical. Crucial to monetary stability and the ultimate force behind money supply is a decent fiscal stance. No issuing policy going straight against the fundamentals of State financial targets is feasible. The Bank of Issue lacks the instruments to enforce such a fully autonomous line. Monetary policy can be constrained only when fiscal policy is credibly constrained.

Transgression of specific breaking points puts at risk the stability of the established monetary standard. History of the BNB (as of many Central banks) boils down to the account of this conflict.

### 1.2. Private versus public / Dependent versus Autonomous Bank

Checks and balances have been put in place in order to safeguard against the abuses of the State. They included self-constraints accepted by the Government; spontaneous devices implemented by the Bank; a more sophisticated set of conventions. The prevailing view at the end of the 19<sup>th</sup> century was, however, that a *private* Bank of Issue whose credit is separated from the credit of the State is the best warranty. At the time the BNB was established, several heavily regulated private issuing institutions were operating across Europe. Only in a few countries “free money” was the rule. State-owned Banks of Issue were the exception, with the Bank of Russia being a well-known example. In other instances – such as Greece – the issuing authority was *de facto* dependent from the Government.

The 1879 design provided by the occupation forces followed the Russian pattern of a state-owned deposit/merchant bank for commercial credit. Later on, a series of reform projects (1879-1885) were inspired by the Belgian, the Romanian and the Greek models. Bulgarian politicians resorted to institutional plagiarism, and to a “copy/paste” approach, introducing into the blueprints eclecticism and baroque promiscuity of different banking cultures. Taking into account that the Romanian and the Greek banks were themselves inspired by Western models, the reforms of BNB followed a Byzantine institutional path that incorporated direct replica and “second order plagiarism”.

The 1885 Law and later piecemeal and more pragmatic changes progressively shaped a stable BNB statute. Unavoidable inconsistencies between the institutional design and the archaic reality produced niches of “economic vacuum” filled up by “parallel forms” and by the underground. At the same time, “imaginary goals” developed, arising from the gap between “enlightened” policies of the BNB and the economic background of the country.

The core debate about the ownership of the bank has been clearly settled in favor of the State. This strategic choice was a crucial contribution to the deeply rooted *etatiste* mentality of Bulgarian society. State ownership became an angrily defended ideological dogma. Private capital was considered deprived from “moral rights” to run the Bank of Issue: private property was labeled as *a priori* dangerous, while the State was treated as *a priori* impartial. The shareholding structure was firmly opposed as ineffective and unsuitable for a country poorly endowed with capital. Possible participation of foreign capitals in the issuing bank was ruled out.

In this way, the 19<sup>th</sup> century European orthodoxy was inverted. A State institution (unlike the rigorous private bank) was supposed to be a “gentle bank”, generous with the budget, benevolent with debtors and tolerating arrears. All the proposals (in 1879, 1883, 1891, 1899) to privatize the BNB have been systematically rejected. This sharply contrasted with the trend in neighbor countries like Serbia and Romania where the Banks of Issue have been established as privately owned institutions. The last and strongest attempt to revert the *status-quo* was the failed intent by the League of Nations to impose a privatization scheme for the BNB in 1928. The plan was in line with the prevailing ideas in Europe and with precedents in Poland, Romania or Greece. BNB remained a State-owned institution, albeit with somewhat greater independence. The newly acquired autonomy, however, rapidly faded out during the Depression and was reduced to nothing in WWII.

In turn, the post-WW II profile of the bank followed the respective mainstream patterns in the East and in the West. After the nationalization of the financial system in 1947 BNB was transformed into an orthodox Soviet-type monobank (1947-1991). Shortly after the collapse of Communism, an independent Central bank was designed (1991) in accordance with the Washington consensus’ principles. It was only with the implementation of a Currency board arrangement (CBA) that BNB departed from the “imitation” tradition. The exotic monetary device was put in place in 1997, in the aftermath of several inconclusive stabilization programs and a sharp financial crisis.

Looking back it can be argued that no sufficiently influent social forces have been interested to separate the Central bank from the State. The political elite have been keen to keep the bank under control, thus leading to a pervasive corruption of monetary policies. Neither a tradition of subtle institutional equilibriums was forged. The eventual choice of a hard and clear-cut regime such as the CBA was a natural upshot of the disillusiones accompanying this long-run trend.

Once the ownership issue of the BNB was firmly settled, the controversy shifted to the safeguards of certain autonomy. Several types of warranties have been tested. Among the financial restraints, legal ceilings for advances granted by the Bank to the Government were introduced. Personal warranties were sought, as well, for the independence of the Governing body of the bank. Arrangements were made in the statute, providing for autonomy of the members of the Credit Committees.

Historical evidence suggests that all the checks and balances have proven to be illusory. The precautionary measures have been debased by the State, and not only in circumstances of *force-major*. Formal limits have been occasionally outpaced or circumvented, while balance-sheets manipulated. In several instances the gold (foreign exchange) reserves have been alienated by the Government. When it seemed necessary to the ruling party, the Governors have been fired. New laws were enacted if the existing ones obstructed Government intervention. Parliamentary commissions have been established to screen details in the Bank's activity (1884, 1920).

The conclusion based on Bulgarian evidence is that there is practically no room for maneuver when the Bank of issue is State owned. (It is still restricted when the Bank is private.) The only credible threat to Government interference with monetary policy remains external pressure exerted by foreign creditors and by the panoply of international organizations. The most effective constraints on issuing policy have been imposed through foreign conditionality: closing (or restriction) of the national bank's window for budget financing have been only possible by outside-driven deep institutional reforms. A restrictive clause barring paper money issue was included as early as 1902 in the contract of the important loan floated by the Banque de Paris et des Pays-Bas led consortium. During the pre-WWI period, menaces to impose extreme models, designed after the Dette Publique Ottomane, have been voiced on several occasions (1899, 1904, 1907). In 1922 the Inter-Allied Commission installed in Sofia after the signing of the 1919 Treaty of Neuilly enforced a formal ceiling on the Government debt to the BNB and to the banknotes in circulation. Later on (in 1928) a deep reform of the National bank was set as a precondition for the issuing of the Stabilization loan under the trusteeship of the League of Nations. The reorganization shaped the institution as an orthodox Bank of Issue managing a gold-exchange standard, strictly limited in its lending to the State. A League's Commissioner and a technical adviser were attached to the BNB. Their role (until they left in 1940) was essential for the handling of strategic and short-term monetary policy decisions. Further on, the Moscow-supported communist regime transposed literally the Soviet model of the monobank. Finally, it was the IMF that launched the idea for a Currency board arrangement and monitored its implementation in 1997.

Stringent institutional framework does not entirely preclude a role to personal qualities in a Bank management: indeed personality seems to matter and

some Governors have been stronger than others in defending the autonomy of the Bank. Public clashes were scarce, but there were some prominent cases, such as the fervent 1894 letter to the Finance Minister by the then Governor Mihail Tenev defending “dissident” positions of the BNB on monetary issues.<sup>1</sup>

This historical record led to a firm belief that “issuing policy is mostly State’s, not Bank’s, policy”.<sup>2</sup> In effect, the institutional image of the BNB has always been closely associated to that of the Government, the climax being during the communist period.

## 2. In Search of a Monetary Standard

A comparative chronology of the BNB and of the Bulgarian currency is presented in Table 1.

**Table 1: BNB and the Lev**

BNB – Institutional milestones	Milestones in the history of the Lev
1879: Established as a State-owned deposit/merchant bank	1880: The Lev as a legal tender. Adherence to the Latin Union
	1880-1887: Monetary chaos and demonetization of foreign currencies
1885: The issue privilege is granted to BNB. BNB as a commercial bank and a bank of issue.	1888-1902: Unstable Bimetallism. <i>Aggio</i> (Premium on gold)
	1899-1902: Suspended gold convertibility
	1902-1912: Restored convertibility. Quasi gold standard
	1912: War <i>force majeure</i> : Convertibility suspended
	1915-1923: Fiat Money; War and post-war inflation
	1924: Stabilization <i>de facto</i> of the Lev at 1/27 of the pre-war gold parity
1928: The BNB is transformed into an authentic Bank of Issue under the aegis of the League of Nations	1928: Stabilization <i>de jure</i> of the Lev. Gold-exchange standard. Lender of last resort.
	1931: On the side of the “Gold block”
	1939-1944: Clearing surpluses with Germany.
	1945-1946: War and post-war inflation.
1947: Nationalization of the banking system. BNB as a monobank.	1947: Dealing with monetary overhang – currency reform
	1990: Default on the foreign debt towards private creditors.
1991: Two-tier banking system	1991-1996: “Transition inflation” unbound.
	1996: Banking and currency crisis. Touching hyperinflation.
1997: Currency Board Arrangement	1997: Regime shift and change of the monetary standard – currency board introduced.
	???- Joining the Eurozone. Changeover to the Euro.

<sup>1</sup> Bulgarian National Bank: *A Collection of Documents (Vol. 1, 1899-1900)*, edited by R. Avramov, Bulgarian National Bank and State Archives, Sofia, 1998, p. 356 (In Bulgarian)

<sup>2</sup> S. Bochev, “The Bulgarian National Bank as a Bank of Issue, a Foreign Exchange and a Credit Institution”, 1924, in: *Stoyan Bochev, Capitalism in Bulgaria. Collected Works (1911-1935)* edited by R. Avramov, Fondazia Balgarska Nauka i Kultura, Sofia, 1998, p. 168 (In Bulgarian)

The striking feature when comparing the two time-lines is their different length. Relatively few institutional changes have been compatible with a quite turbulent history of the Lev. Obviously, each subsequent general framework has been covering dynamic monetary arrangement.

The ensuing regimes follow similar patterns that could be shortly summarized. To start with, they typically pass through a set of trials and errors in searching of the adequate monetary standard. A recurrent episode is the (aborted) adoption of a prematurely imitated “modern” system that proves to be inconsistent with the prevailing economic conditions. Intents to impose credible monetary constraints and conventions face implicit resistance from the economy and chiefly from those interested to relax the financial discipline. Most prominent among them are debtors and (in particular) the Government. As a result the conventions are kept dormant, suspended, simply ignored, or circumvented through new – looser and inflationary – rules and substitutes. The collapse of the successive standards is marked by severe monetary crises triggered by external and/or fiscal disequilibria. The distinctive attribute of this emergency is money supply based on “hollow” assets.

Bulgarian monetary history confirms that official (metallic) standards in peripheral countries are fragile. They easily blow-up, while exit from the monetary rule is relatively straightforward. Ultimately, the ease/difficulty with which rules are transgressed is an indication of the maturity (monetization) of the economy.

Tensions between a relatively rigid institutional arrangement of the Bank of Issue and the dynamic monetary reality generate two kinds of cycles: recurrent shifts from “formal” to surrogate money, and a variable geometry of functions of the Central bank.

### *2.1. Early monetary history: monetary chaos and bimetallism (1880-1892)*

In 1880, shortly after the country obtained Independence, the Parliament enacted a Law allowing for the mintage of coins, and introducing the Lev as legal tender. Gold, silver and copper coins were permitted, and a general ceiling was fixed for their overall quantity.<sup>3</sup> The *official* regime aimed at joining the bimetallic standard of the Latin Union: payments to the Government were accepted in gold and silver coins, including (subject to reciprocity) those of the Union.

The *actual* system, however, stood far from this objective. Loopholes were introduced by the Law itself, accepting parallel circulation of coins from outside the monetary union. This corresponded to the reality where vast panoply of foreign coins (many of them demonetized in their own countries) served as

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<sup>3</sup> R. Avramov, Ed.: *120 Years Bulgarian National Bank (1879-1999). An Annotated Chronology*, Sofia, 1999; A. Christofoff: *Bulgarian Banking: Historical development*, Sofia, 1946, p. (In Bulgarian)

a means of exchange. Besides, mintage of gold coins was indefinitely postponed, while there was no effective limit for the mintage of copper coins. The fundamental disequilibria were rooted in the widespread circulation of silver Rubbles left behind by the Russian army that departed from the country in 1879. An overly appreciated rate of those Rubbles was maintained by the Bulgarian authorities who were reluctant to deflate the key monetary asset of the population. This stance contrasted sharply with policies followed by neighbor countries. Serbia and Romania had depreciated the Rubbles, Turkey demonetized foreign silver coins in 1883 and the Bulgarian market was inundated by silver money. Instead of the bimetallic standard of the Latin Union, a *de facto* silver monometallic regime (with circulating copper coins) was established.

The prime goal of the new State in this context was to unify the monetary material by eliminating the gap between the virtual (“official”) statute of the Lev and the actual circulation. First, troubles came from the efforts to demonetize the Russian Rubbles. They took four painful years and were only completed in 1887. Meanwhile, the illusion that a monetary standard can be imposed by administrative means vanished.<sup>4</sup> The process boiled down to an implicit monetary reform as its final outcome was the control of money supply by the State.

The situation became even more intricate due to the intrinsic conflict of interests between the Government and the BNB. With the privilege of issuing banknotes granted to the National bank (1885) two competing sources of seignorage appeared. The question was who was going to capture the inflation tax. The Government, on the one side, was eager to collect the seignorage of coin mintage in order to monetize its budget deficits. BNB, on the other, was keen to “produce” banknotes’ seignorage, thus broadening its liabilities and reducing its commercial lending rates. The bank’s strategy was to introduce the gold standard as soon as possible. This was not only a question of international monetary trend and prestige. The gold standard, it was thought, would provide access to capital flows thanks to its “seal of approval”. Above all, the new regime would eliminate the *aggio* which is the form inflation tax takes under bimetallism. In fact, the premium on gold in the domestic market appears when there is a disproportionate supply of silver currency, which was typical for Bulgaria during the last decade of the 19<sup>th</sup> century.

The struggle was short-lived and the results were not in BNB’s favor. The bank failed in its first intent to introduce gold banknotes in 1885. The population was unprepared to use the new asset, and still keeping memories of the recent fiasco with the Ottoman bank’s notes. Fiscal policy’s short-term goals definitely prevailed, and the Government proceeded to large-scale silver mintage (1891, 1892, 1894), proscribing at the same time BNB from issuing silver-backed banknotes. This facilitated the monetization of the deficits, but the *aggio* remained at high levels, reaching 7.2% in 1895. Gresham’s Law operated

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<sup>4</sup> Bulgarian National Bank, *ibid.*

unrestricted, eliminating the gold from the currency market. Given the institutional weakness of the BNB vis-à-vis of the Government, the Bank abandoned (after 1892) its explicit ambition to introduce the gold standard and to eliminate the *aggio* through its own efforts.

## 2.2. The gold standard: cycle I (1897-1902) and cycle II (1902-1912)

The next attempt to implement pure gold standard was launched by the Government itself. A Law enacted in 1897 foresaw the introduction of gold Lev at par with the gold Franc. Circulating silver, bronze and nickel coins were to be eliminated. All the accounts had to be kept in gold Lev.<sup>5</sup> Authorities were, however, hesitant. Their optimistic outlook was based on one favorable season of good harvest and on a couple of balance of payments surpluses. The situation was fragile and the Law stipulated that it is the Government's discretion to decide when the enforcement should take effect. The decision was actually postponed *sine die*.

The 1897 attempt turned out ill-prepared and premature. Gold standard was introduced only formally, and a new gap emerged between the *official* institutional arrangement and the *real* regime. Shortly afterwards the economy was hit by a deep financial crisis (1899-1901). The monetary rule was abandoned and convertibility of gold banknotes was suspended from November 1899 till November 1902. Meanwhile BNB was allowed to issue silver-backed banknotes. The Government widely monetized its deficit through credits from the National bank: the entire issue was absorbed by the budget, and statutory ceilings of credit to the Government were occasionally violated. Money supply was entirely based on Government debt. It is not surprising that the *aggio* reached 14% in 1901. This was the end of the illusion that the "progressive" monetary regime could be imposed through merely legal measures.

The *outcome* of this inconsistency with reality was exactly the opposite of the official objective. Instead of a gold standard, a pure silver standard was put in place. At the same time, banknotes earned credibility and irreversibly penetrated the economy.

After the first aborted cycle a new, benign one, developed. The legal framework did not change dramatically but the prevailing economic conditions improved substantially. A series of foreign loans arranged by the Banque de Paris et des Pays-Bas in 1902, 1904 and 1907 strengthened the external position of the country and piled up the exchange reserves of the BNB. They were followed (1909) by the first loan without special warranties, floated by a Viennese bank. Bulgaria entered its most successful decade, characterized by relatively important inflow of foreign capitals (namely in the banking sector) and by a more vibrant business activity.

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<sup>5</sup> R. Avramov, Ed., *ibid.*

Those changes were accompanied by an adjustment in the *actual* monetary regime shifting spontaneously to gold. The premium on gold in the domestic market virtually disappeared after 1906. Gold banknotes crowded-out the silver-backed notes. The result was a quasi-gold standard: although bimetallism was legally preserved, the de facto system was overwhelmingly monometallic. The policy objectives of the BNB changed accordingly. The Bank aimed to minimize the premium of gold over gold-backed banknotes and to support the foreign exchange rate of the Lev. The target variable became its gold/foreign exchange stock, and (like in classical Banks of Issue) monetary policy merged with exchange policy. Reflecting a growing creditworthiness of the country, the stance of the Lev in the foreign exchange markets remained remarkably stable in 1906-1912.<sup>6</sup>

### 2.3. War standard (1912-1919)

Fortune changed with the outbreak of the Balkan Wars in October 1912. The official institutional arrangement had to be amended accordingly. It was customary for the classical gold standard that a suspension of the monetary rule is tolerable for belligerent countries, provided that they return to the norm through deflationary policies after the end of the hostilities.

An important modification had already been introduced when convertible foreign exchange was legally included in the cover ratio (1911). This step led to an implicit gold-exchange standard, thus extending money supply's elasticity. Bolder changes occurred in the immediate aftermath of the declaration of War. "Provisional" suspension of convertibility and outpacing of the ceiling for the Government debt to BNB were announced in October 1912. The BNB was released from responsibility with the well-known *Lettre d'Indemnité*: a legal artifact devised in 1847 and repeatedly used in 1857 and 1866 by the Bank of England and the British Parliament shortly after the enactment of the restrictive 1844 Bank Charter Act. Those changes were ex-post amended by Law only in 1919.

After the end of the Balkan wars BNB managed to stabilize the exchange rate of the Lev, namely with the assistance of a banking pool that intervened in favor of the national currency. The access of foreign banks to external funds was essential for the success of the pool. Things went worse, however, after October 1915 when Bulgaria entered WWI on the side of the Triple Alliance. Financing of military expenditures came through regular German and (to a much lesser extent) Austrian "war advances" (1915-1918) converted into Lev via a fixed rate to the Mark. The BNB re-channeled the advances to the Bulgarian Government, while the incoming sums were *officially* accounted as full-fledged foreign exchange cover of the Lev.

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<sup>6</sup> Bulgarian National Bank: *A Collection of Documents (Vol. II, 1901-1914)*, edited by R. Avramov, Bulgarian National Bank and State Archives, Sofia, 1999

Once more, the *actual* system diverged from the *formal* arrangement. German advances were not an authentic cover: they represented illiquid sums, blocked in Berlin bank accounts, not freely convertible into gold or “free” exchange. The Bulgarian Government did not have sovereign discretion concerning their use. After the Treaty of Neuilly significant amounts remained frozen in Germany, and eventually annihilated by the hyperinflation at huge cost for the BNB. Due to massive Government financing based on the war advances, the bulk of the budget deficit was basically monetized by the National bank. Gold and highly liquid assets were reduced to insignificant fraction of the money cover. By the end of the war (1919) their ratio dropped to mere 5%. Finally, domestic commercial paper (refinancing) was discounted in very restricted amounts as credit to the private sector was completely crowded-out.<sup>7</sup>

Money supply was thus ultimately based on *hollow assets*. Direct loans to the Government hypertrophied and exceeded by far the legal ratio, producing uncontrolled inflation. At the same time the two other monetary assets (foreign exchange and refinancing) were cut down to almost nil. Keeping the formal monetary arrangement unchanged, the Lev suffered a 14-fold internal devaluation and 4-fold depreciation vis-à-vis the Swiss Franc (1919).

#### *2.4. Restoring the Monetary rule (1919-1928)*

WWI was followed by a new wave of inflation that depreciated the national currency even further. By 1923 the Lev fell to 1/27 of its pre-war gold parity. Adopting the emerging orthodoxy elaborated at the Brussels (1920) and Genoa (1922) conferences, Bulgaria opted for a gradual adoption of the gold-exchange standard. This target called for profound economic, as well as legal reforms. On the economic side, fiscal stabilization, an important deflationary squeeze, and a balance of payments adjustment had to be achieved. The access to foreign capital markets had to be reinstated: it was completely disrupted due to the imposed reparation payments and to pending issues with pre-war creditors. A fundamental choice was to restore convertibility at the actual gold parity of the Lev. The return to the pre-war level (as in UK and a few European countries) was discarded as unsustainably deflationary. On the legal side, the statute of the National bank had to be reshuffled according to the modified version of the gold standard.

The Government started progressively repaying its accumulated debt to the BNB. Efforts were made to control monetary policy, the major step being the 1922 enactment of the thresholds (under the pressure of the Inter-Allied Commission) for BNB direct financing and for notes. The initial (completely unrealistic) reparation liabilities of the Treaty of Neuilly were scaled down in

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<sup>7</sup> Bulgarian National Bank: *A Collection of Documents (Vol. 3, 1915-1929)*, edited by R. Avramov, Bulgarian National Bank and State Archives, Sofia, 2001 (In Bulgarian)

1923. Negotiations with creditors led to the 1926 agreement on gradual restoring of the “gold clause” for outstanding debt service. Major events were the Refugee (1926) and the Stabilization (1928) loans floated in the London, New-York and Paris markets under the League of Nations auspices. They were conditional upon the implementation of macroeconomic stabilization measures and structural reforms modeled after those already introduced by the LN in Austria, Hungary, Estonia and in a handful of other European countries. In the end of 1923 the BNB was granted the monopoly of foreign exchange transactions that considerably improved its reserve positions. Since 1924 the Lev was *de facto* stabilized with respect to the US Dollar.

What remained to be done was to stabilize the currency *de jure*, i.e. to adequately transform the institutional design of the National bank. The reforms were carried out through successive amendments in its statute. They started in 1924, were pursued in 1926, and were completed by the new Law of 1928. At last, BNB was transformed into an authentic Bank of Issue operating under a full-fledged gold-exchange standard.<sup>8</sup>

Thanks to the foreign loans BNB was recapitalized and liquefied. Money supply recovered its healthy anchor: foreign exchange became the main monetary asset; refinancing of commercial banks was based on clear principles; direct financing of Government was (almost) entirely ruled out. Convertibility was restored, although with some restrictions. For a while the official and the actual monetary regimes coincided. A large inflow of foreign capital that nurtured credit inflation and a booming economy also contributed to this accomplishment.

### 2.5. The collapse of the gold-exchange standard (1931-1944)

Success came too late, lasting only from 1928 until mid-1929. The blow of the Depression, the massive outflow of short-term capitals fueled by the Central European banking crisis during the summer of 1931 and ultimately, the exit of the UK from gold in September 1931 truncated the experiment with the gold-exchange standard.

The *official* policy of the Bulgarian Governments was aligned to this of the “gold block” countries that refrained from overt devaluations. Gold parity was explicitly maintained in order to avoid a surge in the servicing burden of foreign debt. The gold reserves of the BNB were meticulously preserved. Balance of payments problems, and the shortage of convertible currency were dealt with since October 1931 through clearing agreements, trade policy and capital restrictions.

The *actual* monetary regime rapidly departed from the untouched legal framework of 1928. The combination of clearing arrangements, draconian import quotas and foreign exchange restrictions meant an *effective* suspension of con-

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<sup>8</sup> Ibid.

vertibility without the old-fashioned paraphernalia of the *Lettres d'Indemnité*. Meanwhile, the transfer problem was addressed by a partial default on foreign debt (April 1932) and the eventual sequence of settlements with the bondholders' committees that reduced (by 1935) the payments in foreign exchange to 15% of the interests' gold value. An implicit loosening of monetary constraints was allowed in the domestic market as well. Starting in 1933, larger amounts of convertible exchange were freely traded between importers and exporters with a premium on hard currency which represented an implicit devaluation. By 1937 those "compensation deals" amounted to 36% of the foreign trade turnover.<sup>9</sup>

The situation was familiar from the collapses of the previous monetary regimes. The money supply's anchor had been eroded ("falsified") by the respective devaluations of the British Pound and the US Dollar. Explicit depreciation of the Lev was avoided, but the arrangements mentioned permitted its undeclared devaluation. Alongside, a subtler trench developed within the clearing arrangement with Germany. The fixed exchange rate of the 1932 agreement was maintained despite the gradual devaluation of the Reich mark in the foreign markets. This effective appreciation of the German currency vis-à-vis the Lev boosted Bulgarian exports and (after a period of relatively balanced accounts) started to generate important clearing surplus by the end of the 1930ies. More than half of the export was captured by Germany, and this trend was accentuated after Bulgaria formally joined the orbit of the Axis in March 1941. A key monetary implication of those developments was the Bulgarian authorities' qualification of the Reich mark as authentic "hard currency" in 1941. The decision permitted to include it explicitly in the cover ratio, in spite of the fact that the Mark did not possess the qualities of a reserve currency. The situation from WWI was replicated: a "hollow" (spurious) asset served as a base for money supply. In this instance it was the (completely illiquid) Bulgarian clearing surplus with Germany that served as foundation for the money supply. The Government also resorted to other manipulations, such as "creative accounting" for the cover ratio, explicit monetization of the budget deficits, or issue of surrogate money in the form of short-term Treasury bills used as legal tender.<sup>10</sup>

## 2.6. *The monobank: a monetary standard without money (1947-1990)*

Concomitant to the December 1947 nationalization of the banking sector was the abolition of the 1928 Law on BNB. During the next 44 years the National Bank operated according to an administrative statute without the force of a law. The institution adopted all the requisites of the Soviet orthodoxy. BNB was

<sup>9</sup> A. Christoforoff: *The Course of the Trade Cycle in Bulgaria 1934-1939*, Statistical Institute For Economic Research, State University of Sofia, Sofia, 1939, p. 16 (In Bulgarian)

<sup>10</sup> Bulgarian National Bank: *A Collection of Documents (Vol. 4, 1930-1947)*, edited by R. Avramov, Bulgarian National Bank and State Archives, Sofia, 2004 (In Bulgarian)

the sole lender in the economy: although two or three formally separate banks existed, they lacked all freedom. On paper, the Lev was distantly tied to the US Dollar (and to gold) through the Soviet Ruble, but this post-WWII “gold-exchange standard” was an artifact as the country was not a member of the Breton-Woods institutions, and access to foreign exchange was completely controlled.

Overall, the economy was demonetized and disequilibria took natural, rather than monetary forms. Rationing was performed through commodities’ deficits, not through money. Capital was practically priceless. Credit was provided (almost) automatically by BNB in the frame of the planning goals. Large segments of the economy were isolated from the world market through a grid of exchange coefficients that made every export/import “efficient” at the cost of huge subsidies. There was no means of international exchange in the COMECON, the “Transfer Ruble” utilized being simply an accounting unit, not a multilateral currency.

The *actual* regime, however, was more complex<sup>11</sup> Different sectors had different degree of monetization. While the budget benefited from the privilege of unrestricted funding, households were more constrained, and the state-owned enterprises were denied any strategic or short-term decisions. Zones of spontaneous monetization appeared, producing leakages of “unplanned” and uncontrolled funds. Besides, monetization was unavoidable at the contact with the world capital and commodities’ markets. It was there that periodic balance of payments and debt crises erupted (1959/1961; 1978/1980; 1989/1990). The successive attempts to reform the system that started in the early 1960ies can be summarized as inconsistent efforts to inject monetized enclaves, without questioning the fundamentals of the regime.

The economic unsustainability of communism was reflected in the growlingly chaotic/underground monetization. Larger zones of market prices, of cash transactions, of increasing labor mobility, of overt inflation, or of equilibrium exchange rates in the black market emerged. This was accompanied by megalomaniac State-induced investments in an economy that was not more than previously in a condition to transform internal into serviceable foreign debt. The BNB, like the entire planning machine, lost the command of the economy and, in particular, of money supply. The collapse during the 1980ies came with a critical amount of domestic and foreign debt arrears. By the second half of the decade more than half of the BNB loans were nonperforming, and the Government’s debt outstanding to the Bank was rescheduled for 50 years. The external position of the country became untenable. As a creditor Bulgaria was exposed to insolvent debtors (Third World countries, Marxist

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<sup>11</sup> V. Antonov: “Theoretical foundations of Inflation under Socialism” *Ikonomika*, VI, 1990 (In Bulgarian); R. Avramov, Ed., *ibid*; Bulgarian National Bank (A): *A Collection of Documents* (Vol. 5, 1948-1990), edited by R. Avramov, Bulgarian National Bank and State Archives, Sofia [Forthcoming] (In Bulgarian)

regimes). As a debtor in convertible currency it suffered from the strong US dollar, from the import-driving overvalued official rate of the Lev, and from an extremely inappropriate liability structure with very high share of short-term debt to private banks. Since 1987 roll-over in the free capital markets became increasingly costly and inaccessible. The ailing Soviet Union was no longer in a position to arrange once customary bail-outs vis-à-vis of Western creditors. Foreign exchange reserves were rapidly exhausted in late 1989 – early 1990 and Bulgaria defaulted in March 1990. Open monetization of the disequilibria was unavoidable. So was the change of the monetary regime.

### *2.7. The first “Transition” monetary system (1990-1996)*

A blueprint for a “Washington consensus” – like standard was easily designed after the fall of communism. A two-tier banking system and a formally independent Central bank were introduced in 1991. They operated, however, in a barely reformed context, with predominantly state-owned enterprises, distorted prices, unsupervised banking sector, and in seclusion from the foreign capital markets.

The already well-known divergence between *official* and *actual* monetary regime emerged very soon. BNB’s long-term goal (price stability) was sacrificed to short-term fiscal goals, namely to the easy going capturing of inflation tax. Independence of the national bank remained on paper. The collapse came amid a generalized financial crisis in the second half of 1996 when BNB had to face incompatible goals: to preserve foreign reserves for debt repayments; to defend the exchange rate; to act as a lender of last resort to commercial banks in distress. During the entire period (1991-1996) money supply has been based on “hollow assets” and a biased structure: loans to the Government were simple monetization of budget deficits; refinancing was oriented to insolvent domestic banks; volatile foreign reserves were poorly (risky) managed and invested.

The economic debacle occurred in early 1997 with all the features of a currency crisis. Widespread dollarization eliminated the Lev even in small denominated transactions. Monetary instruments turned out to be completely ineffective, the maturity of government securities falling to 1 week. Hyperinflation and banking panic developed. After the recent Brady-type deal on foreign debt (July 1994), the country was again on the verge of default. The ideal prerequisites for a (new) change of monetary regime were in place.

### *2.8. The Currency Board Arrangement (1997 – Eurozone)*

The shift in this instance was radical and adequate. The CBA introduced in July 1997 boiled down to the launching of a new currency. The issuing institution was completely redesigned. The new anchor (the exchange rate) was the

only one that had remained undiscredited from the previously failed stabilization efforts. The simultaneous political regime change (Presidential elections took place and General elections were called) increased trustworthiness. Finally, the transfer of monetary sovereignty abroad (to the Bundesbank and eventually to ECB) gave the strongest possible credibility. The choice of the German Mark (later on – the Euro) as the anchor currency was the most appropriate one.<sup>12</sup>

The Currency board establishes a gold standard-like monetary rule. Money supply is passive, not discretionary. It is covered by a single hard, liquid, safe and neatly defined asset (the foreign reserve currency). The quality of the money cover can not be forged (unless the Euro collapses) and the asset structure of the money supply can not be biased: risky domestic monetary assets (loans to the Government and refinancing) are simply eliminated. Thus, the recurrent incongruities between *official* and *actual* monetary arrangement being ruled out, it is no longer possible to circumvent and/or to undermine the conventions of the monetary standard.

### 3. The Bulgarian National Bank: A Variable Geometry of Functions

The institutional profile of the BNB has experienced deep changes in the wake of altering monetary regimes and economic backgrounds. Nevertheless, two opposite trends emerge, generating distinct long cycles. Their first phase is made-up by periods of “incestuous” amalgamation of central banking functions with other activities and targets. The second is dominated by a drift to functional cleansing.

#### 3.1. The First Cycle (1879-1928)

Growing heterogeneity was the dominant feature during the 1879-1906 period. Starting as a deposit/short-term credit bank, the BNB steadily added varied activities. The major addendum was the issuing function (1885). The Bank developed, as well, mortgage and agricultural long-term credit. The latter was partly extended indirectly, through refinancing of the Agricultural bank. Besides, BNB became rapidly (as a commercial bank) the favorite vehicle for the investment ambitions of the State and the Municipalities. Although credit to the Government was statutory, it developed in a large scale when deficit financing was needed during emergency periods (1899-1902). Covert Government financing through balance-sheet manipulations was also regular practice. As a result, private credit was crowded-out or crowded-in depending on the budget's needs.

The outcome of this promiscuity of functions was the building up of illiquid assets which is improper for a bank of issue. There was a general bias towards

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<sup>12</sup> Bulgarian National Bank: *Annual Report*, 1997

the long-term end, leading to a maturity mismatch. BNB developed a preference for direct credit, avoiding rediscounting operations with private banks. On the liability side, it had to rely initially on remunerated deposits instead on “free” banknote resources. It was only after the turn of the century crisis that interest rates on deposit fell together with the spread of banknotes’ circulation.

The crisis and the 1902 loan set up a reversal in the institutional shape of the BNB. During the next two decades (1906-1928) a painful accretion of functions led to a neater target structure. First, exchange policies were brought to the fore (1906-1915). During the WWI and the immediate post-war years, the bank was converted into a printing press for the Government (1915-1922). At the same time, inefficient efforts were made to master a consistent exchange policy (1919-1923). With the *de facto* stabilization of the Lev, BNB progressively abandoned direct credit to the economy (1924-1928). Credit to Government, in particular, was gradually discontinued (1926-1928). The 1928 Law gave BNB its purest form: it became a “bank of the banks”, that is, an authentic issuing institution and a lender of last resort.

### 3.2. *The Second Cycle (1931-1997)*

The next long wave rose with the Great Depression. In the early 1930ies the activities of the bank overgrew by the addition of numerous bureaucratic tasks. Trade policy had supplanted monetary policy, and BNB became the technical arm of import and forex restrictions. It also served as a clearing bureau for the numerous bilateral agreements. The bank was the depository of Lev accounts blocked as collateral against the missed foreign debt maturities. Lastly, BNB was at the core of the Supervising authority created in 1931. At entering WWII the National bank started to provide important direct financing to the Government.

The “amalgamation nirvana”, however, was reached by the communist monobank. Planning authorities strived to simultaneously control money supply and money demand. Money supply practically merged with crediting: extension of credit was unrestricted and the Central bank did no longer face the dilemma of the lender of last resort. It was as if the eternal debtors’ ideal of “accessible and cheap” credit was attained through automatic loans, a dense array of preferences, and permanent debt relieves. BNB was the centre of foreign exchange transactions. (In 1964, the Foreign Trade Bank was established, but it practically operated as a branch of the Central bank). Moreover, it assumed a bulk of technical functions – monitoring the technological features of the investment process, controlling wages’ growth, etc. It is true that the Bank completely lost its institutional independence. Its functional place, however, was very high in the hierarchy of *effective* power: for a while, the Ministry of Finance was closed (1987-1990), but BNB remained.

The first attempt to rationalize this heteroclitic entity was made after the fall of the communist regime. It was believed that the design of a two-tier banking system suffices to put in operation a genuine central bank. The reversal proved unsuccessful. In the murky economic context of 1991-1996, BNB behaved like a “development bank” that bailed-out unviable (private and state-owned) banks and enterprises through indiscriminate refinancing. The fuzzy definition of foreign exchange reserves permitted risky investment and losses that undermined monetary policy. The truly radical cleansing was the implementation of the Currency board. It eliminated all but the issuing function of the former Central bank, thus achieving an ultimate institutional simplification.

#### 4. Conclusion

The *longue durée* perspective captures the true significance of the Currency board. It is not just a common regime change, but it is rather one that addresses and disentangles *century long* problems of the Bulgarian monetary sector. The well-known costs of CBA in terms of greater rigidity are a “tax on history” to be paid for turbulent debt memories and for an unconvincing economic policy-making record. The new arrangement overcomes lasting experience with inadequate monetary policy: solves the “hollow monetary assets” problem (unless the Euro collapses); bases money supply on a simple, effective and transparent convention; puts an end to the tradition of inadequate refinancing practices; imposes hard budget constraints onto the Government and other sectors. BNB’s independence is not an issue anymore since most of its traditional roles are cut off. The side effect is that the Bank *lost much of its appeal* as a centre coveted in the struggle for political power. In a way, this is the epilogue of the fierce debate on the autonomy of the Central bank that started in 1879 and lasted almost 120 years.

In a broader outlook, the CBA is the adequate response to the recurrent monetization/demonetization cycles in Bulgarian monetary history. The incipient monetization in 1879-1914 was followed by inflationary demonetization during WWI. The advances with remonetization achieved in the 1920ies were obliterated during the Depression. Further on, the communist regime was characterized by a combination of almost total demonetization with futile efforts to create monetary enclaves. Finally, remonetization attempts in the early 1990ies ended with the 1996/1997 hyperinflation. The CBA opened the path for the irreversible monetization of the economy.

The current monetary standard provides a clear direction, as well. It is a particularly suitable starting point for accession to the EMU. CBA incorporates *ex ante* many of the essential requirements for the members of the European System of Central Banks. More important, the Eurozone constitutes

the credible exit option. As the 2001 experience of Argentina demonstrated, a Currency board without a convincing exit strategy is intrinsically unstable. Thanks to this monetary regime, Bulgaria's path to the Euro is no longer a strategic dilemma, but rather a tactical issue.

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## THE RESEARCH OF THE SERBIAN AGRARIAN-DEVELOPMENT POSITION IN EUROPE

**Abstract:** *Serbian economic and political reality in the years to come is to be observed and tested primarily through the EU Stabilisation and Association Process. Apart from the political, security and other aspects, this implies significant adjustments and the transformation of the overall economic system. Serbian agriculture, that is its agricultural and economic structure and agricultural policy, differs considerably from the European one. By means of relevant analytical and comparative studies this paper is endeavouring to answer the following questions – is Serbia moving towards Europe, and at what pace; to what extent are Serbian agricultural structure and agricultural policy compatible with European processes and standards and what are the crucial problems in this sector that need to be solved on the path towards Europe.*

**Key words:** *Serbia, European Union, agriculture, agricultural policy, agricultural structure*

### 1. Introduction

Big systemic and socio-economic changes happening on the path to European integrations, especially within the so called EU Stabilisation and Association process, can be critically regarded in different ways. With respect to this, agricultural problems and goals (seen as an integral process of food production, population alimentation and sustainable rural development) will be considered here through comparative analysis of several aspects and levels of changes that have happened particularly over the last 15 years.

Given that some sectors have seen instead of the expected harmonisation actual divergence from the EU standards, several possible aspects and potential directions of the process in agriculture and agrarian policy will be considered here. Therefore, this research is focusing on three different but essentially lin-

ked and interdependent groups of issues: (a) comparative research of the global, productive and structural similarities, especially agro-economic development indicators, efficiency in the use of resources and specific characteristics of the agricultural workforce structure, (b) considering and assessing compatibility of general developmental directions with the established sectoral objectives in the field of agrarian policy, and (c) ascertaining similarities amongst chosen mechanisms regarding the intensity of the implemented agrarian measures.

It should be stated that the EU 15 made significant adjustments of its political and especially economic goals through a completely changed agro-political climate, new socio-economic structure and new agrarian market structure and amidst altered circumstances that preceded the accession of 10 new members. Following the practice of former reforms, considerable changes happened in agrarian sector too. Major turns in European policy will undoubtedly influence the direction and intensity of harmonisation processes and Serbian agrarian sector preparations on its path towards European integrations. On the other hand, it should not be neglected that significant institutional changes concerning agrarian policy have also happened in Serbia over the last fifteen years. This paper endeavours to delineate both similarities and differences between the domestic and relevant European documents and directions.

## 2. Serbian and EU agrarian policy – compatibility of objectives

### *2.1. EEC (EU) common agricultural policy and its reforms*

Initially defined by the Agreement of “the six” upon the foundation of the European Economic Community (EEC) in 1957, Common agricultural policy objectives (CAP) have evolved; just as European integrations have, moving from economic community towards a monetary union. Five CAP objectives were laid down by Roman Treaty (famous Article 39): 1) enhancing productivity and technical progress in agriculture; 2) achieving a satisfactory living standard for agriculturists by means of raising wages for those engaged in agriculture; 3) stability of the agricultural products market; 4) alimentation security (food supplies guaranteed) and 5) acceptable prices for food consumers.

A decisive role in the realisation of such defined objectives through the established measures and mechanisms lay with the three basic principles of the policy: 1) a unique market-free movements of goods amongst the member states and establishing a common pricing system and agricultural products subsidies, irrespective of their origin; 2) preferential treatment for EEC products – protection of the internal EEC market against excessive imports, in order to protect EEC producers’ income and ensuring stability of supply, and

3) financial solidarity between food producers and consumers, both amongst social groups and member states, with a view to ensuring a net social effect through the re-distribution of income through the budget.

Based on this, two key projects were initiated: a) production sectors and lists of products to be encompassed by Common Organisation of the Market (COM) were established, and b) a special financial institution was formed – European Agricultural Guidance and Guarantee Fund (EAGGF).

As soon as ten years following its consistent implementation this complex and institutionally completed agrarian policy, marked by pronounced protectionism tendencies towards the “third world” countries and powerful legislation concerning subsidies and incentives for domestic production yielded favourable results.<sup>1</sup> Alimentation-related security and agrarian market stability were established, whilst farmers’ income came closer to, and later on fully reached a competitive level compared to other economic sectors. On the other hand, the system of generous incentives, subsidies and farmers’ guarantees raised several questions and issues: generating market surpluses, issue of financing stocks and export subsidies, consumption of agro-chemicals, big farms, ecological problems, collision with open market principles and trade liberalisation worldwide.

That is why several waves of CAP reforms aiming for structural adjustments in agriculture started as early as in 1968, with the CAP reform memorandum, and particularly in 1972, after the EEC was enlarged to comprise nine member states. A more serious attempt at CAP reforms was a European Commission’s document from 1983 entitled “Common agricultural policy perspectives”. At the time the Europe 10 (as from 1981 Greece became its tenth member) tended to balance its market and find new mechanisms for reducing production. Given the CAP’s original focus on increasing production, this proved to be a turning point in the European agrarian policy (*introducing production quotas, “set aside” land system, limiting budget expenses in agriculture*).

The most significant CAP reform was undertaken in 1992. It happened at the time of the Europe 12 (with Spain and Portugal being members from 1986), amidst numerous and pronounced internal and external pressures. Internal pressures were coming both from farmer lobbies unprepared for reductions in agrarian subsidies and the rivalry between net-receivers and net-suppliers of the agrarian budget.<sup>2</sup> External pressure stemmed from the Uruguay round of GATT negotiations (General Agreement on Tariff and Trade) and trade liberalisation process worldwide. There were three key directions concerning this new turn in the CAP of the 1990s:

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<sup>1</sup> N. Bogdanov, *Poljoprivreda u međunarodnim integracijama i položaj Srbije*, Društvo agrarnih ekonomista Jugoslavije, Beograd, 2004

<sup>2</sup> V. Popović, *Evropska agrarna podrška i održivi ruralni razvoj*, Institut za ekonomiku poljoprivrede, Beograd, 2003

- *Firstly*, shifting focus in support to producers from guaranteeing their products' prices to contributing directly to their income;
- *Secondly*, providing boost to poorer households by means of compensation payments in order to enhance their technical capability;
- *Thirdly*, structural adjustments through associated measures-support to the protection of agrarian environment, early retirements and afforestation of agricultural areas.

Though the intentions of this reform were radical, one of the key "old" CAP problems was not properly addressed – disproportion between households of different size concerning the volume of using the assistance – a small number of households (only around 20% of them and even these were not equally represented by regions) were using a major part of the resources allocated for agriculture in the budget (around 80%); these households had approximately 60% of the land in their possession and employed only 25% of the entire workforce engaged in agriculture.

## *2.2. European agenda 2000 – CAP core reforms*

The end of the 20<sup>th</sup> century in the EU was marked by its intensive preparations for expansion towards East, introduction of a unique monetary system accompanied by limiting of the agrarian budget, growing competition of products from the non EU countries, and active participation in a new round of WTO negotiations.

Certain adjustments of the Common agricultural policy were indispensable amidst such circumstances. Agenda 2000 (adopted by Treaty of Berlin in 1999) was an essential institutional foundation for a new turn in the European agricultural policy. It did not abandon basic goals and "mission" of the CAP, but the key change it brought lay in the fact that by this document, apart from the CAP dominant feature, that is policy of market and prices, its second supporting pillar was built in too – rural development policy.

Apart from recognising the key significance of agriculture in maintaining living standards and rural areas' vitality (by means of developing a multi-functional, sustainable and competitive agriculture), new reforms were also motivated by other internal reasons, such as the fear of re-emergence of market misbalance and paying attention to consumers' interests concerning food safety and quality.

Decisions reached in the strategic document Agenda 2000, as well as the CAP reforms undertaken in 2003 (so called Fischler reform) did not cast any doubt on the essential support provided for agriculture (the question was not "should we...in case that?" but rather "how?"). Therefore, its focus was shifted, that is, mechanisms and intensity of measures necessary in the implementation

of the CAP objectives were adjusted. Apart from shifting the focus towards rural development policy and agrarian multifunctionality, another direction of the changes was directly motivated by the need to adjust the agricultural subsidies in line with the WTO requests and meant redirecting the support towards those measures that market-wise had lesser distortive effects.<sup>3</sup> It was on these grounds that solutions on separating support from products were created, that is the solutions that concerned reduction and final abandonment of direct support to products through institutional (guaranteed) prices and premiums in favour of the system of individual payments to households, that is, to farmers.

### 2.3. Serbian agrarian development policy

Simultaneously with establishing the European Agenda 2000, relevant state authorities and domestic expert and agro-economic public were by a certain coincidence, though not entirely by chance, preoccupied by preparing a new agrarian strategy of the then FRY (in which Serbia, as it is a well-known fact, accounted for around 95% of the economic structure).

Serbia, that is FRY, found itself at the turn of the century steeped in a very unfavourable socio-economic structure, with large share of primary agriculture in GDP (22%) and dominant share of agrarian sector in GDP (31%), being almost inverse economic structure when compared to the economic structure of the EU countries.<sup>4</sup> Hindered growth and a gap of almost a decade's development came as results of a forcible split and dissolution of the former country's integral market (1991), introduction of the international sanctions and economic isolation (1992), wars in the region and dislocation of a huge number of people, and especially NATO's brutal aggression from 1999.

Following a series of expert consultations, "The FRY long-term agrarian development policy" was prepared and finally released in December 1999<sup>5</sup>. This document (up till the end of 2005 the only officially adopted document on the agrarian policy) comprises three parts: 1) grounds and strategic goals of agrarian development, 2) development directions and structural changes and 3) long-term agrarian policy-macroeconomic instruments. Six strategic goals of the agrarian development have been established, based on the given socio-economic structure and assessment of the agricultural development capabilities, starting point being the significance of the agricultural dynamic development for the country's economic, social, political and security stability,

<sup>3</sup> V. Grbić, *Ekonomija Evropske unije*, Megatrend univerzitet primenjenih nauka, Beograd, 2005

<sup>4</sup> M. Milanović, *Prehrambena industrija SR Jugoslavije*, Institut za ekonomiku poljoprivrede, Beograd, 2002

<sup>5</sup> "Dugoročna politika agrarnog razvoja SR Jugoslavije – strateški ciljevi; pravci razvoja i strukturne promene; makroekonomski instrumenti", Savezna vlada SRJ, M. R. Milanović, Ed., "Službeni list SRJ" No. 71/99, "Dnevnik", Novi Sad, 2000

whilst at the same time accepting the reality of economic globalisation and liberalisation processes worldwide, acknowledging the potential role of agriculture as an integration factor in strengthening regional cooperation (South East European Stability Pact), recognising agro-biological and market specifics of the agro-industrial production and the newly-formed strategic and developmental position of agriculture, together with the established relation between the federation and the republic relating to their respective jurisdictions.

- *First*, enhancing the volume and adapting of the agro-industrial production's structure that is going to ensure a permanent national food-related security (self-sufficiency, strategic and operational reserves, continuous increase in export);
- *Second*, rise in the agricultural productions' technical and technological level, productivity and competitiveness, teamed with the optimal use of agrarian resources (land, forests, water, biological diversity, genetic potential etc) and protection of living environment –sustainable development;
- *Third*, balanced integral agrarian, rural and regional developments-strengthening of productive performances and economic protection of the market-oriented producers, stopping de-population and economic-social revitalisation of the rural, especially mountainous and border areas;
- *Fourth*, stable agricultural and food products market-the supply of food that will be in its volume, structure, prices and quality in line with nutritive needs and consumers' purchasing power levels and the tendency to decrease the share of food expenses in family budgets' structure;
- *Fifth*, diversification, increase in competitive export and achieving permanent sufficit in foreign trade exchange of agricultural and food products-based on comparative agro-ecological advantages, productivity, quality, harmonised legislation (in line with EU and WTO) and the equivalent level of internal incentives and external protection of producers;
- *Sixth*, enhancing agricultural capability both institutional and financial-wise with a view to including FRY in international integration processes (on regional, European and global level).

These complex and all-encompassing goals defined amidst the newly-generated conditions called for defining the scope of the very agrarian policy and specifying state authorities' respective jurisdictions (vertically: federation-republics; horizontally: on both levels), especially establishing the principles on which instruments and mechanisms of the agricultural macroeconomic policy will be based. Four principles have been established: 1) Yugoslav integral market of agro-industrial products, 2) priority given to agricultural products of domestic origin, 3) agricultural subsidies ("agrarian budget") from real and

stable sources and 4) economic policy institutional solutions' adaptability to specific features of agriculture.

#### 2.4. Serbian new agricultural strategy

Following six years of the institutional and practical parallelism, the government of the Republic of Serbia adopted at the end of 2005 Serbian agricultural development strategy<sup>6</sup>. As we are primarily interested in the agrarian policy goals in this paper, these are to be put forward here in order to conduct a comparative analysis with former domestic and current European goals. So, Serbian "new" agrarian policy is directed towards the following general strategic goals:

- To build a sustainable and efficient agricultural sector, able to compete on the global market and contributing to the increase in national income;
- To provide food that satisfies consumers' needs regarding quality and safety;
- To ensure support to the living standard of those people who are dependant on agriculture and are not in the position to keep up with economic reforms;
- To ensure support to the rural sustainable development;
- To preserve environment from agricultural production influences;
- To prepare Serbian agriculture for the EU integration;
- To ensure domestic support to the WTO rules; to prepare domestic agricultural trade for those same rules.

Analytical comparisons drawn over the last fifteen years between general agricultural and developmental directions and established sectoral goals of Serbia on the one hand and the EU Common Agricultural Policy on the other have shown a high level of compatibility.<sup>7</sup> Our strategic agrarian-developmental documents, both those brought at the beginning of the 20<sup>th</sup> century's last decade and those brought at the very turn of centuries, are in their entirety based on the European agrarian policy experiences and essentially directed towards European values.

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<sup>6</sup> "Strategija razvoja poljoprivrede Srbije", "Službeni glasnik RS" No. 78/05.

<sup>7</sup> M. Milanović, "Približavanje Srbije Evropskoj uniji – novije komparacije poljoprivrede i agrarne politike", *Ekonomika poljoprivrede*, No. 2/2006.

### 3. Economic and structural-developmental comparisons

#### 3.1. Macroeconomic development indicators

Agrarian policy in its entirety, especially agricultural subsidies, should be considered in view of the significance of agriculture in the socio-economic structure: the role of agriculture in gross domestic product, then agriculture in the total employment rate, the share of food expenses in families' budget, the significance of agriculture in generating foreign trade balance (Table 1).

**Table 1:** Indicators of the level of socio-economic development of Serbia and the EU

Countries / EU	GDP per capita / Euro		Percentage of agricultural labour force in active population (%)		Share of agriculture in GDP (%)		Share of food, alcohol and tobacco in overall domestic expenses (%)		Share of agriculture in foreign trade (%)	
									Import	Export
	2000	2004	2000	2004	2000	2004	2000	2004	2004	2004
1	2	3	4	5	6	7	8	9	10	11
Serbia	1,430	1,920		15.7	13.8	14.2	49.7	37.2	7.5	21.5*
EU-10	8,570	8,740	21.5	...	...	...	...	...	...	...
minimum	6,420	9,600	5.3	2.3	2.5	2.5	17.0	15.7	2.1	2.7
maximum	18,500	18,400	45.2	17.7	11.4	3.1	39.3	35.4	7.8	18.4
EU-15	22,648	24,400	4.3	3.8	1.7	1.6	17.0	...	6.1	6.0
minimum	1,563	17,000	1.9	1.3	0.7	0.6	14.8	13.1	1.3	1.1
maximum	44,879	49,500	17.0	12.6	6.8	5.2	22.7	29.7	11.9	19.9
EU-25	...	22,600	...	5.0	...	1.6	...	...	6.0	6.0
New candidates										
Bulgaria	5,400	6,600	11.2	10.7	15.8	8.2	45.1	16.0	6.2	11.0
Rumania	6,030	7,000	45.2	32.6	11.4	12.2	37.4	...	6.8	3.3
Croatia	...	10,200	...	17.0	...	8.2	...	...	8.7	8.3
Turkey	6,430	6,500	32.7	34.0	14.2	...	50.5	...	4.8	9.5
US	35,350	34,500	2.7	0.7		0.9			4.1	8.1

\* SMTK: food and living stock, alcohol and tobacco, animal and plant fat and oils.

Source: EU Directorate General for Agriculture and Rural Development: *Statistical and Economic Information*, Basic Data, February 2006; RZSS: *Statistički godišnjak Srbije* 2005, Beograd, 2006.

According to these parameters, Serbia differs significantly, not only at the present state of affairs (achieved socio-economic structure), but also in developmental trends, that is in the intensity and directions of economic structural changes. Contrary to the common rules of socio-economic development, recent researches<sup>8</sup> have indicated towards a retrograde process within economic structural changes, especially over the last fifteen years; namely, there has been a decrease in the share of industry and an increase in the share of agriculture in GDP.

Indicators of the level of socio-economic development (Table 1) reveal Serbia's very unfavourable position compared to the EU, especially in comparison to the most developed EU countries:

- Purchasing power of the population is ten times lower than the EU average;
- The share of agricultural in active population is 3-4 times higher than the EU average;
- The share of agriculture in GDP is approximately 10 times larger than the EU average;
- The share of food expenses in overall family budget is almost three times larger than the EU average, etc.

### *3.2. Agrarian-economic development comparisons*

If we observe Serbia on its path to the EU accession in agricultural field not only through comparative evaluations of its economic development and agricultural position in socio-economic structure but also through comparative parameters of agrarian development, then a considerable lagging behind can easily be diagnosed, both regarding changes of agrarian structure as well as yields and productivity of production factors.<sup>9</sup>

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<sup>8</sup> M. Milanović, "Agrokompleks u ekonomskoj strukturi SR Jugoslavije – značaj i promene 1955-2000", *Ekonomika poljoprivrede*, Vol. 49, No. 3-4/2002.

<sup>9</sup> M. Milanović, "Približavanje Srbije Evropskoj uniji – novije komparacije poljoprivrede i agrarne politike", *ibidem*

**Table 2:** *Serbian (Serbia and Montenegro) and the EU agrarian development indicators, 2004*

Countries / EU	Number of agricultural households	Average size of household (ha)	Employed in agriculture	Average yield and productivity			
				Wheat	Corn	Sugar cane	Milk
				t/ha	t/ha	kg of sugar/ha	l/per cow
Serbia	770	6.5	529	4.3	5.5	6.05	2,427
EU-10	3,587		3,445				4,739
minimum		1					
maximum		79.4				6.91	
EU-15	6,284	20.2	6,208	7.22	9.19	9.77	6,323
minimum		4.8					
maximum		57.4				11.02	
EU-25	9,871	15.8	9,653	6.51	8.44	8.61	6,018
New candidates							
Bulgaria	666	4.4	319				
Rumania	4,485	3.1	3,024	3.4	4.49		
Croatia			268				
Turkey			7,400				
US	2,113	179.5	1,032				

Source: Same as for Table 1

Data as shown in Table 2 clearly reveal the differences in agrarian development indicators:

- Average Serbian farm is almost four times smaller than in EU-15 (three times smaller even when compared to the EU-25 average values), and 10 times smaller than European highest national averages (plus, 30 times smaller than the average US farm);
- Farms that vary considerably in size employ (engage actively) relatively equal number of agricultural workers<sup>10</sup>;
- Average main crop yields in Serbia are lower by 50-90% than European;
- Average milk production per cow is almost three times lower than European average values, etc.

<sup>10</sup> On average, 0.7 employee is engaged per 6.5 ha farm in Serbia; in EU-15 average figure is 1 employee per farm, but the farm in question covering the space of 20.2ha; whilst in the United States there are on average 0.5 employees per farm, the farm being 180ha in size.

### 3.3. Labour force in European and Serbian agriculture

Researches regarding Serbian agricultural labour force face various methodological problems and contrasting available information. In comparative analysis of socio-economic structure, indicators such as the share of agricultural in overall population and the share of active agricultural in overall active population are used most often. On the other hand, labour force analyses are often carried out based on the assessments about the unemployed, employed and non-active. Reliable data on the number of agricultural producers are acquired by general record of population (usually once in 10 years, results of the 2002 record have been used in this paper), whilst data on the employed are acquired through annual surveys (data from a survey on labour force have been used here) on the basis of which assessments of main population contingents are conducted.

Apart from the dynamic inconsistency of the data sources, there are considerable differences regarding the contents of corresponding variables monitored and analysed. These differences occur in respect to the specific features of individual contingents, that is, depending on whether a population contingent was grouped on the basis of its activity (except for agriculture, forestry and water works used to be included before, and now it is only agriculture, forestry, hunting and fishing) or on the basis of its occupation, taking into account formal status of individuals, or work status-that is individuals' real activities.

**Table 3:** *The employed in agriculture (in thousands)*

	2000	2001	2002	2003	2004	2004/2000
EU-25	10,680	10,595	10,419	10,149	9,653	90.4
EU-15	6,770	6,724	6,539	6,557	6,208	91.7
Bulgaria	377	266	299	320	319	84.6
Croatia	:	:	:	259	268	
Rumania	4,926	4,801	3,683	3,530	3,024	61.4
SERBIA	633	691	687	674	704	111.2

Source: EU: Eurostat (*Community labour force survey*), 2005; RZS: "Anketa o radnoj snazi", Bilten No. 451/2006

Assessments (based on the survey) on the number of individuals employed in agriculture by far surpass the data concerning the number of agricultural active population. These differences in analysed figures are obviously illogical and therefore do not give room for making precise and reliable conclusions on socio-demographic structure that is on social potentials in view of engaging labour force in agricultural activities. A methodological and contents-related harmonisation is thereby called for, that is, an overall alignment of domestic statistical researches with relevant international and European statistical standards.

The downward tendencies of the number of overall as well as active agricultural population are continuing and consequently, though with varying intensity, the share of agricultural in overall employment.

Downsizing of the employed in agriculture is much more intense in the new EU member states than in original ones. But the most intense downsizing of the kind has been recorded in the new EU accession candidates, especially in Romania. Over the last five years the agricultural labour force contingent in this country (and it will still be convincingly the most “agrarian” EU member state) has been reduced by almost 40%. But despite such a reduction Romanian agriculture still engages almost one third of the employed. What is exceptionally interesting is that after the Romanian EU accession one fourth of the entire EU agricultural population will be employed precisely in this country (with almost three million of agricultural producers).

**Table 4:** *The share of agricultural in overall employment (%)*

	2000	2001	2002	2003	2004
EU-25	5.7	5.6	5.4	5.3	5.0
Belgium	1.9	1.4	1.8	1.7	2.2
Czech Republic	5.2	4.9	4.9	4.5	4.4
Denmark	3.7	3.5	3.2	3.3	3.3
Germany	2.6	2.6	2.5	2.4	2.4
Estonia	7.0	7.1	6.5	6.3	5.5
Greece	17.0	16.0	15.8	15.3	12.6
Spain	6.9	6.5	5.9	5.7	5.5
France	4.2	4.1	4.1	4.3	4.0
Ireland	7.9	7.0	6.9	6.5	6.4
Italy	5.2	5.2	4.9	4.7	4.2
Cyprus	5.4	4.9	5.4	5.2	5.1
Latvia	14.4	15.1	15.3	14.6	13.3
Lithuania	18.4	16.5	18.6	18.7	16.3
Luxembourg	2.4	1.5	2.0	2.4	2.1
Hungary	6.5	6.1	6.1	5.4	5.3
Malta	1.4	2.1	2.1	2.5	2.3
Holland	3.3	3.1	2.9	2.9	3.2
Austria	6.1	5.8	5.7	5.5	5.0
Poland	18.7	19.2	19.6	18.2	17.6
Portugal	12.5	12.9	12.5	12.8	12.1
Slovenia	9.6	9.9	9.7	8.4	9.7
Slovakia	6.9	6.3	6.6	6.0	5.1
Finland	6.2	5.8	5.5	5.3	5.0
Sweden	2.9	2.6	2.5	2.5	2.5
UK	1.5	1.4	1.4	1.2	1.3
EU-15	4.3	4.2	4.0	4.0	3.8
Bulgaria	13.2	9.7	10.7	11.1	10.7
Croatia	:	:	:	16.9	17.0
Romania	45.2	44.4	37.7	37.7	32.6
SERBIA	20.4	22.3	22.9	23.1	24.0

Source: As for Table 3

With regard to labour force, globally taken, European agrarian structure has not changed considerably since 10 new member states joined the EU. Though the number of the employed in the EU-15 agriculture has risen by around 55% in the EU-25 agriculture (from 6.2 mil to 9.6 mil), the agricultural share in overall employment rates has gone up for merely 1.2 per cent points. It proves an almost minor (and still downward) share of agriculture in Europe's overall employment scheme (on average only 5%). Differences in countries' respective shares are still quite significant, ranging amongst the old members from the lowest share in the UK (only 1.3%) to the highest in Greece (12.6%) and amongst the new members in Poland (17.6%) and Romania (with up to 32.6%), amongst potential members.

Sadly, both the present situation and tendencies in Serbia are quite different from European averages. The share of agriculture in the overall employment (24%) is five times larger than in the EU. On the top of it and unlike in other countries there has been an increase in the number of the employed in agriculture in Serbia recently (due to the "results" of so called transition in other sectors, that is due to the rise of general unemployment rate from 12.1% in 2000 to 18.5% in 2004, amounting even to 20.8% in 2005).

#### *3.4. Age structure of the employed in agriculture*

European agricultural labour force has a mainly consistent structure with respect to participation and distribution of certain age groups and there are no significant differences between EU-15 and EU-25. A basic characteristic is that one fourth of the employed is younger than 35 and only 8% of the employed is on average older than 65 (see Table 6). However, there are also some peculiar discrepancies. Agriculturally most developed countries have the youngest labour force-Denmark has the greatest number of employees younger than 35 (32.3%) and Netherlands (38.4%). On the other hand, some Mediterranean countries have the oldest labour force structure-older than 65 make more than one third of the labour force in agriculture in Portugal (35.6%), followed by Cyprus and Slovenia (as well as Croatia) with around 20%. An interesting piece of information with respect to this (that is, if it is true) is that there is less than 1% of the employed older than 65 in Czech Republic and Slovakia.

**Table 5:** *The employed in agriculture grouped by gender and age (2004)*

	Structure in %											
	younger than 25		from 25 to 34		from 35 to 44		from 45 to 54		from 55 to 64		65 and older	
	M	F	M	F	M	F	M	F	M	F	M	F
EU-25	5.8	2.1	11.8	5.4	16.4	9.0	15.8	9.7	10.4	6.0	4,9	2,7
EU-15	5.8	1.8	12.0	4.5	17.3	8.3	15.4	8.6	11.6	6.5	5,7	2,7
Bulgaria	5.8	2.0	9.0	4.7	12.7	9.0	17.2	9.6	12.6	7.5	6,5	3,5
Croatia	3.9	2.4	6.0	5.2	9.8	7.8	12.2	11.0	9.7	10.2	10.8	11.1
Rumania	7.1	4.7	11.5	9.1	9.3	7.0	9.6	8.5	8.2	9.3	7.5	8.3
SERBIA	6.5	<	13.3	<	28.9	<	31.2	<	<	<	19.5	<

The data refer to both genders in Serbia (in total) whilst the data that apply to the age group 55-64 are included in the 45-54 group.

Source: EU: Eurostat (*Community labour force survey*), 2005; RZS: "Anketa o radnoj snazi", Bilten No. 451, 2006

Judging by the 2002 census, Serbian agricultural labour force age structure is truly alarming. It is sufficiently illustrative to mention that active agricultural producers older than 65, that is older than upper threshold of working age, make one fifth of the total labour force (19.6%), and what is even more important, there are even three times more of them than those younger than 25 (6.5%). On the other hand, that same year, 778.9 agricultural farms and only 529, 2 agricultural producers were registered, implying that one and a half farm came on every active agricultural producer. We are not dealing here with the distribution of farms by their size, though it should be stated that further fragmentation process is continuing (owners are becoming involved in non agricultural activities, average farm covers 2.4 ha of arable land, has only one head of cattle, 2.5 pigs, 2 sheep and 12 chickens).

If we start to research comparatively agrarian development parameters of Serbia and the EU, along with the estimates of the level of economic development and the position of agriculture in socio-economic structure of Serbia and the EU, then a huge lagging behind can be spotted, both in changing agrarian structure and in the overall factor productivity. Namely, an average farm in Serbia is almost six times smaller than one in the EU-15 (five times smaller even compared to the EU-25 average); these farms differing considerably in size still hire (actively employ) almost an equal number of workers. In more concrete terms, on average 0.7 worker is engaged per a 3.6ha farm in Serbia; in the EU-15 the number is one worker but the size of farm is 20.2ha; in the US, there is 0.5 worker per farm on average, the size of farm being 180ha.

#### 4. Comparisons of the intensity of agrarian support measures

In absence of the elements for calculating AMS (Aggregate Measurement of Support) for each product, the agrarian policy objectivisation beyond the threshold of Serbian agricultural subsidies can be conducted only through aggregate comparative considerations from several different angles. In the process the attention should be directed to the following categories and their relations: 1) subsidies per unit of fixed assets in agriculture – that is agricultural and/or arable land; 2) the share of subsidies in GDP, in GDP realized in agriculture, or in value added in agriculture; 3) subsidies per capita, taking into account overall population, as every individual citizen is at the same time both (direct) donor and (indirect) receiver of subsidies; 4) the share of subsidies in public expenditures.

**Table 6:** *Subsidies – Budget expenditure for Serbian and EU agriculture (values for 2006)*

	EU	Serbia	Ratio(1):(2)
	(1)	(2)	(3)
Agricultural expenses – in total (mil Euro)	65,309	132	497 : 1
EU budget	51,203	...	
National budgets	14,106	...	
Total population (in thousands)	457,189	7,498	102 : 1
Number of active agricultural producers (in thousands)	9,653	529	18 : 1
Agricultural area (in thousands ha)	162,393	5,107	32 : 1
Relative subsidy levels:			
Per capita in total	143	18	8 : 1
Per active agric. producer (Euro)	6,767	249	27 : 1
Per hectare of agricultural area (Euro)	403	26	15 : 1

Source: <http://europa.eu.int/comm/eur-lex-budget-data-p2006>; Republika Srbija: *Program raspodele i korišćenja sredstava subvencija u oblasti poljoprivrede, šumarstva i vodoprivrede za 2006. godinu*, Beograd, January 2006

Agricultural subsidies in Serbia encompass a whole range of various measures that can be classified in around twenty different and by significance and volume of funds very unequal forms of internal support. In the last three years, the aggregate value of agrarian support funds has risen nominally by around 17% but effectively has decreased by around 15%.<sup>11</sup> We are not con-

<sup>11</sup> Serbian agrarian budget for 2003 added up to 9,929.7 million dinars, or 155.45 million eur; 11,616 million dinars were planned for 2006, which according to the end of March 2006 dinar/euro exchange rate amounts to around 132 million eur.

cerned here with classifying and quantifying these measures on those with minimal distortive effect on trade exchange which are allowed by the WTO Agricultural Agreement (“green box”) and those forbidden by the agreement or requiring their level to be reduced (“yellow” and “blue boxes” respectively). Effectively, there has been no delimitation of these different forms of internal support and focusing on general economic policy measures: expert consulting, research, training, inspection and quality control, fighting against infectious diseases, protection of plants and animals, marketing, promotion, infrastructure development, building public stocks, protection of environment.

The focus of agrarian support is still on direct subsidies that aim to increase production. This approach to agricultural subsidies results from a prevalent attitude that has three important components: 1) Serbian agro-ecological resources are utilised insufficiently and economic conditions for their utilisation are unfavourable; 2) domestic market for certain products is not saturated, that is market demand potential by far surpasses current supply, and 3) a more efficient use of resources can be achieved through changing relation costs-income, either by a direct influence on one side of the equation (on the side of costs, through allowances) or the other (on the side of income, through bonus payments).

A prevailing share of subsidies is disbursed on individual product basis, where almost 30% of subsidies are aimed only for milk production bonuses.<sup>12</sup>

## 5. Concluding considerations

Analytical comparisons between general agrarian directions and established sectoral goals of Serbia and the European Union CAP show a high level of compatibility. Our strategic agrarian documents, both those brought at the beginning of the last decade of the 20<sup>th</sup> century and those brought at the very turn of the century, are entirely based on European experiences in agrarian policy and in general directed towards European values. However, Serbian agrarian policy measures differ significantly by their type, form and especially by their level of subsidising from European parameters, primarily market policy-import protection, production and export subsidies, along with rural development measures.

Speaking of the objectivised parameters of agricultural significance in the socio-economic structure, Serbia is significantly different, not only by the current status but also by its developmental trends, that is by economic structure changes intensity and directions. Contrary to the common rules of socio-economic development, there has been a retrograde process over the last

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<sup>12</sup> Amidst the conditions of a monopolised market of final dairy products, following the so called ownership transformation (re-capitalisation and privatisation) of dairies, the purpose of such a support to dairy production should be given a serious scrutiny.

fifteen years in the form of decreasing the share of industry in GDP and increasing the share of agriculture in GDP.

Based on the available comparative statistical material, it can be concluded that Serbian agricultural labour force structural characteristics are by far less favourable than European: relative agricultural employment is several times lower and age structure far more unfavourable. It has to be stated that in the absence of relevant data, a comparative assessment on the effectiveness of using working hours in agriculture in Serbia and the EU has not been done.

Relatively high and still growing share of agricultural in overall employment verifies our theses that so called transition in Serbia manifests itself as a process of deindustrialisation of socio economic structure.

Analytical comparisons made lead to the conclusion that productivity and agricultural competitiveness levels, that is our total agrarian (in) efficiency can be mainly accounted for by differences in the number and structure of agricultural labour force. Also, bearing in mind that European Union is neither agriculturally nor socio-economically a homogenous group, especially after the last enlargement for 10 new member states, there are some comparisons that enable objectivisation of Serbian agricultural position against the current European reality. Besides that, European regional differences concerning agricultural labour force structure, especially the directions of changes in the sector, can indicate towards some domestic potentials of the agricultural multifunctionality, especially local community development.

If we analyse the process of Serbia approaching to the EU in agricultural sector through comparative parameters of agrarian development, a large lagging behind can be spotted, both in agrarian and rural structural changes and total productivity level. Key difference lays in the fact that Serbian agrarian support measures are determined by economic sectors, not by regions; that is, there is no uniform policy of rural and regional development.

Preparations of agrarian sector for a qualified and competent participation in a very complex procedure of concluding an Agreement on association and stabilisation between Serbia and EU, and accession to the WTO, envisage not only internal institutional adaptations and external harmonisation of agrarian standards and measures, but also a serious restructuring of agriculture and agro-industry, which is the entire agrarian and rural economy.

Besides, this paper has revealed a considerable discrepancy between general agricultural domestic statistical data sources (especially concerning the employment rate and labour force statistics) and relevant European data sources. The lack of relevant original indicators makes any more detailed analytical comparisons between agricultural conditions and structural changes impossible. This calls for a methodological and content-wise harmonisation, that is, a comprehensive alignment of domestic statistical researches with relevant international and European statistical standards.

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## INTEGRATION OF THE TERRITORIES OF SLOVENIA AND SLOVAKIA INTO THE ECONOMY OF NEWLY FORMED STATES AFTER THE BREAK UP OF AUSTRIA-HUNGARY

**Abstract:** *The paper deals with the process of Slovene and Slovak integration into a new political and economic area after the break up of the Austro-Hungarian Monarchy in 1918. It focuses in particular on economic problems which stemmed from the fact that both Czechoslovakia and Kingdom SHS emerged by the integration of entities coming from diverse cultural, political and economic backgrounds. On the basis of the Slovene and Slovak sources, it presents the economic position of Slovenia and Slovakia upon the disintegration of the Austria-Hungary, the transport problems on the markets of both newly formed states and the problems related to unequal taxation policy and introduction of new currencies. The paper concludes by the presentation of two basic national-economic orientations (autonomist and centralist), which emerged as a response to the economic problems in Slovenia and Slovakia.*

**Key words:** *Slovenia, Slovakia, Austria-Hungary, Kingdom of Serbs, Croats and Slovenes, Czechoslovakia, 1918, economic history*

### 1. Introduction

The changes on the political map of the Central Europe after the World War I fatally affected this area. The former political, cultural and economic superpower – Austria-Hungary – broke up. From its ruins, a number of succession countries arose, founded on the national or the national-integralism principles. The Slovene territory became a part of the newly established Kingdom of Serbs, Croats and Slovenes (hereafter the Kingdom SHS) and the Slovakian territory was integrated into the Republic Czechoslovakia. The two new Slav state formations emerged from the entities stemming from different

environments: Czechoslovakia from the Austrian and Hungarian parts of the former Austria-Hungary; and the first Yugoslav state from the provinces belonging to the former Monarchy, Bosnia and Herzegovina – which had been directly annexed to Vienna – and from two formerly independent kingdoms (Serbia and Montenegro). A new political, cultural and economic area was established, which could not assure any rapid integration or consolidation. Slovenia and Slovakia had many similar features in this process, despite entirely different starting positions.

## 2. The foundation of states on the national integralism principle

The Kingdom SHS as well as Czechoslovakia were both founded on the national integralism principle. The former one comprised the south-Slav nations of the Habsburg monarchy: Slovenes (1,060,000 according to the census conducted in the new state<sup>1</sup>), Croats and Serbs from Slovenia, Croatia and Bosnia and Herzegovina joined with the Kingdom of Serbia, that already encompassed the former Kingdom of Montenegro and Vojvodina.<sup>2</sup> The newly founded state: the Kingdom SHS was a multi-national entity consisting of a variety of South Slav nations, Germans, Albanians, Hungarians, Czechs, Slovaks, Romanians, Turks and others. Thus, the games which the history played by drawing the maps along the eastern side of the Adriatic Sea eventually resulted in a many-coloured national picture. Slovenes came from the Habsburg authority, which united a similarly nationally diverse country by the noble motto: *Viribus unitis*, under the authority of the Serb Karađorđević dynasty. In both countries they were a minority nation, but there was nevertheless one decisive difference. In the Kingdom SHS, they were – at least initially – a constituent element, which in the given circumstances at least partially met their national aspirations. At first, Slovenes formed – together with other south-Slav nations under the Austria-Hungary – an independent State of Slovenes, Croats and Serbs (State of SHS), but because of the unpredictable international situa-

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<sup>1</sup> Spominski zbornik Slovenije: *Ob dvajsetletnici Kraljevine Jugoslavije*, Ljubljana, 1939 (hereafter: *Spominski zbornik Slovenije*), p. 544. It should be underlined that after the formation of the post-World War I borders, almost a quarter of Slovenes remained outside the borders of the first Yugoslavia.

<sup>2</sup> With the conclusion of the “Velike Narodne skupštine srpskog naroda u Crnoj Gori” (Great National Assembly of the Serbian Nation in Montenegro) of November 26<sup>th</sup> 1918, the Kingdom of Montenegro ceased to exist and its territory was integrated into the Kingdom of Serbia. A day before, on November 25<sup>th</sup> 1918, the conclusion on the integration of Vojvodina into the Kingdom of Serbia was adopted by the “Narodna skupština” (National Assembly) in Novi Sad (Vojvodina). Ferdo Čulinović, *Državno-pravna historija jugoslavenskih zemalja XIX. i XX. vijeka. Druga knjiga (Srbija – Crna Gora – Makedonija – Jugoslavija, 1918-1945)*, Školska knjiga, Zagreb 1954 (hereafter: Čulinović, *Državno pravna historija*), pp. 151-152, 197.

tion the above-mentioned integration was unavoidable. The Italians occupied the major part of the Slovene territory on the west, Austria was a threat to the northern border, and the new state was still not recognised internationally.<sup>3</sup> We could agree that "(...) weak and insecure Slovenes were quite pleased to come under the Belgrade protection".<sup>4</sup>

The situation was similar in Czechoslovakia. It was likewise a multi-ethnic state, with only two million Slovaks, i.e. fewer than Germans who lived there. Since Czechoslovakia was established as a national state founded on the right to self-determination, there was a need for a suitable and elegant solution proving that these assertions were true. This solution was called "Czechoslovakism" and meant that Czechs and Slovaks were one political nation.<sup>5</sup> Since in fact this was not true, this caused many problems in the development of the state. As a Slovak historian Dušan Kováč comments it: "The statistical aspect is always simpler than the political and historical one".<sup>6</sup> And he adds that the Czechoslovakism suited also Slovaks, as it prevented them from being a minority nation in their own national state.<sup>7</sup> It should be pointed out though that in the constitutional or formal sense, czechoslovakism was non-existent. In the Constitutional Charter of the Czechoslovak Republic of 29 February 1920 there was no single word,<sup>8</sup> or article dealing explicitly with this issue. But, there were several implicit proofs that the constitutional Czechoslovakism existed, similarly as the Yugoslav Vidovdan (Vidov day's) Constitution of 1921 implicitly enacted the national unitarism and state centralism.<sup>9</sup> First there is a line in the preamble to the constitutional charter saying: "My, národ Československý",<sup>10</sup> further, there is the name of the country – the Czechoslovak Republic. Although in this paper we use Czechoslovak in a single word, as

<sup>3</sup> For more on the reasons which dictated the integration of the State of SHS with the state of the Karađorđević family, see: Branislav Gligoričević, *Parlament i političke stranke u Jugoslaviji 1919-1929*, Institut za savremenu istoriju – Narodna knjiga, Beograd, 1979 (hereafter: Gligoričević, *Parlament i političke stranke*), pp. 273-275.

<sup>4</sup> Pirjevec, *Jugoslavija*, pp. 16-17.

<sup>5</sup> Similarly, the Vidovdan Constitution of the Kingdom SHS defined Serbs, Croats and Slovenes as three "tribes" of a single Yugoslav (three-name) nation. See: Čulinović, *Državno-pravna historija*, p. 263.

<sup>6</sup> "Štatistický pohľad je však vždy jednoduchší ako politický a historický", Kováč, *Dejiny Slovenska*, p. 187.

<sup>7</sup> Ibid.

<sup>8</sup> Ludovít Novák, *Československý národ ako väčšinový národ štátny*, 1935, republished in: *Slovenská otázka v 20. storočí*, Kalligram, Bratislava, 1997 (hereafter: Novák, *Československý národ*), p. 208.

<sup>9</sup> For more on the unitarist and centralist character of the Vidovdan Constitution, see: Jurij Perovšek, "Unitaristični in centralistični značaj vidovdanske ustave", *Prispevki za novejšo zgodovino* 33 (1993) 1-2, pp. 17-26.

<sup>10</sup> Novák, *Československý národ*, p. 209.

do the Slovak and Czech authors and contemporaries of that period, the original name of the country written down also in the post-War treaties giving the country international recognition (the Treaties of Saint-Germain and Trianon) was République Tchéco-Slovaque in French and Czech-Slovak State in English. Also the name of the new South-Slav state is written in the same manner: L'État Serbo-Croate-Slovène and the Serb-Croat-Slovene State. It clearly emphasises the constituent nations of these states. This is why an influential Slovak linguist in the inter-war period Ludovít Novák supported the idea that the Czechs and Slovaks wrote the name separately, thus pointing to a particular common national character stemming from the "merging of two Slav nations having equal rights".<sup>11</sup>

### 3. Economic heritage

In Slovakia, which belonged to the economically undeveloped Hungarian part of the Monarchy, agriculture was the main economic activity. On the Hungarian territory, industry only began to be developed in the last third of the 19<sup>th</sup> century. Given the development lag behind the Cisleithania, the Hungarian government supported this young and still evolving economic activity by numerous financial injections, tax reliefs, discounts in railway transport and similar incentives. The rate of industrial development stood at an incredible 7.3% per year, which was above the rates in any developed European countries.<sup>12</sup>

The speed of catching up with the West was remarkable. But to actually reach the level of development of the West, these rates of industrial growth would have to last for twice as long as they have (provided that the rates of growth of the western economy were moderate). Just before the break out of the world war, the Slovak industrial production per inhabitant accounted for 50% of the average industrial production of the western economies.<sup>13</sup> It is by this fact that we become fully aware of the actual economic situation of the central part of the Central European area – Hungary, whose prospects were poor despite its rapid development. Then, the country was plunged in the maelstrom of war, followed by its break up and division of its territory between the successor states. The northernmost part of the territory – Slovakia became a part of the new state of Czechs and Slovaks.

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<sup>11</sup> "Spojením dvoch rovnoprávných slovanských národov", *ibid.*

<sup>12</sup> Lubomír Lipták, *Slovensko v 20. storočí*, Kalligram, Bratislava, 2000 (hereafter: Lipták, *Slovensko v 20. storočí*), p. 14; compare: Jozef Faltus, Václav Průcha, *Prehľad hospodárskeho vývoja na Slovensku v rokoch 1918-1945*, Vydavateľstvo politickej literatúry, Bratislava, 1967 (hereafter: Faltus – Průcha, *Prehľad hospodárskeho vývoja na Slovensku*), pp. 11-13.

<sup>13</sup> Lipták, *Slovensko v 20. storočí*, p. 15.

The much more developed Czech lands stemming from the Cisleithania's part of the Monarchy were industrialised even before the war. In 1910, 39.6% of the population worked in industry and 34.4% in agriculture. In Slovakia, the figure for industry was lower almost by a half (18.4%), whereas in agriculture it was almost double (62.6%).<sup>14</sup> The economic integration of the two parts would probably have been easier if the industrially developed part merged with the area which was agriculturally intensive and developed. But the data on the population structure deny both, the former and the later presumption. Slovakia was an undeveloped agrarian country with the yields per hectare by two and a half times lower than in the Czech lands.<sup>15</sup> A Slovak historian Ľubomír Lipták gave a simple description of the merging of the two parts. The territory of Slovakia "(...) lagged significantly behind the developed countries of the Western and Eastern Europe, but it could by no means be ranked among the most underdeveloped parts of Europe. While the Czech provinces could be considered a kind of easternmost foothills of the western capitalist industrial civilisation, but still by a certain level below the top, Slovakia represented the western separate guard of this poorer part of Europe, only with slightly higher rate of industrial development."<sup>16</sup>

Slovenia – like the Czech lands – belonged to Cisleithania – the developed part of the former Monarchy. But not only politically but also economically the odds were more in favour of the Czech lands. In Slovenia – like in Slovakia – most of population lived of agriculture. In 1931, this figure was still above 60%.<sup>17</sup> Nevertheless, Slovenia was much better off than Slovakia. In its "Austrian period", Slovene economy benefited from several positive factors, all contributing to its rapid and efficient industrialisation. The construction of transport infrastructure was of particular importance. The Southern Railway run through the entire Slovene territory, connecting not only Vienna with the harbour of Trieste, but also Slovene territory with the developed markets. Also good energy supply of Slovenia and a high level of education of population is worth mentioning.<sup>18</sup> As regards the energy supply, the power plant Fala on the

<sup>14</sup> Václav Průcha, "Equalization of the Economic Levels Between Slovakia and the Czech Lands in the Years 1918-1989", *Challenges of Economic History*, Budapest, 1996 (hereafter: Průcha, *Equalization of the Economic Levels*), p. 209. Compare table.

<sup>15</sup> Ibid., p. 208.

<sup>16</sup> "(...) výrazne zaostávalo za vyvinutými krajinami západnej a strednej Európy, avšak nepatrilo ani zďaleka medzi najzaostalejšie európske oblasti. Zatiaľ čo české kraje boli akýmsi najvýchodnejším predpolím západnej kapitalistickej industriálnej civilizácie, ale stáli o stupienok nižšie za jej špičkou, Slovensko tvorí zasa akoby západnú vysunutú stráž tej chudobnejšej polovice Európy, pričom na stupienku industriálnej súťaže je o máličko vyššie." Lipták, *Slovensko v 20. storočí*, p. 15.

<sup>17</sup> *Spominski zbornik Slovenije. Ob dvajsetletnici Kraljevine Jugoslavije*, Ljubljana, 1939 (hereafter: *Spominski zbornik Slovenije*), p. 544. Compare table.

<sup>18</sup> The literacy at the beginning of the 20<sup>th</sup> century was almost 90%. Žarko Lazarević, "Na južnih obzorjih. Gospodarska izkušnja Slovencev v prvi jugoslovanski državi", *Nova revija*, April-May 1995 (No. 156-157), (hereafter: Lazarević, *Na južnih obzorjih*), p. 190.

Drava River close to Maribor was of particular importance. Its construction started in 1913 by *Steiermärkische Elektrizitäts-Gesellschaft* from Graz, which provided also almost twenty million crowns of necessary funding. This energy production giant was completed in 1918. After some complications with nostrification, this power plant eventually provided electricity for Slovene towns and the economy.<sup>19</sup> When speaking of the key factors of economic development in Slovenia, one should not forget about the main driving force of industrialisation – the financial capital. Only sufficient financial capital concentrated in adequately developed banks and other financial institutions could guarantee development. In Slovenia, these institutions were developed already before the turn of the century.

**Table 1:** *The percentage of population engaged in selected economic activities, in 1921*<sup>20</sup>

ECONOMIC ACTIVITY	SLOVENIA	KINGDOM SHS	SLOVAKIA	CZECH LANDS
Agriculture, forestry, fishery	63.1	75.9	60.7	31.5
Industry and crafts	16.5	9.8	17.4	39.7
Trade and finance	3.7	3.2	4.1	6.3
Transport	4.7	1.9	3.5	5.4
Public services and free occupations	4.5	3.5	5.0	5.9
Other and people without occupation	7.5	5.7	9.3	11.2
	100	100	100	100

Sources: *Spominski zbornik Slovenije*, p. 544; Průcha, *Equalization of the Economic Levels between Slovakia and the Czech Lands*, p. 209.

<sup>19</sup> The power plant sold the electricity also to Graz. Jože Šorn, "Slovensko gospodarstvo v poprevratnih letih 1918-1924", editors: N. Borak, Ž. Lazarevič, *Zbirka Ekonomska knjižnica*, Cankarjeva založba, Ljubljana, 1997 (hereafter: Šorn, *Slovensko gospodarstvo v poprevratnih letih*), pp. 218-221.

<sup>20</sup> Data for the Czech lands and Slovakia relate to the total population, data for Slovenia and Kingdom SHS are based on the occupation of the master of the family, as data on total population for Slovenia were not published in 1921. The figures for Slovenia and Kingdom SHS are therefore slightly lower than the actual figures, but they nevertheless allow comparison. Moreover, the data on Kingdom SHS include also Slovenia and not only the rest of the territory of the new state. Although the figures excluding Slovenia would have been slightly different, they can be taken as an approximate of the situation in the rest of the state, since Slovene population accounted for a mere 8.85% of total population in 1921 (*Spominski zbornik Slovenije*, *ibid.*, p. 544).

#### 4. Economic position in the new state

When Slovenia, as an agrarian state but with well developed infrastructure, entered the new political reality, it suddenly became its most developed part. The most undeveloped southern parts of the Kingdom SHS could not catch up with the northern parts.<sup>21</sup> The new state was also smaller than the former one, which meant also a smaller market. The economic climate was nevertheless positive for Slovenia and Slovene companies, at least in the initial development period. The new undeveloped markets were eager for industrial products and also enjoyed heavy border protection. After the war, the Serb customs tariffs were applied throughout the country, which meant high tariffs on imported goods.<sup>22</sup> The companies used to tough competition in the former Austria could thus thrive in such conditions.

Even the contemporary – post-war analyses of the economic perspective of Slovenia in the new state highlighted these advantages. A commentator of a liberal newspaper *Jugoslavija* wrote: “In the former state, we were a country whose industry was still in its infancy (...); even now our industry has not yet been fully developed, but our neighbours in the new state are in this aspects still much further behind.”<sup>23</sup> Since Slovenia did not have an autarchic agriculture but depended on the imports of foodstuffs from the southern parts of the kingdom, its economic orientation was undisputable: the country was to become an industrial centre of the new state.<sup>24</sup> The great ideas, however, were not always supported by a concrete political and economic action. Thus, the economic development in the first two post-war years was only negligible. Measured in terms of imports of machinery and machinery parts, one cannot speak of a true development upturn before 1922, when the imports of machinery equipment accounted for as much a 5% of state’s total imports.<sup>25</sup> The large part of the imported equipment of course remained in Slovenia.

While Slovene economic thinkers were justifying the suitability of industrial construction in Slovenia despite its alleged territorial exposure, their Slovak colleagues experienced a similar process of setting up the state economy in practice. By saying that the development in Czechoslovakia followed the

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<sup>21</sup> Compare: Lazarević, *Na južnih obzorjih*, p. 196.

<sup>22</sup> *Ibid.*, p. 197.

<sup>23</sup> “Gospodarska orijentacija Slovenije”, *Jugoslavija*, June 12<sup>th</sup>, 1921

<sup>24</sup> Compare: *Ibid.* The author of the paper quoted also the objections to the planned industrialisation, above all the demoralisation, which was to necessarily follow industrialisation. It would therefore be advisable for the sake of the “mental health of the nation” to further promote agriculture. The second objection was the exposure of the Slovene territory in the case of a potential military conflict.

<sup>25</sup> Adolf Golia, “Industrija v Sloveniji”, in: *Spominski zbornik Slovenije*, p. 375.

“Slovene model”, we mean that much more industrially and infrastructurally developed Czech lands proceeded with their industrial development (like all the years before), but Slovakia remained doomed to the role of the agricultural supplier. This was particularly the case in the 1920s when it even experienced deindustrialisation. The Czech industry constantly predominated over the Slovak industry, which was still in its early stages and could not compete with the Czech one.<sup>26</sup> Nevertheless, Slovakia’s economical development was slowly and persistently catching up with the Czech development.<sup>27</sup> In the first post-war years (1920 and 1921), 129 joint-stock companies were established, and many of them were production plants.<sup>28</sup>

The breakdown of the most intensive industrial activities in Slovenia and Slovakia shows quite a similar picture. The development of the wood manufacturing should be mentioned in particular. Both countries had similar conditions for it: sufficient natural resources (forests), adequately educated workforce, great demand for wood (post-war reconstruction) and what was most important: the loss of wood contingents from the largest pre-war exporter of wood – Russia. Also mining and construction material manufacturing were in their expansive phases. Besides, Slovenia also had strong steel and textile industries, whereas Slovakia profited from beer brewery, which managed to survive the strong competition of Czech beer largely thanks to high railway tariffs.<sup>29</sup>

## 5. Economic problems

### 5.1. Underdevelopment of transport infrastructure

One of the main problems upon the formation of the new economic area was in both cases transport. Poor infrastructure connections with the new market often significantly reduced, if not eroded completely the competitiveness of domestic enterprises. The new markets were not easily accessible. It was up to the new state transport policy to create equal conditions for all the enterprises, allowing also enterprises from more distant areas to be competitive.<sup>30</sup> Railways

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<sup>26</sup> Průcha, *Equalization of the Economic Levels*, p. 210.

<sup>27</sup> Slovakia only started to really catch up in development with the Czech lands after the economic crisis of 1929–1933, and continued with the accelerated economic growth up to 1989. - Průcha, *Equalization of the Economic Levels*, pp. 210, 218–219.

<sup>28</sup> Faltus – Průcha, *Prehľad hospodárskeho vývoja na Slovensku*, p. 34.

<sup>29</sup> Adolf Golia, “Industrija v Sloveniji”, in: *Spominski zbornik Slovenije*, p. 375; Faltus – Průcha, *Prehľad hospodárskeho vývoja na Slovensku*, p. 33.

<sup>30</sup> Compare: Imrich Karvaš, *Sjednocení výrobních podmínek zemích českých a na Slovensku*, Orbis, Praha, 1933, p. 81.

were at that time the most important means of transport. But in the post-war period, its advantages were overshadowed by numerous weaknesses: poor inter-connections, problems with coal, locomotives<sup>31</sup> and above all, shortage of railwaymen. All this, in addition to many other factors, resulted in extremely high transport tariffs, which were regulated by the tariff policy. The contemporaries described it as being, "(...) accidental, lagging behind the pulse of economic life (...)".<sup>32</sup> The alternative transport routes were navigable rivers and the sea. Slovenia, which under Austria had an exit to the Adriatic Sea, lost a third of its national territory as a consequence of the Rapallo Treaty of 12 November 1920. At the same time, Slovenia suffered great economic damage by being cut off from the sea.<sup>33</sup> The Danube River was a great advantage, as it offered cheap connections in the Central Europe. But it passed by Slovenia, although Slovenes often arguing of having a Central European location. Slovakia with its harbour Bratislava, on the other hand, profited a lot from it, although again it was irrelevant for its economic integration with the Czech lands. The Slovak economy thus faced a similar problem as the Slovene one. Although the customs barriers fell, the new barriers arose – the transport tariffs. They can easily be called a special form of customs tariff.<sup>34</sup> For exporters, they represented a great burden, and for less succesful enterprises they also meant protection from products from newly integrated parts of the state.<sup>35</sup>

## 5.2. Lack of unified tax system

Let us now try to imagine a Slovene or a Slovak businessman trying to do business on the new, expanded market. A hypothetic Slovak businessman produces and sells beer and a Slovene one trades in wine. The former tries to sell his product to the eastern Czech lands, and the latter to Serbia. Despite severe conditions for business and high transport tariffs, he makes a deal, sells his products and generates an income. The sore moment of truth comes when the profit has to be shared with the state. The state, of course, collected taxes. But here,

<sup>31</sup> After the break-up of Austro Hungary, the rolling stock of the Austro-Hungarian railways was a particular problem in the succession negotiations. It was decided at the conferences in Portorož and Vienna in 1921 that all the undistributed trains which were on the territory of an individual country belong to that particular country. - Josef Gruber, *Dopravní politika*, 1924, p. 103.

<sup>32</sup> Črtomir Nagode, "Naš promet", in: *Spominski zbornik Slovenije*, p. 408.

<sup>33</sup> Compare: "Jutro", November 13<sup>th</sup>, 1920: "Slovenija odrezana od morja in mora znova preobraziti svoje gospodarstvo".

<sup>34</sup> Compare: Faltus – Průcha, *Prehľad hospodárskeho vývoja na Slovensku*, p. 86.

<sup>35</sup> Such a situation may be examined on the above-mentioned case of the Slovakian and Czech beer industry: the Czech exports to Slovakia were prevented by high transport tariff. After the tariff had been lowered, the above-mentioned process of deindustrialisation began in Slovakia.

enterprises from various provinces were treated unequally, and this additionally threatened the competitiveness on the new market. In Slovenia, the Austrian tax system applied, which was much different from the tax practices in other parts of Kingdom SHS. The key difference was that Slovene tax payers had to pay personal income tax – a tax which did not exist in eastern parts of the Kingdom. Likewise, Serbia did not apply the excise duty on wine. Thus, the inhabitants of the former Austria-Hungary, and indirectly also enterprises, had to pay higher taxes and were in an unequal position with the individuals and enterprises from Serbia and Montenegro.<sup>36</sup> Taking all this into account, the performance was in fact more expensive on the new markets than it had been in the old monarchy, and besides the markets were more inaccessible. A Slovak brewer was faced with similar problems. In Slovakia the Hungarian tax system applied, which meant high duties. In the times of Austria-Hungary, this was not so problematic, as the tax morale was low and organisation of tax collection was rather primitive. In Czechoslovakia, the new government introduced an efficient system of filling the budget, but at the same time forgot about the levelling of tax burdens.<sup>37</sup> Still in 1923, the Union of Slovak Industrials warned the President Tomáš G. Masaryk about this problem in their memorandum. Like the Slovene businessmen, they also pointed out the problem of personal income tax, which before the integration applied only in the Czech part, but was after that introduced also in Slovakia.<sup>38</sup> It can be concluded that at least in the first post-war years, the

<sup>36</sup> Vladimir Murko, "Državne in samoupravne finance v dravski banovini v l. 1918-1938", in: *Spominski zbornik Slovenije*, pp. 474-475. The tax system was only levelled on 8 February 1928, by entering into force of the Direct Taxes Act. On the demand of the Serb deputies, it abolished personal income tax – a modern tax which allowed the concern for subsistence minimum and more equitable taxation. Compare: Branislav Gligorijević, *Parlament i političke stranke u Jugoslaviji 1919-1929*, Institut za savremenu istoriju – Narodna knjiga, Beograd 1979, (hereafter: Gligorijević, *Parlament i političke stranke*), p. 253. In the discussion, the deputies of the Peasants Democratic Coalition severely objected the government proposal that even after the levelling of taxes the "prečanski" lands continued to pay personal income tax for another year. Eventually, the government proposal was accepted, with a compromise solution that the non-taxable part of the income is increased. Compare also: Žarko Lazarević, "Vendarle poenotenje davkov", in: *Slovenska kronika XX stoletja 1900-1914*, Nova revija, Ljubljana 1995, p. 330.

<sup>37</sup> CZ – A U T. G. Masaryka, MAR, Slovensko, kar. 1, Sl. 2.

<sup>38</sup> Members of the union clearly emphasised that Slovakia was more heavily burdened by taxes than the Czech lands.

CZ – A U T. G. Masaryka, MAR, Slovensko, kar. 1. Sl. 1, memorandum Krajinskej skupiny pre slovensko Ústredného sväzu čl. Priemyselníkov v Bratislave, 5.9.1923. After the tax reform in Hungary in 1909, the legislation foresaw also the personal income tax, but this act was not implemented before the outbreak of war. It entered into force on 1 January 1915, but not in its entirety. Upon the founding of the Czechoslovakia, the tax act of 1909 thus applied in Slovakia. - Johannes Popitz, "Einkommensteuer," in: *Handwörterbuch der Staatswissenschaften*, 3. zv. (De Bosch-Kemper – Finanzausgleich), Verlag von Gustav Fischer, Jena 1926, pp. 455-456.

tax policy was in both cases dictated from where the political power was concentrated, and it disregarded the actual economic needs. It suited Prague that Slovakia paid the personal income tax but for Belgrade it was better that it was paid only by the people from the “*prečanski*” parts of the state.<sup>39</sup>

### 5.3. Currency problem

The problems related to the formation of a new economic area were also accompanied by the problems related to the break up of the old area. Despite the rapid and relatively elegant disintegration from the Austria-Hungary, the economic separation was not easy. For quite some time, the population of the newly formed states was reminded of the former state by the images on the Austro-Hungarian coins, which remained in circulation. The post-war devastated Austro-Hungarian state economy could no longer fill the Vienna budget and the state was financed through borrowing with the emission bank, which was issuing ever new banknotes. This, logically, led to a rampant inflation, and the new counties rejected to accept this devalued money. They decided for the currency separation,<sup>40</sup> i.e. they marked all the banknotes of the former monarchy circulating on their territory and took them as their own currency; they started to form new currency foundations. In Czechoslovakia, the situation was easier because the merged provinces had not had their own national bank or currency. After four months of preparations, the law on the introducing of a brand new currency – the Czech crown – was passed on 25 February 1919.<sup>41</sup> The Yugoslav situation was more complicated. After the war, the following currencies circulated in the state: the Austro-Hungarian crowns in the “*prečanski*” lands, the dinar in Serbia, the perper in Montenegro and the Bulgarian lev in Southern Serbia.<sup>42</sup> The crown banknotes were soon (in two attempts) marked. Only when the National Bank of Serbia was transformed into the National Bank of Kingdom SHS on 31 January 1920,<sup>43</sup> conditions were met for introducing a new single currency. Given the political significance of the former Kingdom of Serbia, it was understandable that it was the dinar that became the

<sup>39</sup> The Serb political circles referred to the people from the Yugoslav countries which belonged to the former Austria-Hungary as “*prečani*” (those living across something), as they lived on the other side of the Sava, Donava and Drina rivers, if looking from Belgrade.

<sup>40</sup> The requirement of “marking” of banknotes which circulated in the territory of new countries was later on also included in the Treaty of Saint Germain. - Šorn, *Slovensko gospodarstvo v poprevratnih letih*, p. 64.

<sup>41</sup> Štefan Horváth – Ján Valach, *Peňažníctvo na Slovensku 1918-1945*, Alfa, Bratislava, 1978, pp. 23-25.

<sup>42</sup> Ivan Slokar, “Valutne razmere, devizna politika in bankarstvo”, in: *Slovenci v desetletju 1918-1928. Zbornik razprav iz kulturne, gospodarske in politične zgodovine*, Ed. Josip Mal, Leonova družba, Ljubljana, 1928, p. 553.

<sup>43</sup> Šorn, *Slovensko gospodarstvo v poprevratnih letih*, p. 127.

state currency. Soon, another problem surfaced, i.e. the exchange rates between all the currencies in circulation. As the values of currencies differed, exchange rates had to be determined. Slovenes discussed the value of the crown within the economic section of the National Council already in the late October 1918. An economist dr. Milko Brezigar tried to prove in his calculations that the value of the crown was only one sixth of that before the war and the State SHS should only take over (mark) such an amount of banknotes. A politician dr. Ivan Tavčar advocated the changeover at the *al pari* exchange rate, i.e. 1:1.<sup>44</sup>

After the formation of the Yugoslav state, 80% of the Austro-Hungarian crown banknotes were actually taken over. It was followed by the negotiations on the dinar-crown exchange rate. Although Slovenes demanded the *al pari* changeover, the law of 25 October 1922 set out the 1:4 exchange rate.<sup>45</sup> As the crown's purchasing power was believed to have exceeded this rate, the "*prečanski*" circles were at a loss for a part of their assets. Again the economic interest of those with political power prevailed. Nevertheless, the efficient currency changeover was a precondition for further functioning of the common market and for the normal operations of the banking sector.

The economic policy guidelines were formed in the economic section of the National Council, established in August 1918. The responsibility of the section was to lay the grounds for efficient functioning of the new Slovene economy, to care for approvisionnement, for reconstruction of the Primorska region and to address all the vital economic challenges.<sup>46</sup> After the establishing of the National Government of SHS in Ljubljana, the economic issues became the responsibility of the government, more specifically of its ministries for trade and industry,<sup>47</sup> food, finance, transport, public works and crafts, and agriculture.<sup>48</sup>

## 6. Crossroads of economic policy

Upon the integration of the 1 December, changes were announced in the managing and organisation of the Slovene economic policy. But, they were only announced, as the integration "(...) failed to reveal any influence at all

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<sup>44</sup> Ibid, pp. 62-63.

<sup>45</sup> This was set out already by the Ministerial Council on February 13<sup>th</sup>, 1920. - Vladimir Murko, "Državne in samoupravne finance v dravski banovini 1918-1938", in: *Spominski zbornik Slovenije*, p. 474.

<sup>46</sup> Jurij Perovšek, *Slovenska osamosvojitev v letu 1918. Študija o slovenski državnosti v Državi Slovencev, Hrvatov in Srbov, Modrijan*, Ljubljana 1998, (hereafter: Perovšek, *Slovenska osamosvojitev v letu 1918*), p. 108.

<sup>47</sup> Despite the name of the ministry, it was also responsible for joint-stock companies, insurance companies and regulative savings banks. - Šorn, *Slovensko gospodarstvo v poprevratnih letih*, p. 77.

<sup>48</sup> Perovšek, *Slovenska osamosvojitev v letu 1918*, p. 111.

on the work of economic administrative institutions”.<sup>49</sup> It was not before the spring 1919 that a new course was taken, which typically characterised the first Yugoslav state and its brief history. The government in Belgrade started to centralise its activities, it strived for the subordination of the Ljubljana Economic Committee for Trade and Industry directly to the Belgrade Ministry of Trade and Industry; despite the strong resistance on the side of Slovenia, it eventually succeeded in October 1921.<sup>50</sup>

The expectations and experiences of Slovene economic experts assured organised adaptation of the economy to the new circumstances. On the other side of Leithe (in the Hungarian part of the Austro-Hungarian Monarchy), Slovaks, who were politically organised in the Slovak National Council, waited for their economic independence completely unprepared. Moreover, their National Council had no funds necessary to establish the state apparatus. Everything was in the hands of the Czech National Committee<sup>51</sup> and later on of the Government in Prague. After the state had been established, a special minister plenipotentiary for Slovakia was appointed the head of the supreme governing office for Slovakia, with the seat in Bratislava.<sup>52</sup>

One of the most prominent members of the economic section of the Slovene National Council was a Slovene economist dr Brezigar. He published his views, which he also promoted at the section's meetings, in his work: *An Outline of Slovene National Economy*, in September 1918. The purpose of the book was explained in its foreword (although the title itself explained it well), saying that “So far, we have not known the S l o v e n e, and even less so the Y u g o s l a v economy, but it was high time that we built it. And it is up to us whether the building will be solid a one or not.”<sup>53</sup> For the building to be solid enough, Brezigar analysed all the sectors of the economy and foresaw the necessary steps. He has not yet dealt with the formation of the common market. At the economic conference organised by the economic section of the National Council on 18 September 1918, he warned against the poor preparedness for the coming period of transition. He explained how the European countries were preparing for economic changes, by establishing special offices

<sup>49</sup> Šorn, *Slovensko gospodarstvo v poprevratnih letih*, p. 78.

<sup>50</sup> Ibid, p. 86.

<sup>51</sup> In the preparations for the economic independence, the Czech National Committee only played the patron of the Czech bourgeoisie, which in fact prepared the programme. One of its key representatives was Jaroslav Preiss, the head of the Czech Živnostenska bank, who was to become the minister of finance of the new republic but never did. - Vlastislav Lacina, *Formování československé ekonomiky 1918-1923*, Academia, Praha 1990, (hereafter: Lacina, *Formování československé ekonomiky*), pp. 60-61.

<sup>52</sup> A Slovak politician Vavro Šrobár became the minister (appointed on 7 December 1918). - Lacina, *Formování československé ekonomiky*, pp. 68-69.

<sup>53</sup> Milko Brezigar, *Osnutek slovenskega narodnega gospodarstva*, Omladina, Celje 1918, foreword.

and commissions to overcome the transitional period. Also Slovenes would need to prepare and organise accordingly.<sup>54</sup> Let us illustrate how badly Slovenes were acquainted with the situation in the Balkans, the area with which they were soon to be integrated into a common state: before the world war, only 6.5% of Slovene companies knew the territories of other Yugoslav nations and had trade relations with them. Even in the initial post-war period, these relations were still weak.<sup>55</sup> Any “elegant” reorientation of Slovenia to the southern markets was therefore by no means taken for granted. Slovenes were in need of an economic policy carefully conceived by experts.

Slovenia was the most developed province in the Kingdom SHS and its interest in the economic issues was understandable. Slovakia, which was only poorly economically organised and dependent on the Czechs, was not an economic engine of the new area. These questions were first raised by Slovak businessmen and industrials who encountered concrete problems. But it was the young economists, who returned from their studies abroad, who dealt more thoroughly with them. They first presented their views in the 1930s; Imrich Karvaš<sup>56</sup> and Peter Zafko<sup>57</sup> were the most renowned ones.

Zafko claimed that it had been completely disregarded back in 1918 that the two territories which were to be politically and economically integrated were of entirely different economic character. It was only realised later that Slovakia was an agrarian land and should remain that way. Nobody was concerned whether Slovak land would produce enough bread for the entire country, despite the natural increase in population. The situation could have been

<sup>54</sup> Pogled v novi svet, poročanje na gospodarskem posvetu, ki ga je sklical “Narodni svet” (September 18<sup>th</sup>, 1918), Slovenska Socijalna Matica, Ljubljana, 1918, p. 11.

<sup>55</sup> Jasna Fischer, “Slovenska gospodarska bilanca ob vstopu v Jugoslavijo”, in: *Prevrati in slovensko gospodarstvo v XX. stoletju. 1918-1945-1991*, editors: N. Borak-Ž. Lazarević, Cankarjeva založba – Zbirka Ekonomska knjižnica, Ljubljana, 1996, p. 21; compare: Žarko Lazarević, “Od regionalnega k slovenskemu narodnemu gospodarstvu” (Preobrazba slovenske gospodarske strukture v drugi polovici 19. in v 20. stoletju), in: *Slovenija 1848-1998: iskanje lastne poti*, editors: S. Granda, B. Šatej, Zveza zgodovinskih društev Slovenije, Maribor, 1998, p. 272.

<sup>56</sup> Imrich Karvaš, born in 1903, a professor on the Bratislava Faculty of Law, was the secretary of the Chamber of Trade and Industry in the late 1920s, after that a secretary of the Union of Slovak banks and in the 1930s the secretary of the National-Economic Institute for Slovakia and Transcarpathian Ukraine. During the World War II, he was the governor of the Slovak National Bank and a member of the resistance. Augustín Maťovčík a kol., *Reprezentačný biografický lexikón Slovenska*, Matica slovenská, Martin, 1999 (hereafter: *Reprezentačný biografický lexikón*), p. 159; *Slovenská otázka v 20. storočí*, Ed.: R. Chmel, Kalligram, Bratislava 1997, (hereafter: *Slovenská otázka*), p. 528.

<sup>57</sup> Peter Zafko was a general secretary of the Central Association of Slovak Industry since mid-1930s. He supported regionalism, which was to level off the economic disparities between Czech lands and Slovakia. *Reprezentačný biografický lexikón*, pp. 373-374; *Slovenská otázka*, p. 539.

solved – as Zaťko claimed – only by the regional development based on new foundations.<sup>58</sup> Karvaš warned the hard-line autonomists – who advocated a dualist system in Czechoslovakia, with Slovakia as an independent economic entity – of the true possibilities of the Slovak economy. The autonomists believed rather naively that only autonomy could bring an instant recovery and construction of the Slovak industry. According to Karvaš, they would have to take into account the need for several decades of development, which would exhaust the closed Slovak (mainly agrarian) economy. As noted by many economists of that time (also by dr. Brezigar), economy was discussed all over, and solutions were sought in redemptive slogans. Autonomism was definitely one of them, for many a heavenly way to a better future, whilst in reality a thorny way of economic problems.<sup>59</sup>

The circles which advocated economic autonomy of course counted on the political autonomy and the related restructuring of the entire state. In Slovenia, the catholic Slovene People's Party (SLS) – the central political power in the first Yugoslavia – promoted such policy. The party belonged to the autonomist political block and supported the economic independence of Slovenia.<sup>60</sup> In both successor states, the struggle between the supporters and opposition of various state-administrative and state-economic concepts left behind many different critical views and theses. In Slovenia the natural adversaries of the SLS – the centralist and unitarian young liberals with their newspaper *Jutro* – took the “Karvaš line”. In their responses to the goals of political Catholicism, they emphasised an importance of the new market, claiming that “in the huge European industry (...) Slovenes can only compete within the large Yugoslavia, which is wide open to us”.<sup>61</sup> Should by any change an economic border be established on the Sotla river, the agrarian Serbia would quickly find a mutual trade interest with the developed European industry, whereas an autonomous Slovenia would enter the period of economic misery.<sup>62</sup>

Despite all the endeavours for reforms, both countries remained centrally led. Belgrade and Prague tried to understand, perhaps benefit from, and sometimes even abolish the economic diversities of individual parts of the state. In the Kingdom SHS, quite interestingly, the centre of political power assured

<sup>58</sup> Peter Zaťko, “Postavenie Slovenska v ČSR zo stránky hospodárskej a politickej”, essay from 1932, republished in: *Slovenská otázka*, pp. 123-126.

<sup>59</sup> Imrich Karvaš, “Na čo autonomisti nemyslia, essay from 1933”, republished in: *Slovenská otázka*, pp. 156-157.

<sup>60</sup> See: Jurij Perovšek, *Programi političnih strank, organizacij in združenj na Slovenskem v času Kraljevine SHS (1918-1929)*, Viri 13, Ljubljana 1998, doc. No. 20 (Program Slovenske ljudske stranke oblikovan ob volitvah v Narodno skupščino Kraljevine SHS leta 1923), pp. 82-86; compare: “Jutro”, April 3<sup>rd</sup>, 1923, editorial.

<sup>61</sup> “Jutro”, April 3<sup>rd</sup>, 1923, editorial.

<sup>62</sup> Ibid.; Gligoričević, *Parlament i političke stranke*, p. 287.

that the whole country was catching up with Slovenia.<sup>63</sup> In Czechoslovakia, on the contrary, the political centre made sure that Slovakia would not catch up too rapidly with the Czech parts of the country. In agrarian Slovakia, the proportion of population engaged in agriculture even rose by 4 % in the first decade within the new republic.<sup>64</sup> Clearly, the differences and contrasts within the Kingdom SHS and the Republic Czechoslovakia – which were a legacy of the two states being composed of politically and economically completely different units – greatly influenced the position of Slovenia and Slovakia in their new state communities. In addition to obvious positive effects brought about by a changed political situation after the World War I in the central and South-Eastern Europe, the life of Slovenes and Slovaks was complicated in particular by the fact that in their endeavours for internal consolidation, the first Czechoslovakia and the first Yugoslavia quite wrongfully swore on the policy of national integralism and state centralism. A Czech writer Milan Kundera commented that the compound word Czechoslovakia was too young and without beauty; if a country could be conceived on the basis of such an unreliable word, a novel cannot be.<sup>65</sup> Throughout the short history of their cohabitation, the nations in both states failed to build up a “common novel” and settle the relations amongst themselves. And the 1990s have done away with the two countries for good.

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<sup>63</sup> In 1910, the average national income per capita on the Yugoslav territory accounted for 62% of the Slovene one, and before the World War II it stood at 70%. - Lazarevič, *Na južnih obzorjih*, p. 206.

<sup>64</sup> From 1921 to 1930 by 74,166 persons or 4.1%. - Zdeno Jaura, “Prístupy k vzťahom medzi priemyslom a poľnohospodárstvom na Slovensku v dvadsiatych rokoch”, *Ekonomický časopis*, 30 (1982) 9, p. 839.

<sup>65</sup> Milan Kundera, *Umetnosť romána*, Slovenska matica – Partizanska knjiga, Ljubljana, 1988, p. 130.

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## DOUBTS OVER JAPANESE “ECONOMIC MIRACLE”

**Abstract:** *The slowing pace of Japanese economic growth has come as a consequence of growing contradictions between the need for unlimited industrial power in the world economy on one hand, and scarce stocks of natural and energy resources on the other. Japanese economy that developed thanks to its capability to respond to external and internal challenges is yet to find the answer to challenges arising from these contradictions. The main answer is in the way of reaching adequate growth rate and competitiveness of the economy that does not have natural and energy sources of its own.*

**Key words:** *Japan, Japanese economy, slowing pace of economic growth*

### 1. Methodological problems

Public and expert attention worldwide was drawn to the slackening pace of the Japanese economic growth at the beginning of the last 20<sup>th</sup> century decade. Used to the Japanese unflinching economic growth, the world saw its stumbling as Japanese new “economic miracle”. Researchers in numerous fields had tried to explain the Japanese “economic miracle” phenomenon after the Second World War. It proved to be a complex task. But first the following issue needs to be addressed: in order to measure its scope the nature of the malady that has befallen Japanese economy and keeps pestering it for a decade has to be determined.

In trying to answer the above dilemma two difficulties may be encountered: first, the absence of clear definitions of economic malfunctions, and second-reasons that motivate authors upon diagnosing difficulties met by the Japanese economy.

#### 1.1. Definitions of economic malfunctioning

Both the nature and the reasons of the “Japanese third miracle” are debatable. The end to the impasse over this issue is nowhere to be seen as economic

theories do not offer any clear definitions of economic malfunctioning. They are referred to by some authors as "crises" that can be a form of recession or depression. Some others see the crisis as a form of fault that stands somewhere in between recession and depression.

Short-term dysfunction of the conjuncture of economic circumstances is usually referred to as recession. Its main characteristics are temporary decrease in the economic growth rate and increase in unemployment. The condition is treated by economic circumstances management measures-both fiscal and monetary by which back to normalcy is ensured.

Depression is a difficult, long-term economic malfunction that happens simultaneously in structure and economic overall circumstances. Its main features are steep drop of the gross domestic product and significant increase in unemployment. Back to normalcy scenario does not exist. It is treated primarily by a deep structural revival, together with undertaking economic climate management measures.

Economic malfunction that is more serious than recession but milder than depression are called crises. Crisis can be both economic climate-related and structural. Going back to normalcy is feasible. Crisis is cured by certain structural changes and economic climate management measures.

The following diagnosis options have appeared so far concerning the nature of the illness Japanese economy was encountered with at the beginning of the 90s: break, crisis, depression and halt.

### *1.2. Unclear motivation*

The main problem encountered by researchers of the Japanese experience concerning economic and social development is not in the fact that they differ largely amongst themselves, both in Japan and abroad. The main trouble lies in their motivation, in answering the question what actually triggers their views.

In very simplified terms we can say that Japanese economists advocate two main approaches

Less developed countries regard Japanese economic achievements with true admiration. And it is clear why. There is a strong desire in these countries to use Japanese experiences with a view to overcoming poverty. That is where mythical faith in the Japanese concept of development comes from.

On the other hand, many eminent authors in developed countries are sceptical regarding the Japanese economic model. Some even voice fear with respect to its success. Firstly, a country that manages over just a couple of decades to climb the ladder of success to the effect of turning from a pauper into a powerful economic force instils fear of starting to rule some crucial parts of the world's market due to its sudden and high competitiveness level. Secondly, Japan served as a role model for other Asian countries out of which many have

already made their respective “economic miracles” come true. Thus Japan has found itself at *the head of the Asian flock of soaring geese*<sup>1</sup> that have left the rest of the world far behind. Owing to the Japanese economic take-off, the whole of Asia has soared towards high society, thereby creating a tendency for the centre of the world’s economy to get transferred from Europe to Asia.

Again running the risk of overly simplifying things we can say that Japanese authors favour four main approaches to the phenomenon: romantic, realistic, cosmopolitan and synthetic.

“Romantics” are inclined to put the Japanese economic miracle primarily down to the exceptional nature of the Japanese cultural heritage where crucial ingredients are Confucian ethics and Samurai resourcefulness and dedication.

“Realists” claim that Japanese economic success has come as a result of relying on some other economically developed countries, such as England, France and Germany. Their arguments sound convincing. At the time when Confucian ethics and Samurais were at their peak Japan was in economic shambles-on the very bottom of the ocean of poverty, together with other Asian countries. Japan managed to surface from this sea of Asian poverty only when it replaced Confucian dogmas and Samurai knighthood with developed countries’ technology, their economic principles and their profit-making experiences.

However, “romantics” are not without arguments in this debate either. If we maintain that the particular nature of Japanese cultural heritage is not at the bottom of its economic climb then a question remains as to why many other countries in the world are still steeped in poverty. Why don’t these countries achieve their own “economic miracles” by seeking help and relying on the same developed economic factors? Is it by accident that all countries based on the Confucian tradition consecutively accomplished their relative “economic wonders”?

Japanese “cosmopolitans” have taken the easiest way out. They contend that generally speaking profit-making mechanisms all over the world are going through a crisis. Therefore, being a part of the global system, Japanese economy is necessarily undergoing a crisis too.

And finally, those who advocate “synthetic” approach endeavour to account for the Japanese economic route by combining cultural and standard type of economic analysis.

## 2. Analytic foundation: three miracles in one century

Over merely several generations which have been borne on the wings of their traditional mottos concerning *rich country, powerful army*, (*fukoku kyohei*) and *industrial development* (*shokusanogyo*), Japan has converted from

<sup>1</sup> Term taken from: Shinichi Ichimura, *Political economy of Asian and Japanese development*, ECPD, Belgrade, 2002, pages: 26-27.

indigence to a modern post-industrial society.<sup>2</sup> Kazushi Ohkawa and Henry Rosovsky claim that: “No other country in the world’s history has ever reached the status of international significance as quickly as Japan did.”<sup>3</sup> Up until hundred-odd years ago, an “unimportant empire” situated at the hinterlands of East Asia, did not particularly interest those who were occupied by global political and economic affairs.<sup>4</sup>

It was in the last decades of the 19<sup>th</sup> century that Japan stunned the world for the first time. Japan was the first non-European country to have gone through modernisation processes. Within merely several decades Japan managed to dispense with the typical Asian poverty that had been pestering its people for centuries. It formed a modern industry and was now standing side by side with the world’s major economies. The Europeans had taken centuries to cover the same “distance” and achieve the same results

It was after the Second World War that the country of the “rising Sun” startled the world again. That was when Japan achieved its second “economic miracle”. Namely, within two decades Japanese destroyed economy rose from the ocean of global poverty and ascended the world’s economic throne.

On the eve of the last 20<sup>th</sup> century decade this island-empire surprised the world once again. It has fallen into a sort of economic slumber from which it has not been able to wake up for over a decade and a half.

## 2.1. The first “economic miracle”: rising from the halt

### 2.1.1. Achievements

During the reign of Tokugawa (1603-1867), when Japanese economic development research starts, there was barely any difference between the Japanese and other Asian countries’ economies. Japanese economy was backward and old-fashioned and its main branch was agriculture. Peasants accounted for about 80% of the population and they usually owned small properties, covering less than 1ha. They were making their ends meet with great difficulty.<sup>5</sup>

Still during the reign of Tokugawa Japan differed from other Asian countries in the sociological sense. Its urban culture was quite developed. Edo,

<sup>2</sup> Akira Kuroda, “Origins of Japanese production: From Fukoku Kyohei to zero defects”, *SOAS Economic Digest*, School of Oriental and African Studies, University of London, January 1997, Vol. I, No. 1, p. 1.

<sup>3</sup> Kazushi Ohkawa, Henry Rosovsky, “Capital formation in Japan”, in: Kozo Yamamura, Ed.: *The Economic Emergence of Modern Japan*, Cambridge University Press, 1997, p. 204.

<sup>4</sup> Ohkawa, *ibid.*, p. 204.

<sup>5</sup> E. Sydney Crawcour, “Economic Change in the Nineteenth Century”, in: Kozo Yamamura, Ed.: *The Economic Emergence of Modern Japan*, Cambridge University Press, 1997, p. 5.

Kyoto<sup>6</sup> and Osaka were amongst the biggest cities in the world. Between 40 and 50% of the male population were educated to at least some degree.

In the Meiji era (1868-1912) industrialisation was instigated. By the end of the 19<sup>th</sup> century the production of goods and services had been quadrupled. The Agricultural share in the gross domestic product had fallen to less than half. A basic infrastructure necessary for industrial development had been built too. By 1910 factories' production had accounted for 10% of the gross national product (GNP), whilst export reached over 10% of GNP. A seriously poor agricultural country had turned overnight into a world's great industrial force.<sup>7</sup>

### 2.1.2. Creating circumstances for development

A significant turning point in Japanese development was the Meiji restoration in 1868, when under outside pressure shogun system was overturned, the throne was handed over to the emperor Meiji (*Meiji* – “enlightened rule”)<sup>8</sup> and the country was opened for international trade. The Meiji era was a period of great institutional changes. Feudal system was dissolved, caste divisions were abandoned, obstacles for free movement of people were removed, ports opened for foreigners, agrarian and tax reforms conducted, central bank founded

The state played a crucial role in overcoming the centuries' long economic halt. It built roads, railways, conducted other public works, erected factories-role models for entrepreneurs, hired foreign experts, sent the Japanese abroad to learn and get familiarised with modern science, technology and ways of profit-making.

According to Sydney Crawcour, it is crucial that Japan started its economic awakening after more than a century of industrialisation having been underway in Western Europe and North America. Japan thus was able to use the experiences of already industrialised countries.<sup>9</sup> Ohkawa and Rosovsky claim something similar. They contend that Japanese economic ascent had in all of its stages modern Western technology as its foundation. An important moment in this process was the private share rise in overall investments.<sup>10</sup>

These arguments sound pretty convincing. But two questions remain to be answered: first, why had Japan been waiting till the end of the 19<sup>th</sup> century to break the halt and why did they need Western impetus to do so, and second, why was Japan the first Asian country to have set off on accelerated economic growth journey?

<sup>6</sup> *Edo* was initially the name for today's Tokyo. Kyoto (“Western capital”) was the old empire's capital. When the throne was moved to Edo, it was renamed Tokyo (“Eastern capital”).

<sup>7</sup> Crawcour, *ibid.*, p. 1.

<sup>8</sup> Ohkawa, *ibid.*, p. 211.

<sup>9</sup> Crawcour, *ibid.*, p. 1.

<sup>10</sup> Ohkawa, *ibid.*, p. 205.

### 2.1.3. Sociological readiness for the "European type of development"

Japan is the first Asian country to have joined economically highly developed countries, though it was amongst the last Asian countries to have come in contact with the "European type of development"<sup>11</sup> that helped it to succeed. Main reasons for this are: the nature of its inherited social system and the nature of its international position.

Japan was sociologically prepared for a new stream of development. At the time when it started its forcible opening towards the world it had a social system in power much more similar to the Medieval Europe than to other Asian countries' systems. Therefore, it had come closer to the European type of development through self-movements more than any other Asian country. This is quite understandable given that it was the only Asian country that, similar to Europe, had the so called "complete" version of feudalism that had caused the initial accumulation of capital in Europe. So, similar social systems had similar historical effects.<sup>12</sup>

In order for the process of initial accumulation of capital to be completed only a political prerequisite lacked- a development-oriented country. This was finally achieved through an outside impetus. As a result of the foreign powers' pressure the opposition forces started coming swiftly together, they abolished feudal system and created a new country. This new country enabled the finalisation of the initial capital accumulation process whereby Japan switched to the capitalist way of production.

Upon its opening towards the world, Japan was involved in the world's market. This expedited the process of initial accumulation of capital and brought the country in touch with business skills, technology, organisation and all other ingredients of the European type of development.

Even before the Meiji milestone the learned Japanese had realised that Japan could successfully oppose European conquerors only by making use of European tools-industry and science.<sup>13</sup> Whilst the Shogun government was highly sceptical towards everything with European prefix and had held the country over two and a half centuries in a complete isolation from the outside world ("sakoku"), the samurais- who carried out the Meiji coup- brought along their military views and nationalism, but also saw in European profit-making tools, technology and organisation main vehicles for equipping Japan in order to avoid other Asian countries' destiny. At the same time, as Japan had never been colonised, it was, unlike the majority of other Asian countries, spared a humiliating

<sup>11</sup> On the concept "European type of development" see: *Asia-general part*, section "Internal factors".

<sup>12</sup> Perry Anderson, *Lineages of the Absolutist State*, Verso, London, 1974, p. 419.

<sup>13</sup> E. H. Norman, *Origins of the Modern Japanese State*, Random House, New York, 1975, p. 144.

gly oppressive foreign rule and consequently was never infected by xenophobia and resistance of its people towards everything that was European.<sup>14</sup>

To sum it up, Japan mastered the European type of development much easier and quicker than other Asian countries because: it was the only Asian country sociologically “prepared” for the new kind of development; it had a necessary level of independence so that it managed to create a sovereign country as a main lever for creating conditions for an autonomous development; as it had never been a colony, it was spared of the local population’s psychological resistance towards a foreign type of development.

For all these reasons, Japan was “borrowing” technology and money-making tools from the world’s most developed parts much more quickly than any other Asian country.

## 2.2. Second “economic miracle”: ascending to the world’s economic throne

### 2.2.1. Achievements

Economic history knows of no other society than Japanese that over such a long period of time (that is, from 1955 to 1973 in the Japanese case) managed to reach continuously a constantly high economic growth rate, whilst at the same time maintaining a just and equal distribution of fruits of the progress. Average real GNI growth rate was 9.6% per year.<sup>15</sup> Within less than two decades Japan was considered to be one of the world’s most developed countries. Though lacking in natural resources, it grew into a world’s economic giant (keizai taikoku).<sup>16</sup> In the period of this quick economic growth, the Japanese elite long-standing dream came true: Japan had caught up with the Western world, both technologically and economically.<sup>17</sup>

The 1973 oil crisis called a halt to the Japanese fast economic climb. The first immediate consequence came in the form of sudden rise of inflation and rents. High inflation, in turn, brought higher prices and expenses and decreased demand and production. That is how the oil crisis impeded Japanese economic growth rate.<sup>18</sup> Technical progress rate dropped as well.<sup>19</sup>

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<sup>14</sup> Paul A. Baran, *Political Economy of Growth*, A Modern Reader Paperbacks, New York and London, 1968, p. 160.

<sup>15</sup> Yutaka Kosai, “The postwar Japanese economy, 1945-1973”, in: Kozo Yamamura, Ed.: *The Economic Emergence of Modern Japan*, Cambridge University Press, 1997, p. 159.

<sup>16</sup> Ibidem, p. 160.

<sup>17</sup> Ibid.

<sup>18</sup> Mitsuo Saito, *The Japanese Economy*, World Scientific Publishing Company, Singapore, 2001, p. 170.

<sup>19</sup> Ibidem, p. 169.

Still, the oil crisis did not paralyse Japanese economic development altogether. Entrepreneurs were not sitting laid back, doing nothing. They started undertaking some long-term and far-reaching changes in the economic structure. The consumption of petroleum was reduced by means of adopting new technologies, investing in energy-saving equipment and replacing petroleum with other energy sources. The inflation was harnessed.<sup>20</sup>

However, even with the economic growth rate three times lower than it had been in the peak of the progress, Japan managed to achieve yet another "miracle": reducing oil import meant that production expenses went down, which then brought about an increase in the domestic economy competitiveness. Japan now became a country with a high current account sufficit<sup>21</sup>

### 2.2.2. Creating conducive environment for progress

Mitsuo Saito states that Japanese post-war economy continued its quick growth from the pre-war era. In the period 1888-1940 average annual growth rate reached around 3.5%, whilst in the period 1890-1940 it amounted to 3.2% in the US.<sup>22</sup>

Takafusa Nakamura claims that it was precisely the II World War economy that created a good foundation for its quick post-war rise. It was over the II World War period that prototypes of chemical and heavy industry were created and subsequently ended up as a core of the post-war growth. Further, financial institutions founded during the II World War in order to finance the war industry proved to be a basis for financial grouping after the War (kinyu keiretsu). Another thing regarded as the War legacy is the Japanese economy being directed by the state and the Bank of Japan, which is seen as an identifying feature of the Japanese economic rise. The so called seniority wage system was introduced at the time when the control of rents was established and associations of companies emerged as inheritors of Patriotic industrial associations (Sangyo hokoku kai). During the War, the state bought off rice directly from producers and at competitive prices. Nakamura concludes by saying: Though the War memories for those Japanese who lived through it are horrible, the War era can be seen as the first stage of the fast post-war progress."<sup>23</sup> Essentially, it turns out that it was during the II World War that Japanese model of development that was going to prove extremely successful later on, was born.

<sup>20</sup> Ibidem, p. 172.

<sup>21</sup> Shinichi Ichimura, *Political economy of Japanese and Asian development*, ECPD, Belgrade, 2002, p. 8.

<sup>22</sup> Ibidem, p. 11.

<sup>23</sup> Takafusa Nakamura, "Depression, recovery and the war, 1920-1945", in: Kozo Yamamura, Ed., *The Emergence of Modern Japan*, Cambridge University Press, UK, 1997, p. 157.

The post War occupiers undertook a set of measures that proved beneficial for Japanese economic rise: limiting military expenses, right to form unions, introducing right of suffrage for females, agrarian reform, dissolving economic conglomerates – *zaibatsu*<sup>24</sup> and imposing bans on monopolies. Yutaka Kosai sees the dissolution of these conglomerates, along with banning economic power concentration, as particularly conducive for the creation of a concrete industrial.<sup>25</sup>

Changes in the international relations were also conducive for the Japanese economic progress. The States provided Japan with both financial and expert help for rebuilding its economy. Japan got free access to the American market and technologies whilst at the same time had its own market highly protected.

The occupation ended in 1952. Japan was now shaping its own developmental policy, known as Japanese model of development whereby the second “*economic miracle*” was achieved.”<sup>26</sup>

### 2.2.3. Factors of progress: Japanese model of development

Constant debates concerning the Japanese “economic miracle” were fired by the Japanese themselves. They have never officially defined terms such as Japanese progress strategy of Japanese model of development. Just like other peoples of the Chinese civilisation they learned the price of their own dogmas that had kept them at the economic standstill for centuries.<sup>27</sup> When they finally dispensed with these under outside pressures, they started in a prejudice-free way to make use of all those experiences that had withstood the test of time elsewhere. They let foreigners incorporate Japanese solutions into their own theoretical patterns. By means of this a loose definition of the Japanese model of development was created. Its main ingredients are:

- a) *Country of progress*. Japan had a highly-qualified management and authorities who were able to predict directions of the world’s economy and therefore choose those branches that were potentially most profitable and likely to develop. By employing the method of administrative directing (*gyosei shido*) the state influenced big private companies’ key decisions concerning investments and other issues. The power of decision-making was conferred on top business management, governmental authorities and party in power’s high-ranking officials.<sup>28</sup>

<sup>24</sup> Literally: *zai* – fortune; *batsu* – a powerful individual (a powerful person or a family).

<sup>25</sup> Kosai, *ibid.*, p. 164.

<sup>26</sup> Japan’s taking to the industrialisation path during the reign of emperor Meiji is regarded as the Japanese first “economic miracle”.

<sup>27</sup> Hu Jichuang, *A Concise History of Chinese Economic Thought*, Foreign Languages Press, Beijing, 1988

<sup>28</sup> Takatoshi Ito, Hugh Patrick, “Problems and Prescriptions for the Japanese Economy: An Overview”, in: Takatoshi Ito, Hugh Patrick, David E. Weinstein (Eds): *Reviving Japan’s Economy*, The MIT Press, Cambridge, Massachusetts, London, England, 2005, p. 3-4.

- b) *Guided market.* Japanese state market friendly. The state assistance depended largely on the companies' success on the market, principally global market.
- c) *Life-long employment.* Long-term employment and rise of wages proportionate to the number of working years resulted in the workforce dedication and loyalty, as well as their readiness to make sacrifices in those times when their companies were in dire straits. In return for retaining their posts, employees did not even resist technological innovations that normally cut the need for working places
- d) *Export orientation.* The state offered preferential treatments to those companies that were ready and capable to dive into the global economic game.
- e) *Borrowing of technology.* Japan used to borrow technologies<sup>29</sup> but then went so far in perfecting the borrowed technology that by its final products it by far surpassed the technologies of those countries from which they had borrowed in the first place.
- f) *Fairness in distributing national income.* Simultaneously with a high economic growth rate, Japan managed to achieve a high rate of fairly-proportioned distribution of the national income which no other developed country could boast. At the time of Japanese economic rise the Corrado Gini index was lower in Japan than in Sweden. This justness in the distribution of national income contributed to the social and political order in the country, which, in turn, boosted the economic growth even further

This model produced the post-war "economic miracle". Japan managed to achieve such a miraculous economic rise after the War to a great degree owing to its capability to bridge a huge production and technology gap between Japan and the most developed part of the world. This economic rise was accomplished as a result of the following:

- a) Making efficient use of cheap to start with but certainly ample expert workforce;
- b) Fast-growing and in the end very high saving rate, which allowed for domestic financing of economic investments;
- c) Entrepreneurial investments aided by the newest technologies;<sup>30</sup>
- d) Proper state economic policy and building of appropriate institutions which were conducive for economic rise.<sup>31</sup>

<sup>29</sup> Ohkawa, *ibid.*

<sup>30</sup> Ito, Patrick, *ibid.*, p. 3-4.

<sup>31</sup> *Ibidem*

### 2.2.4. “Stepping out” of the handbook type of economy

According to the classic “location theory”, easy accessibility of resources is a main prerequisite for a proper and beneficial distribution of industrial branches. Japan is one of those countries that are lacking in natural resources such as coal, oil, metal ores etc. It does not produce bauxite, magnesite, nickel and phosphate. Therefore, being a country with scarce natural resources, it depends largely on import. Judging by its natural resources accessibility Japan cannot be said to have been predestined for industrialisation, but it has grown into an industrialised country.<sup>32</sup>

Japanese model of development takes credit for this as it proved as exceptionally fruitful, especially up until the oil crisis. Another strong point of the Japanese economy is in Japanese companies’ capability to find ways to strengthen their international competitive power amidst a continuous crisis. By means of this a typically Japanese feature of having companies as its main pillar of development was fortified.<sup>33</sup>

### 2.3. The third “economic miracle”: lapsing into a standstill

In 1990 Japanese economy sank into a standstill. This was when bubbles on the securities and real estate markets burst. On March 20<sup>th</sup> 1990 the Bank of Japan announced a real mess by raising the official discount rate from 1% to 5.25%.<sup>34</sup> The economy lapsed into a deflation that it has not been able to fully recover from ever since.

Japan finally kissed goodbye to “economic miracles”.<sup>35</sup> In the period 1991-1998 economic growth rate was only about 1.2%. The Japanese economy has thus covered a long path of approximately 10% growth rate to 1% annual growth rate.<sup>36</sup>

For over 40 years, between 1955 and 1995, the unemployment rate never exceeded 3%. After 1998, it exceeded 4%. Approximately 2,9 mil people were unemployed.<sup>37</sup> Rents were stagnating, total income and bonuses were going down, health security and education expenses were rising, spending taxes were up. Business units going bankrupt and people getting sacked became a “common place”.<sup>38</sup>

Generally speaking, the 90s remained remembered as “the lost decade”.

<sup>32</sup> Ibid., p. 7.

<sup>33</sup> Makoto Itoh, *Japanese Economy Reconsidered*, Palgrave Macmillan Ltd., Houndmill, Basingstoke, Hampshire, England, 2000, p. 22-23.

<sup>34</sup> Ichimura, *ibid.*, p. 11.

<sup>35</sup> Saito, *ibid.*, p. 243.

<sup>36</sup> Itoh, *ibid.*

<sup>37</sup> Saito, *ibid.*, p. 243.

<sup>38</sup> Itoh, *ibid.*

### 3. The nature of the economic growth standstill

Such a dramatic turning point in the economic situation cannot be satisfactorily explained by one reason only. The length of duration of the third "economic miracle" caused debates not only concerning its nature and causes, but also regarding the sustainability of the Japanese model of development.

#### 3.1. A pause

Some authors, for example András Hernádi, claim that slackening pace of the Japanese economy is not a sign of a crisis but rather a break, necessary in order to find ways to achieve new levels of development.<sup>39</sup> Hernádi maintains that the opinion about the serious crisis of the Japanese economy which is quite widespread both in Japan and elsewhere is largely unfounded. The assessments on the state of the Japanese economy are based on either unreliable statistical data or on misinterpretation of the data. This applies to foreigners; as for the Japanese, they are under considerable pressure from this alleged crisis as they are facing the necessity of adapting to new circumstances. They have to come to terms to a set of unfavourable facts:

- a) The very advanced stage itself of the Japanese economy serves to reduce the growth rate;
- b) The period of abundance resulting from artificially created credits has come to an end;
- c) New challenges have emerged in the form of globalisation and IT technologies which exert external pressure
- d) The traditional system of recruiting workforce and managing them has become outdated; shareholder capitalism has outweighed stakeholder capitalism

This is where Hernádi draws his conclusion from about the current Japanese economic state being more of a necessary overhaul than a crisis. The overhaul is happening gradually, preserving the old tradition but slowly absorbing new trends.<sup>40</sup>

This diagnosis cannot by any means be denied generosity. Hernádi opposes the sweeping doubting of Japanese economic achievements and its capabi-

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<sup>39</sup> András Hernádi, "Japan's Trade and FDI Policies in the First Decade of the 21<sup>st</sup> Century – Facts and Probable Trends", *Working Papers*, No. 152, March 2005, Institute for World Economics, Hungarian Academy of Sciences, Budapest, p. 3.

<sup>40</sup> András Hernádi, "Crisis or Transformation? Japan Viewed from Hungary", in: András Hernádi, Makoto Taniguchi, *Japan and Asia in a New Global Age*, *Working Papers*, No. 114, Institute for World Economics, Hungarian Academy of Sciences, Budapest, May 2001, p. 19-21.

lity to weather difficulties. Still, this poor Japanese economic climate has been in force for a long time now, more than a decade and a half, to be considered merely a pause before yet another renaissance.

### 3. 2. *Crisis of general economic circumstances first and then structural crisis*

An American economist Paul Krugman is the most renowned critic of the “Asian economic miracle”, including the Japanese one. He affronted the Easterners by trying to prove that their economic growth was not based on “inspiration, but rather on perspiration”<sup>41</sup>, that is, that it came more as a result of huge total factor use than high total factor productivity. Krugman summarised the Japanese economic growth path as follows:

“Once upon the time, there was a densely populated island country that, despite lacking natural resources, managed to become one of the world’s greatest industrial powers through its hard work and talent. But a time came when the magic ceased. Following a short, over-heated blossoming, a decade-long decline ensued. The country whose name used to be a symbol of remarkable economic feats has now become the symbol of withered glory.”<sup>42</sup>

The author who was repeatedly awarded prizes for the convincing simplicity of his economic writings has here made a sacrifice to the altar of exceedingly embellished speech by means of overly simplifying the matter.

Krugman belongs to the stream of economists who see the immediate reason for the Japanese economic standstill in general economic circumstances. He is very quick to assert his affiliation. He says about himself that he is: “the most notorious advocate of inflation as a cure for the Japanese economic decline”. He also agrees that Japan has been undergoing some structural problems too: failure to disentangle from a traditional heavy industry phase; education system that favours obedience over initiative and resourcefulness; a system of conducting business that isolates managers of big companies from the market reality. But- Krugman continues to ask himself- do such structural problems have to lead necessarily to high unemployment in order to cure low economic growth? Is the recession a price of inefficiency?

He does not think so, just as Keinz did not. According to him, the following should be done. All the available resources ought to be directed towards solving the structural problems. It is a time-consuming task. But the recession is to be cured by long-term measures in order to retain the workforce employment levels by means of printing money so that investors and consumers could con-

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<sup>41</sup> Paul Krugman, “The Myth of Asia’s Miracle”, *Foreign Affairs*, Vol. 73, November-December 1994, pp. 62-98.

<sup>42</sup> Paul Krugman, “No pain, no gain?”, <http://web.mit.edu/krugman/www/> (January 23<sup>rd</sup>, 2006), p. 1.

tinue spending. In other words, the cure for the Japanese economic crisis is so called managed inflation.<sup>43</sup>

However, the inflation advocates have lost their battle to the mainstream opinion. The winning opinion was advocated by the Bank of Japan and Japanese Ministry of Finance. According to them, re-inflation (restoration of deflated prices to a desirable level) would undermine people's trust in the economic policy whereby the general economic condition would be worsened because there could be created a false sense of recovery. But the recovery would be only short-term. A long-term consequence would be a decrease in pushing towards necessary reforms. According to this view, it is better to administer the bitter medicine forthwith, which is to allow the rise of unemployment so that companies should be able to dispense with redundant workforce on their own, than to procrastinate and delay the day of facing the destiny.<sup>44</sup>

In short, Krugman does not deny the existence of structural weaknesses in the Japanese economy but he thinks that in order to resolve these weak points huge unemployment is not necessary. Structural revival measures are indispensable in a long-run. But current problems are to be solved by short-term general economic state management measures, because, as Keinz used to say, "In a long-run, we are all dead".

### *3.3. Structural crisis followed by the crisis of general economic circumstances*

According to the other school of thought which includes quite a few followers, Japan's main problem comes from deep structural causes: its institutions have failed to adapt to global changes, economy has not made use of new technologies; general rigidness, that is lack of flexibility.

Richard Katz and Frank Gibney, American economists and renowned Japanologists, claim that the current standstill in Japanese economic growth is of structural nature.

#### *3.3.1. Exploiting the Japanese model of development*

Katz claims that the "Japanese model" has simply been spent. According to him the model's main ingredients are: industrial policy, protecting domestic economy against import, big companies' cartels and financing directed through the banking system. As Katz sees it, this model was suitable for a lower level of Japanese economic development. It helped this agrarian and poor country to catch up with leading industrial powers within a record period of time.

But after Japanese economy reached its peak, it stopped. The final outcome was unfortunate and ominous. The Japanese economy did not merely

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<sup>43</sup> Ibidem, p. 2.

<sup>44</sup> Ibidem, p. 1.

stop growing and developing. It was worse than that. It started jeopardising its workforce who it was supposed to be protecting. Rents went down, pensions started decreasing, two million work posts were dispensed with, the unemployment rate (the highest after the war) was still going up. Though Japan was famous for its export-oriented economic pattern, it is the only big industrial power whose foreign trade value compared to the domestic gross product is not any bigger today than it was four decades ago.<sup>45</sup>

Katz sees the main cause of the “Japanese model’s” doom in its economy being “two-fold”. He maintains that the root of the Japanese economic malady is a long-standing policy of protecting the domestic market. He says that the Japanese economy is a classic, school example of an economy that used to blossom owing to the selective use of protectionism, but then it stumbled through not being able to keep up with and adapt to modern changes. Thanks to such policy Japan has built a distorted “two-fold” economy- exceptionally strong exporters and splendidly inefficient domestic production.<sup>46</sup>

How was the “two-fold” economy created?

### 3.3.2. Protecting domestic industry no matter what

This is how Katz explains this. During the 50s and the 60s the government advocated the policy of boosting the industries from the export economic branch, such as automobile production, electronic devices, semi-conductors and machinery. These were at the time so called infant industries. Through temporary protectionism and subsidies these industries managed to take off.<sup>47</sup>

On the other hand, during the 70s Japan expanded its protectionism against import to a variety of other industries that had either lost competitiveness, such as the production of basic steel, or had never been competitive in the first place, such as the production of cement, glassware, oil processing etc. By means of this, Japan took a dangerous turn from helping winners to protecting losers. The protectionism led to a completely moribund state of entire industries. For example, the overall production of the Japanese meat processing industry reaches merely to one third of the productivity of the same industry in the States. And the same industry in Japan employs approximately two million people, more than car and steel industries together. Katz sees domestic cartels as the main reason for such inefficiency, along with monopolistic pricing and other measures directed towards competition limiting. This practice would not be

<sup>45</sup> Richard Katz, “What Japan Teaches Us Now”, *The American Prospect Inc.*, January 9<sup>th</sup>, 1998, p. 1; <http://www.prospect.org/print/V9/40/katz-r.html>, January 23<sup>rd</sup>, 2006, In his criticism of the “Japanese model” Katz went to an extreme in his writing Richard Katz, *Japan: The System That Soured – The Rise and Fall of the Japanese Economic Miracle*, M. E. Sharpe, 1998

<sup>46</sup> Katz, “What Japan Teaches Us Now”, *ibid.*, p. 1.

<sup>47</sup> *Ibidem*

possible now if free import had been allowed which would have made the Japanese market more desirable and competitive.<sup>48</sup>

Similar to Saito<sup>49</sup>, Katz also claims that the 1973 oil crisis was an important factor that largely shaped the Japanese economic flow. However, he regards the crisis' consequences in a bit different way than Saito. Namely, Katz claims that the crisis was followed by yet another resuscitation of protectionism. In aluminium, petrochemical, textile, basic steel and ship construction industries prices were decided upon rather irrespective of the market. And these industries accounted for a half of the entire produce of processing industries and employed around one third of all factory workforce

Fearing the reshuffling of production which could have potentially brought along downsizing and reducing the overall industrial production volume, companies and employees exerted pressure over the state pleading for assistance. The state came back with a positive reply endeavouring to support the companies that had invested billions in now defunct factories and equipment. Katz also states that election considerations and calculations that are deep-rooted in Japanese politics contributed to such a state decision. Cautious not to lose power, the leading Liberal-Democrat Party resorted to protectionism in order to win the employees over and "save working posts".

The other form of protectionism by which the state protected Japanese industry against drop in production was the official approval and green light to so called "recessional cartels" in a wide range of industries. The cartels made it possible for these industries to establish monopolistic prices, volume of production and investments quotas. In the sector controlled by the cartels, though there was no at any point an official ban on import, import was negligible. Indirect support to domestic cartels proved an obstacle to import. Owing to such support, Japanese producers were able to impose much higher prices to their domestic buyers than elsewhere in the world. The price of steel, for example, was by 60% higher than elsewhere, cement by 70%, and petrochemical products by 64%. To which extent these industries were protected is well illustrated by some telling figures concerning the share of import on the domestic market in 1992: only 1.2% of cement, 7% of steel and 8% of petrochemicals were imported.<sup>50</sup>

### 3.3.3. Social security

There is no "state of prosperity" in Japan, but rather "society of prosperity". True, there are state-run programmes regarding unemployment benefits and deposit protection. But scant funds are allocated for these purposes. Social secu-

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<sup>48</sup> Ibid., p. 1-2.

<sup>49</sup> Saito, *ibid.*

<sup>50</sup> Katz, "What Japan Teaches Us Now", *ibid.*, p. 2.

rity in Japan lies on so called “convoy system”. It means that the strong and efficient keep afloat the weak and inefficient. Certain companies and families bear the brunt of social security responsibility. Big companies provide one third of the workforce with “life-long employment”, along with ensuring constant work for small suppliers in times of drop of production, at discount prices though. Rents go down but people are never evicted and thrown out in the street. Banks that find themselves on the brink of bankruptcy get merged with bigger banks

But this philosophy on “sharing difficulties” leads to a systemic inefficiency. If a bank cannot be let go bankrupt, its debtors cannot either. If posts are secured not by transferring people to work somewhere else but rather by keeping them on payroll, companies cannot be let decline and close down either. High prices in Japan are just a form of the hidden unemployment and they serve as a mechanism for distributing income at the advantage of the inefficient and to the detriment of the efficient.<sup>51</sup>

### 3.3.4. Caught between a rock and a hard place

This hidden form of social protection could be maintained all the time whilst the highly-efficient export sector was able to subsidise the inefficient domestic sector. But as from the end of the 80s the export sector could no longer bear the same burden. It was caught between a rock and a hard place: on the one hand, it was under huge pressure from high domestic expenses, and on the other hand the pressure came from the Yen boost of value. High value of the currency was a means to harness the rise in trade sufficit.

As there was no proportionate rise of import, trade sufficit levels were preserved. It became a source of problems for Japan. For economic reasons the rest of the world could not stand the Japanese trade sufficit higher than 2 or 3% of the Japanese gross domestic product. If Japan wanted to import 20% of its GDP it could export 22-23% of GDP

So, what happened given this foreign trade policy of Japan?

When trade sufficit reaches 2-3% of GDP the Yen has to go up in order to slow down the export. And so the Japanese economy keeps going round and round: trade sufficit rise causes the rise of the Yen. The rise of the Yen slows the export down. Trade sufficit is thus reduced. The Yen goes down again. Export is on the increase, followed once again by an increase in trade sufficit

What happens next?

Katz says: “This is a big irony. Japan is trying to boost the economic growth by means of boosting export whilst at the same time, because of the protectionism it keeps relying on, it is the only big country that, compared to

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<sup>51</sup> Ibid., p. 3.

its GDP, does not export today more than it used to several decades ago." And finally, protectionism-which enables the rise of prices in the country-hinders the export of cars, computer chips and other goods. That is why capable Japanese companies which are export-oriented keep moving their factories out of Japan into other countries.

And what is the final outcome?

Protectionism, which is among other things justified by the protection of work posts, causes the export of the most expensive and most productive working posts to other countries. Several millions of work posts have been abolished in industries. Another piece of irony is in the fact that the majority of these work posts have been dispensed with in high-productive and export-oriented industries. Thus, by means of pushing the export sector away the dominance of low-production sector in the economy is increased. This, in turn, impedes the economic growth of the country. Katz claims that even if Japanese economy were to work today to its full capacity the highest growth rate it could count on would be 2% – which is half the rate from the period 1975-1990.<sup>52</sup>

### 3.3.5. Economic anorexia

According to Katz, one of the most important reasons that explain Japan's continuing poor economic growth rates is the "cartelisation" of its economy, which Katz sees as an important ingredient of the Japanese economic model. That is the reason why in Japan high prices and high profit go hand in hand. That explains as to why "the share of workforce in the national income is too low whilst the share of capital is too high". A natural consequence of such unequal distribution of national income is a sort of "economic anorexia" – chronic decline in domestic economic demand. Companies still keep saving by the same rate as they used to in the time of intense economic growth. However, with the decline in the growth rate, the need for investments drops too. There are fewer opportunities for companies now to invest in domestic economy. Every year the cash surplus worth approximately 3-4% of GNI is spent on buying property in the country and abroad.

It is not true that the Japanese could not figure out a potential solution. The Haruo Maekawa Commission recommended switching to a type of economy "driven" by demand. But first a difficult task from the political viewpoint would have to be accomplished: abandoning the cartelisation. Instead of doing this the state pumped into the economy some "monetary hormones" whereby the bubble from the end of the 80s was prepared. A huge number of irrecoverable credits were thus created. Japan lapsed into a financial crisis. The crisis is not a cause to its economic malady but rather its symptom

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<sup>52</sup> Ibid.

In short, Katz's expose marks the following as the main reasons of the Japanese economic standstill: protectionism, monopoly on the domestic market and insufficiency of effective demand.

Still, Katz attaches the biggest importance to protectionism. And in order for Japan to run away from it, two conditions ought to be met:

- a) Creation of a social security system that would be able to cushion the economic dynamics' consequences, and
- b) Equal distribution of foreign trade profits.<sup>53</sup>

### 3.4. Harmful effects of a "country of progress"

American economists are obviously worried about the same issue, which is Japanese protectionism. Gibney differs a bit from Katz in his considerations on the topic.

According to Gibney, competitive private companies went in Japan arm in arm with a strong state influence over economy. And all went well whilst the two sides implemented the selective export policy in order to catch up with the Western countries. The joint enterprise proved a success. However, the success did not last.

- a) Teaming of bureaucrats and entrepreneurs created interest-driven groups. A myriad of new regulations were brought with a view to making the access to the Japanese market very difficult for new companies, especially foreign ones. Big companies allied within so called *keiretsu* groups, and various trade associations were dictating trading terms.
- b) Japan relies also on "cultural protectionism" whose advocates claim the Japanese culture is essentially different from any other. That is why the Japanese wishes and needs can be successfully met exclusively by domestic producers. Therefore: "Buy Japanese!"
- c) Everything is strictly prescribed in Japan. As from the Meiji restoration onwards trade has been conducted within a "capitalist, progressive country". Within such a system, companies are engaged in the same sharp competition as those in Western countries are. But both labour and capital operate jointly within the prescribed industrial policy.
- d) Japanese consumers were used to buying exclusively Japanese products, at prices far higher than those on the world's market.

But everything comes to an end. Japanese entrepreneurs at one point became clear that the Japanese economic system had rusted away. As they saw it, in order to revive it, the following ought to be done:

- a) Boosting of the domestic demand, and
- b) Opening of the Japanese market

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<sup>53</sup> Ibid.

In essence and officially the authorities went in for the same. Still, like everywhere else, Japan had its own approach on this matter too. What is regarded as "deregulation" in the West, is referred to as *kisei konwa* in Japanese, which does not mean (as it does in the West) the abrogation of regulations, but rather "mitigating the legislation". It is obvious that Japan is not ready to renounce the "country of progress" pattern.<sup>54</sup>

### 3.5. "Economic maturity"

A Singapore economist Chong Yah Lim explains the slackening pace of Japanese economy by the very fact that it has become a "mature economy". And it is a known fact that all mature economies have far lower economic growth rates that Japan used to have over the period of "economic miracle". Still, this is only an empirical finding, not an explanation. The question remains as to why "mature economies" have to slow down their progress?

Lim – who refers to these economies as "elephant-economies" – offers a picturesque explanation. Elephants are inert because they eat a lot. In the same way, when a country reaches a high level of development it starts spending a lot and investing less and that is why its pace becomes less brisk. "As these countries are alike elephants, they spend a lot. Their saving rate is low. Their population is ageing. If their investment rates are low, then economic growth rates should be expected to be low too."<sup>55</sup>

However, Lim does not dispel all of our dilemmas either. To a degree, Japan stayed elusive to him as well. It is correct that the investment rates have become relatively low in Japan, but not as a result of the saving rates being very low through an excessive spending. Once again, Japan diverges from usual explanations: inclination towards spending is still low in Japan; there is high proneness to saving and low investment rates in domestic economy.

### 3.6. "Depression"

Shinichi Ichimura maintains that it was at the threshold of the 90s that the Japanese economy lapsed into depression. He underlines that Japan "is dangerously steeped in depression caused by a break heralded by the Bank of Japan when March 20<sup>th</sup> 1990 official discount rates were increased from 1% to 5.25%. (...) The recession that had been in force from the beginning of the 90s now took on a shape of depression." As a proof that Japan is dealing with a depression Ichimura cites a significant decrease in economic growth

<sup>54</sup> Frank Gibney, "Introduction", in: Frank Gibney, Ed., *Unlocking the Bureaucratic Kingdom*, Brookings Institution Press, Washington, 1998, pp. 3-5.

<sup>55</sup> Lim Chong Yah, *South East Asia – A long Road Ahead*, Second Edition, World Scientific Publishing Co, Singapore, 2004, p. 373 and 375.

rates, though these still stayed positive. As he sees it, “the main reason for this extended recession was the loss of trust amongst the business and financial sector entities, incurred by a sharp drop in real estate prices and consequently harsh, negative consequences for their wealth”.<sup>56</sup>

It is interesting that Ichimura sees the economy not being able to “get back to normalcy” as the reason for regarding a long duration of low economic growth rates as a depression.

### 3.7. “Permanent crisis”

Makoto Itoh advocates a view that Japanese economy is in the state of “permanent crisis”. He says that “soaring economic growth now resembles an ancient fairytale about miracles, though it happened in reality only recently”. Japanese economy has been going through an incessant decline as from 1973 to the day. Itoh refers to it as a “permanent crisis”. For the duration of the decline two downward turning points happened: high economic growth started to decline and switched first to lower, and then to completely low growth during the 90s. On both occasions the outcome was a growth lesser than a half previous growth.<sup>57</sup>

Judging by his approach upon analysing Japanese path of development Itoh can be classified amongst Japanese “cosmopolitans”, being at a greater distance from Japanese “romantics” than from “realists”. In his analysis he does not take into account the “uniqueness of Japanese culture” as one of the factors of its economic progress. His starting point sees the Japanese economy being one part of the world’s global economy encompassing all the developed; therefore, Japan shares with the rest of the countries a general crisis in the ways of profit-making on which this global economy is founded. That is why he relies on the standard economic analysis when analysing Japanese economy. As the economy of the developed is undergoing a crisis worldwide, Japanese economy cannot avoid the crisis either.

In accordance with the standard economic analysis, Itoh sought to cast a light on both sides of the Japanese economy – “strong” and “weak”. Still, in his analysis he has not escaped the necessity to acknowledge some particular features of Japanese economy compared to the economies of other developed countries.

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<sup>56</sup> Ichimura, *ibid.*, p. 9.

<sup>57</sup> Itoh, *ibid.*, p. 4.

#### 4. Strong points of the Japanese economy

##### 4.1. *The Yen adventure*

Itoh is one of the few Japanese economists who understood the foreigners' difficulties to get to the bottom of all the peculiarities of the Japanese economic and social development and who managed to lead them through Japanese economic paradoxes.

One of these paradoxes is conversion of a strong global market blow into an opportunity to penetrate that same market. Itoh illustrates this clearly by the 1973 oil crisis case. Sudden increase in petroleum prices caused a sharp increase in trade deficit and steep drop in economic growth, as the coefficient of independence from energy import was very high. Japan is the only country that managed, precisely owing to the petroleum crisis, to replace its trade deficit with a high trade sufficit.

How Did Japan succeed in this?

Itoh offers the same answer as Mitsuo Saito: Japan overcame the petroleum crisis and turned into a country of sufficit by means of boosting its economy's competitive power. The following question to be answered is: How did Japan manage to increase its competitiveness amidst crisis-coloured conditions? A rhetorical answer that imposes itself is very simple: in the "Japanese way". Analytical answer is much more complex as it diverges from all usual understandings of the economic science.

Namely, as states Itoh, according to a typical, school analysis, domestic currency has a tendency of going up in the circumstances marked by floating foreign currencies and trade sufficit. Owing to this rise of value of domestic currency, foreign currencies are now worth less when exchanged for the domestic currency, which leads to two-fold consequences: facilitation of import and hindering of export. By means of this balance of payments is stabilised. However, Japanese experience one again stood out and differed from economic handbooks' examples. Japanese answer to the oil crisis and increased value of the Yen was not the usual stabilising of the balance of payments. The answer was much deeper: boosting of the Japanese industrial competitiveness.<sup>58</sup> But, how was this possible?

Here is the answer. Thanks to the employees' quick consent Japanese big companies swiftly resorted to the automated type of production and management in order to increase their competitiveness. Workforce in big companies and unions consented to this process of automatisisation and changing of the

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<sup>58</sup> Ibid., p. 20.

working posts structure for the following reasons: a) big companies offered “lifelong employment”; b) unions were organised in companies; c) though transferred from one post to another, employees would remain with the same company; d) upon the introduction of new technologies, wages were still decided upon based on the number of working years. As a result of such system of relations within companies Japanese economy reached the highest level of factory automatisisation in the world. For example, 60% of the entire number of produced robots was installed in Japanese factories in 1986. There were 175 000 robots in Japanese industry in 1988, which is 5 times more than in the US and ten times more than in Germany.<sup>59</sup>

Simultaneously with the introduction of increasingly new technologies, the process of ever-growing working discipline was underway and it was built and maintained through special groups such as Quality Control Group (QC) and a movement “Poka Yoke” (zero waste).<sup>60</sup> Within ten years as from the beginning of depression in mid 70s the productivity in Japanese processing industry was more than doubled. Effectively, it was growing more intensely than it used to during the economic rise period.

What happened? Japanese companies managed to increase their international competitiveness as a result of the quick growth of labour productivity, owing to which they succeeded in overcoming the consequences of the petroleum crisis and the Yen inflation. Not only did economy start making surplus in foreign trade but it was also increasing it, especially as from the mid 1985. This was helped by the dollar inflation that happened the same year. So, the Yen inflation did not hinder the Japanese trade sufficit growth.

But how was it possible for the trade sufficit to rise even though the Yen inflation was underway? Precisely due to the Yen inflation expenses for the import of energy and precursors were reduced because now, expressed in Yens that had inflated, these expenses were cut too. So the total value of the import expressed in Yens dropped. This contributed to a significant rise of the sufficit. Export did not decrease significantly because Japanese companies had increased their competitiveness. Still, the increased trade sufficit served to boost the Yen inflation even further. A “vicious circle” was thus created.

The final outcome was the following: Japanese trade sufficit and foreign currency reserves became the highest in the world. At the same time, Japan became the biggest creditor. How? It was made possible by means of investing a major part of the sufficit in buying securities in the US which became the biggest debtor country.

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<sup>59</sup> Ibid.

<sup>60</sup> Akira Kuroda, “Origins of Japanese production: From Fukoku Kyohei to zero defects”, *SOAS Economic Digest*, January 1997, Vol. 1, No. 1, p. 1-2. *Poka-yoke* literally means *preemption of mistakes* (*poka* – mistake; *yokeru* – preemption).

At the same time big Japanese companies' financial status was considerably improved. How? By introducing modern electronic IT technologies big companies managed to increase their work productivity without major investments in factories and equipment. Higher profits that were made were not invested in their entirety in permanent capital. Companies were able now to use part of their reserves generated by profits and resources made available through stock emissions in order to pay off old debts. That is how the companies' excessive indebtedness incurred in the period of intense growth was terminated.

Another consequence resulting from the continuing Yen inflation that was based on the increase in Japanese industrial companies' international competitiveness was the quick growth of the Japanese GNI per capita, expressed in US dollars. Owing to this, Japan exceeded the States in its GNI in 1987 too. Amongst the most developed countries only Switzerland was in front of Japan. This is how the long-awaited Japanese goal was achieved and even more importantly, it was achieved during a constant economic crisis in 1973, therefore, in an unlikely time and largely due to the Yen inflation.

At the end of the 80s most of the Japanese were glad to share with the rest of the world the impression that Japan had become the leading economic power in the world. Proportionately low unemployment rate boosted the picture of Japan as a country of successful economy.<sup>61</sup>

#### *4.2. Climb on the wings of Fordism*

Two new questions are to be answered now: first, on what intellectual basis did the Japanese economy reach the "world's throne"; and second, why did it descend it?

Economists differ in establishing Japanese economic policy theoretical coordinates. Many saw the policy as Keynesian. Some of them, for example Krugman, claim that Japanese economy lapsed into a crisis precisely because it did not rely on the Keynesian therapy,

Itoh states that Japanese economic policy was closer to Fordism than to Keynesianism in the period of rise.

Undoubtedly, the opinion prevailed after the II World War that full employment and sustainable economic growth could be achieved only through the effective demand policy. It cannot be denied that this policy had been effective up till 70s, when the profits started going down, amongst other reasons because Western countries, in order to achieve full employment, had switched the monopoly on the labour market from foreign demand to supply whereby they contributed to rising production expenses.

Itoh states that there is no proof that the Keynesian policy was ever implemented in Japan. Fiscal policy was not used in order to boost economic

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<sup>61</sup> Itoh, *ibid.*, p. 22-23.

growth. But the truth is that the state relied on public expenses incurred by the infrastructure construction works, such as ports, roads and railways. But on the other hand it is also true that the state did not rely on so called deficit financing as recommended by the Keynesianism. The state budget was in sufficit, rather than in deficit. The question remains as to how it was possible that Japan stood out from the rest of the world again.

Itoh explains it in this way. The sufficit was generated by “natural growth” of tax income that came as a result of an economic climb much quicker than expected. So, Japan found a way to ensure economic growth relying on voluminous public expenses but without deficit financing.

The following question jumps out now: If the Keynesianism is regarded as a cure for economic standstill, how come it was not capable of curing the crisis and depression that arose after 1973?

Itoh sees the Japanese economic policy at the time of economic rise being intellectually closer to the French regulation school than to Keynesianism. But the demand was not generated through the Keynesian policy of deficit financing but rather through a “social contract” between labour and capital. According to this “contract”, whether it was concretely written or tacit, the increase in rents was proportionate to labour productivity growth. This is referred to as “Fordism” and is named after the model relation between labour and capital that was in force at the Ford factories, its main features being high labour productivity and high rents. By means of this so called “circle of good” (*circulus virtuosus*) was boosted.

What are, therefore, main differences between Keynesianism and Fordism? Namely, in Fordism necessary effective demand was not generated by public expenses but rather by labour households’ increase in expenses, since real rents were going up proportionately to the productivity growth.

Indirectly, Itoh considers the Fordism to be the explanation for the creation of the Japanese “economic miracle”. During the period of intense economic growth Japanese unions exerted pressure through so called “spring offensives” (*Shunto*) and raised rents. By means of this, effective demand of labour households was increased. Facts corroborate this view. Between 1950 and 1970 the processing industry was on the increase at the rate of 9.7% per year and real rents went up at the annual rate of 5.7%. The Japanese growth rate at the time depended on the expansion of the domestic, not foreign market. Export coefficient (export/DGI) was merely around 10%. The increase in real rents, along with the simultaneous employment boost, was decisive factors in the domestic market expansion.<sup>62</sup>

However, Japan does not fit here either in the same patterns as other developed countries. Its Fordism was not as articulate as the Western one. There

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<sup>62</sup> Ibid., p. 7.

was no explicit "social contract" in Japan on indexing the rise of rents and productivity.<sup>63</sup>

The question remains as to what happened to the Japanese Fordism.

## 5. Weak points of the Japanese economy

Itoh claims that two weakest points of the Japanese economy are: aggravating living standards and fiscal crisis.

### *5.1. Aggravating working and living conditions*

The economic crisis that according to Itoh started in 1973 and has lasted ever since has had a two-fold detrimental effect to human resources: aggravating working and living conditions and growing inequality in the distribution of national income. As opposed to the time of intense prospering, the disproportion between high productivity growth and real wages standstill was on the increase in the time of crisis. Between 1975 and 1985 productivity in the processing industry grew even faster than in the period of economic climb, whilst real rents grew much more slowly. So, the Ford-ian pattern of the growth of solvent demand (through the growth of real rents) being proportionate to the growth of labour productivity, had been abandoned.

Japanese companies were no longer so generous in their distribution of the fruits of labour productivity which used to be to labourers' advantage. They used labourers' loyalty to increase productivity, boost global competitiveness, strengthen financial position and create reserves of purchasing capability for financial operations (*zaitech*). At the same time, companies reduced wages in various ways: limiting the number of permanent, full-time employees, cutting the cost of overtime hours, benefit payments, even rents. Unions' position was weakened. Hard labour was no longer rewarded. By means of employing these measures companies managed to make sufficit and facilitate the Yen inflation. Export-oriented companies were forced to save on workforce expenses and keep continuing "rationalisation". A new "vicious circle" was thus closed: increasingly difficult working conditions, amounting competitiveness of companies, further Yen inflation and further "rationalisation" based on labourers' dedication.

An important method of "rationalisation" in Japanese companies was cutting the share of "permanently employed". The "temporarily employed" were cheaper, that is those who did not work full working hours, such as re-employed housewives, people fired from some other companies, foreigners without working permits and similar. Unions entailed only permanently employed members. Their foundation and negotiating power were on the

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<sup>63</sup> Ibid., pp. 6-9.

wane. For all these reasons it was not possible for labourers to oppose the “rationalisation” that entailed downsizing, especially amongst the permanently employed, reducing any supplementary sources of income and real rents. Gaps in wages are on the increase everywhere.<sup>64</sup>

Foreign observers, used to regarding Japan only as a country of full employment, were now witnessing in disbelief the growing unemployment in Japan. Admittedly, the official data showed that unemployment rate in Japan stopped at 4.5-5%, which still made it half the Western European unemployment rate. However, if the Western European methodology for calculating unemployment rate were to be applied, the Japanese rate should be multiplied by two. So it follows that Japanese unemployment rate in reality reached 9%, the same figure that applied to the Western Europe.<sup>65</sup>

During the “bubble economy” period at the end of the 80s the gap between respective material status of the rich and poor was expanding, as well as differences between rural and urban areas. The Japanese were starting to cast back their minds with nostalgia to the times of economic rise that was accompanied by a high rate of the equity of distribution and the belief that the entire population had become “middle class”.<sup>66</sup> Japanese neo-liberal restoration had aggravated the Gini index situation.

## 5.2. Fiscal crisis

Another weak point of the Japanese economy is fiscal crisis. Japan is very peculiar on this matter too. During its economic ascent Japan had a balanced state budget. So, a high rate of economic growth was achieved without having any deficit financing. After 1973 Japan was lapsing more and more into budget deficit. The total long-term public debt rose from 6.5% of the GNI in 1973 to 66% in 1999. The state short-term debt added to it, the entire amount of the public debt soared to 101.2% of the GNI. Also, 65% of income tax in 1998 was soaked up by the public debt interest rate. Therefore, the state resorted to measures that aggravated living conditions: cutting social investments and introducing spending taxes.

At the same time, the state was increasing public expenses in order to help construction companies and save banks and other financial institutions. Simultaneously, the official interest rate was reduced with a view to relieving the pressure from paying off the public debt, banking and other financial institutions’ debts. Thereby, living conditions for the elderly aggravated as they were counting on savings interest rates as their source of income. Big com-

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<sup>64</sup> Ibid., p. 25.

<sup>65</sup> Makoto Itoh, “The Japanese Economy in Structural Difficulties”, *Monthly Review*, Vol. 56, No. 11, 2005, p. 8; <http://www.monthlyreview.org/0405itoh.htm> (February 17<sup>th</sup>, 2006)

<sup>66</sup> Itoh, *Japanese Economy Reconsidered*, *ibid.*, p. 25.

panies, which made use of tax relieves, continued their investments abroad without paying any taxes domestically.<sup>67</sup>

There is an economic law that not even the Japanese managed to avoid: *everything comes at a price and every price has to be paid by someone*. The price of success is paid by workforce. As Itoh states, as from the mid 70s living conditions have not improved significantly. Everything was denominated in Japanese Yens. Real wages were almost at a standstill. True, when compared to the international level, they seemed to have tripled. But the point is in the fact that the Yen inflated against US dollar from 360:1 in 1971 to 120:1 in the 90s. This example illustrates tellingly how difficult it is to measure wages and wealth.

However, the Japanese were forced to confine the practice of growing equality of distribution from the period of economic rise to a trunk of great long-gone memories.

### 5.3. Principal causes of "permanent crisis"

As Itoh sees it the principal causes of such crisis were: "complex depression", relocation of industry that is, "de-industrialisation", drop of demand and redundancy of capacity, demographic decline.

#### 5.3.1. "Complex depression"

Itoh refers to the situation in Japanese economy as "complex depression", that is, a decline in not only general economic flows but also in property value and stocks. The fact is that the burst of the "economic bubble" was followed by a deflationary spiral of stocks and real estate prices, which caused a financial chaos and a complete standstill of economic growth. The assets' prices spiralled downwards by thousands and thousands billion of Yens. Financial institutions were struck severely by such deflation. These were particularly jeopardised by a sharp drop of mortgaged real estate prices whereby huge amounts of credits and loans taken from banks had become irrecoverable. The total value of irrecoverable credits in 146 banks in 1998 reached 12.3% of the entire amount of credits these banks had given in the first place. Additionally, the Basel Committee had increased the coefficient of its own capital to 8% of the entire assets precisely in order to ensure protection against irrecoverable credits risk. Thus the banks' manoeuvring space was even further limited. By means of this small and middle companies were particularly struck as they were relying heavily on bank credits.

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<sup>67</sup> Ibid., p. 26.

### 5.3.2. De-industrialisation

The Yen inflation boosted Japanese investments abroad, primarily buying foreign securities and then also direct investments. In other Asian countries land, workforce and precursors were cheaper so that production in these countries was more fruitful than in Japan. Thereby, Japan was increasing its international competitiveness. Japanese companies were forced to relocate their factories to other countries through the Yen inflation and the drop in domestic demand incurred by inflation. The absolute number of working posts in Japanese industry has been on constant decrease as from 1993. Up till 1998 1, 8 mil of working places, or 12%, had been lost. Therefore, through indirect investments industry has been moving out of Japan.

The service sector has been blooming. As from 1993 60% of the workforce has been employed within the sector. However, the international service competitiveness is very low. Japan has been recording constant deficits in the service trade. "This is how de-industrialisation of the Japanese economy, accompanied by the boost in service areas, has led to a drop in the economic growth rate."<sup>68</sup>

### 5.3.3. Drop in demand and redundant capacities

The third structural mishap of the Japanese economy is the combination of the drop in demand and redundancy of capacities. Deflation caused the demand for various goods to drop. Consumer demand was decreased by companies going bankrupt, workforce sacked, wages and other sources of income cut. Spending tax was introduced as well. The utilisation of the processing industrial capacities in 1993 was reduced by 17% compared to 1990. Once the bubble burst, it kept declining.<sup>69</sup>

The government did not realise the significance of the consumer demand. Instead of boosting it, the government invested huge funds in saving stumbling banks, other financial institutions and construction companies. The outcome was opposite from the expected. Instead of boosting economic flows, deflation was encouraged as there was a surplus of residential and other premises, as well as processing capacities.<sup>70</sup>

### 5.3.4. Demographic decline

Just like other industrialised countries, Japan has to face the consequences of its ageing population. So on the one hand it has seen an increase in social expenses whilst on the other hiring of new staff is happening to an increasingly less

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<sup>68</sup> Ibid., pp. 26-32.

<sup>69</sup> Ibid.

<sup>70</sup> Ibid.

degree.<sup>71</sup> This trouble is all the more prominent in Japan as there is a distinct resistance to importing workforce from other Asian countries. The question is whether Japan has been preparing itself for a zero growth rate model of economy.

#### *5.4. Itoh's paradox*

There are only few Japanese authors who keep criticising Japanese path of development like Itoh does. But at the same time there are few Japanese authors who have "enlightened" with such conviction the "strong points" of Japanese economy either. He did it at the cost of certain methodological inconsistency. Though he keeps highlighting the standard economic analysis, he could not avoid acknowledging the peculiarities of the Japanese path of development. The best proofs for this are: first, the fact that Japan used the Yen re-valuation to bridge the chronic balance deficit and convert it into a chronic sufficit, and second, Japan used the oil crisis for its economy's technological take-off and increasing its international competitiveness. These are the successes never repeated by any other country since.

### **6. The end of emulation-the end of "economic miracle"**

Japanese economist Saito displays his impartiality on the matter once again. He is one of those scientists who neither try to cover up for faults of the Japanese path of development neither do they take part in the trendy "myth busting".

#### *6.1. Not all that glitters is gold*

The fact is that what drew the world's attention to Japan in the first place was precisely the steep increase in wages per capita denominated in dollars.

Saito reminds that high economic growth rates do not necessarily mean an increase in general welfare of the population. Not even a high average GNI per capita is sufficient. Qualitative factors have to be taken into consideration: means of distribution, state of the living environment, health care, social insurance and stability, accommodation and living conditions, urban living conditions etc. The Gini index in Japan was amongst the lowest in the world. But at the same time the living conditions and state of the living environment are invidious when compared to the Western developed countries. Main factors that have contributed to the aggravation in the state of the living environment are: quick industrialisation, overpopulation and sudden rise of motorisation. It was only in the 70s that Japan started undertaking measures in order to protect the living environment.<sup>72</sup>

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<sup>71</sup> Ibid.

<sup>72</sup> Saito, *ibid.*, p. 13.

## 6.2. Waning “economic miracle”

Saito never questions Japanese qualities which have brought about the Japanese “economic miracle” and which have been so persistently insisted upon by the Japanese “romantics”. However, his analysis of the Japanese path of development is much more convincing than theirs. Endeavouring to explain the slackening pace of the Japanese post-war economic growth, Saito (like many other Japanese economists) takes into consideration these two factors as the most important: a) the 1973 oil crisis that is seen as the turning point in Japanese economic flows, and b) catching up with the most developed countries.

Saito repeatedly highlights the 1973 “oil crisis” as the hardest blow for the Japanese economy after the II World War. This blow intercepted the take-off of the Japanese economy referred to as “economic miracle”. Still, Japan survived the oil crisis better than any other industrialised country. Though the Japanese economic growth rate was halved through a sudden increase in energy prices, it remained almost twice as high as in other countries. But the reality is that after the oil blow the Japanese economic growth pace was no longer an “economic miracle”.

Almost all other Japanese economists see “catching up with the developed” as one of the reasons for Japanese economy slowing down, amongst them many foreign economists too, for example Lim. But there has been no explicit theoretical explanation as to why catching up with developed economies would necessarily have to lead to the Japanese economic cul-de-sac. Not even “the economic maturity”, invoked by many as a reason for ending the “economic miracle”, is a convincing reason. The US economy is even more mature than the Japanese, but it still has not fallen into the same kind of inertia

Saito – it is not clear whether on purpose or unintentionally- offers one quite logical explanation to the effect of spending the “Japanese model”: the end of opportunities for imitative development. He explains comprehensively the way Japan managed to catch up with the West by means of using the Western ready-made experiences and technologies. When the opportunities for imitation were exhausted, Japanese economic growth started slowing down.<sup>73</sup>

Therefore, it stems from Saito’s explanations that imitation tactics were fruitful in the process of “catching up” but that at the same time imitation did not suffice in keeping up with the West. Original solutions are called for now. And these are reached through lots of expense, hard work and time, even in Japan.

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<sup>73</sup> Ibid.

## 7. Criticism and ethics

The analyses made by critics of the "Japanese model" sound convincing. But at the same time they have a number of weak points, enough to cast doubt over their correctness.

Similar to some other economists, among them some Japanese too, Katz states that the Japanese economic model was fruitful over the period of catching up with the most developed countries. When Japan caught up with these countries its model stopped working. However, Japanese "economic miracle" grinding to the halt shortly after the role models had been caught up with is an empirical finding, not a theoretical explanation. The question remains as to why other countries that found themselves at the roughly same level of economic development as Japan after the II World War did not use the "catching up with the developed" for the purposes of quick industrialisation as Japan did.

The explanation that states the "economic miracle" stopped through "two-folded nature of economy" appears convincing. But the explanation as to why Japanese economy grew "two-folded" in the first place is not remotely that convincing. If we accept that highly-efficient export-oriented industries were founded through the state assistance that entailed protection against import and subsidies in order to help these industries, it remains unclear as to why other industries stayed low-productive despite the fact that the state protected them equally against import and ensured indirect subsidies by means of enabling high prices.

Also, many other countries implemented the policy of boosting export through protection against outside competition and offering subsidies, but these still remained poor. And if the Japanese model is indeed so faulty, as Katz's findings indicate, then how is it possible that the same model within merely two and a half decades managed to turn a poor, agricultural country into a leading world's industrial powers

In short, a question remains: if the "Japanese model" is inadequate but still enabled Japan to catch up with the most developed countries, why have not other countries, which are still poor, managed to achieve the same?

Many critiques of the Japanese path of development put together by foreign authors are marred by a shadow of partiality. The suspicion to the effect of bias arises from their constant endeavours to break down the "Japanese myth" at any cost. Essentially, what often stands behind such intentions is fear of the Japanese economic power growth. Krugman admits to it openly.<sup>74</sup>

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<sup>74</sup> Krugman, *The Myth of Asia's Miracle*, *ibid.*

## 8. Analogies

Though analogy is not a scientific method (*Comparaison n'est pas raison*), it is not unwise to make use of it. It appears to be helpful in better understanding of the Japanese economic adventures.

By force of circumstances, Japan had roughly the same path of development as Western Germany. Both countries embarked on the industrialisation journey relatively late. In both countries state played a key role in forming modern economy – “Junker capitalism” in Germany and “Samurai capitalism” in Japan.

Both countries achieved their respective “economic miracles” following the II World War. Both stuck to a similar model of market economy: “social-market” economy in Germany and “guided market” in Japan.

In both these countries highly-expert state authorities were able to predict the directions of global economic flows and consequently choose those industrial branches that were most likely to succeed on the global market and invest huge funds in them. Japan had another huge benefit of having a free access to the US market and technologies whilst at the same time being able to protect its own industry in the time of its take-off through various high customs and tariff hurdles.

Being a defeated country, the same as Germany, Japan had no military expenses. All the resources were therefore directed to the economy. For this same reason Japan, again the same as Germany, considered economic progress to be the only way for rehabilitation and return to the world's stage

When these goals were achieved there was no more collective motivation to incite collective effort, labour and sacrifice. Both Japan and Germany had to confine their “economic miracles” to economic historians. However, both countries are still considerable economic powers today.

## 9. Concluding considerations

Several facts have to be considered upon producing an over view of the Japanese path of economic progress.

Namely, economic history has seen no other country that covered the distance between indigence and the state of being one of the world's richest countries in less than a century and a half. Also, being a country poor in natural resources, Japan is the only country to have built its wealth almost exclusively through its own labour and knowledge. Japan based its industrial progress on borrowing technologies. In the meantime, by developing its own scientific and applied researches, it joined the club of leading technological powers.

It seems that slackening pace of Japanese economic flows is neither recession, nor a usual crisis, nor depression. Poor economic flows have been in force for too long to be considered a recession. Obviously it is not a depression either because Japan is not dealing with either great drop in social produce or with an excessive unemployment. A crisis in the usual sense of the word cannot be the case here either as "back to normalcy" scenario is not feasible even if the best programme for managing economic flows and structure were to be employed, for a simple reason that changes have happened in the global economy which influence Japan significantly and which cannot be reversed.

So we are witnessing here a contradiction between a global tendency towards the indefinite, never-ending growth of processing power on the one hand and the limitation of natural resources on the other, first of all natural precursors and energy. If this were a crisis then it would be a crisis of the type of development the *differentia specifica* of which is turning the surplus produce into capital, the feature that global economy lies on

For all these reasons it seems that the most appropriate diagnosis for the Japanese economic malady today is "time-out". The length and nature of the time-out will depend on the environmental challenges on the one hand, and on the Japanese capability to respond to these challenges on the other. Being a country poor in natural resources Japan will have to continue to take great care of the means which they have been achieving all their "economic miracles" with: hard work and dedication, knowledge, managing skills, science and technology, the quality of being economical, as well as readiness to make sacrifice for common good.

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## ECONOMIC GROWTH AND “TWIN DEFICITS” IN THE UNITED STATES OF AMERICA: COULD THE SAD ENDING BE ESCAPED?

**Abstract:** *For many years, the economy of the United States of America has been facing both balance of payments deficit and government budget deficit. Could we then talk about so called “twin deficits”? There are two lines of thought: one advocating the view that these two deficits have nothing to do with each other and the other claiming that budget deficit incites the balance of payments one and vice versa. However, by laying out two short summaries of the two deficits’ movements through history, the conclusion on the interdependence of the two deficits can be drawn. Although over the last few years an unofficial international financial system colloquially labeled as Bretton Woods II has been created and is enabling for the time being the continuation of the status quo, it is realistic to expect that the US economy will not be able to avoid necessary adjustments, which will undoubtedly have an impact on the world’s economy, especially on economies of the underdeveloped countries.*

**Key words:** *balance of payments deficit, government budget deficit, Bretton Woods II, New economics, the USA*

### 1. Introduction

Over the last two years the annual economic growth rate of about 3.5% has been registered in the US. The US trade deficit stood at 612 billion of dollars in 2004 whereas the balance of payments deficit (or “external deficit”) amounted to 670 billion of dollars, which came to 5.7% of GNP. In the meantime, in a year that saw a significant economic growth American budget deficit (or “internal deficit”) reached 412 billions of dollars, or 3.6% of GNP. Is American

economic growth sustainable considering the "twin deficits"?<sup>1</sup> Are there twin deficits in the first place? If these two deficits were sustainable in the long run then American economic growth could be said to have a realistic basis and its future development could be expected. However, is American external deficit long-term sustainable? The only precise answer to the question is-sadly, no. In line with this, the question that we should seek an answer to is the following: When is the balancing of American external deficit expected? Also, it would be equally important to assess consequences of such adjustments, both in American and global terms. Searching for answers to these questions, the first part of the paper covers the nature of the link between American external and internal deficits with a view to establishing whether it is correct to talk about the "twin deficits" phenomenon in the first place. The second part of the paper entails a short overview of the oscillations in American external deficit through history, with special attention to the factors that brought about its growth; whilst the third part expounds on the mechanism called Bretton Woods II that contributes nowadays to the global perseverance of the macroeconomic *status quo*. The last, fourth part describes possible solutions to the implementation of as painless balancing of American external deficit as possible and the manifestation of the mildest negative consequences on American economy.

## 2. Is there the phenomenon of the "twin deficit" at all?

There are two theories nowadays explaining the relation between American external and internal deficits. The first theory advocates the existence of the so called "twin deficits". According to this view, the expansionist fiscal policy directly affects external deficit growth as it significantly stimulates both the consumption and importation rise. The advocates of this view often state that the growing external deficit is financed through government loans that are being more and more taken out through making use of the foreign savings that end up in the US through foreign investors. Meanwhile, in order to keep its financing the growing external deficit presumes a continuous and growing influx of foreign funds. Resulting from this, as this school of thought states, the main reason for the increase in external deficit appears to be the presence of the budget (internal) deficit and government's increasing indebtedness. That is why it is necessary to achieve a decrease in the internal deficit and government's indebtedness rate with the view to harnessing the external deficit growth. The solution to the issue of reduction of the budget deficit, which would automatically lead to the reduction of the balance-of-payments deficit, has been long known: tax increase and cutting expenses. These issues are extremely politically sensitive in the US and other countries too because

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<sup>1</sup> The term "twin deficits" refers to balance of payments deficit and budget deficit.

cutting expenses is very difficult to achieve in practice. American president Ronald Reagan, the founder of “the Reagan-economy” was able to experience the correctness of the stated, as he managed to carry out the desired increase in taxes but failed to achieve the necessary cutting in governmental expenses.<sup>2</sup> In order to account for the situation Milton and Freedman talked about the “*status quo tyranny*”. Namely, it has turned out that an iron triangular is created amongst the bureaucrats, politicians and that part of private sector which benefits from a governmental program and renders it thus more difficult to cancel.<sup>3</sup> Anyway, tax increase or expense cutting would have to result in the hindrance of American economic growth, which would then undoubtedly cause some negative political consequences for the party in power. Similarly, budget deficit decrease would have to affect shifting of the direction of American foreign policy along with raising the issues of its financing.

The other school of thought casts a doubt over the interrelation between the budget deficit and current account deficit<sup>4</sup> by often claiming that over the modern American economic history the two deficits have not always moved in the same direction. Moreover the followers of this view often state that the US economy has got a unique position that cannot be compared to any other world’s country’s economy. They also see the reason for the existence of the US external deficit in the huge attractiveness of the US economy and foreign investors’ eagerness to invest precisely in it. The followers of this view also point out a remarkably long period of the economic and political stability in the US; no other developed country has had a similar situation during the 20<sup>th</sup> century. Proprietary rights are protected and have been adhered to; there is a considerably broad palette of various forms of property at the foreign investors’ disposal, including numerous forms of securities. Investors are treated with respect and there are no major incidents that would indicate towards any kind of discrimination of foreign investors when compared to the domestic ones. In this sense, the continuous growth of American productivity is often accentuated; it has contributed and is still contributing to foreign investors’ strong belief that American future economic growth will be even higher and that profit rates stemming from the invested capital will be ever increasing. Attracting of foreign capital contributes to the American interest rate remaining continuously low and its demand being incessantly stimulated. The continuing growth of American demand relieves pressure from some other deve-

<sup>2</sup> G. Walton, H. Rockoff, *History of the American Economy*, 10<sup>th</sup> Edition, Thomson-South Western, USA, 2005, page 559.

<sup>3</sup> M. Friedman, R. D. Friedman, *Tyranny of the Status Quo*, Harcourt Brace Jovanovich, San Diego, 1983

<sup>4</sup> See, for example, M. Mussa, “Sustaining Global Growth while Reducing External Imbalances”, in: F. C. Bergsten and the Institute for International Economics, *The United States and the World Economy: Foreign Economic Policy for the Next Decade*, Institute for International Economics, Washington D.C., 2005, page 80.

developed economies which should at a convenient moment undertake appropriate measures to stimulate their own respective demands and decrease savings, all in order to assume a part of the responsibility for global growth. This sort of reasoning is obviously distracting public attention from the fiscal and foreign policies of President Bush (junior) as it concentrates exclusively to foreign policies implemented in Europe and Asia. According to this view, Europe should finally finalize the implementation of necessary structural reforms in order to stimulate domestic demand that would then stimulate export from the US too. On the other hand, Asia should allow their currencies to devalue with a view to amortize American trade deficit. It stands to reason that followers of this view do not see the fiscal and foreign policies of President Bush's administration as a main factor that explains the existence of American deficit. It is expected that the US have to bear the brunt anyway, of both generating the demand that enables the world's economy growth, and maintaining global security. The advocates of this view also hold that adjustment highlights should be placed on those countries that “generate” too high level of savings.

### 3. Sources of the American external deficit growth: short historical overview

American external balance was constantly on the surplus side as from the end of the First World War up till the 1960s. Consequently, the States accumulated huge funds as a result of enormous sums owed to them by other economies, which turned them into the world's largest creditor. During the late 1960s American current account surplus started to drop. The situation called for a considerable depreciation of the US Dollar (which is often cited as the cause of the Bretton Wood concept's collapse), which was supposed to help returning to the state of current account surplus. However, the strategy failed. From the world's largest creditor American economy was suddenly reduced to the world's largest debtor.

#### 3.1. *The emergence of “twin deficits” in the US during the 1980s*

American external balance lapsed into deficit during the 1980s. An important reason for the deterioration of the state of American external balance was a relatively intense recovery of American economy that ensued after the global recession in the early 1980s and manifested itself primarily through a huge increase in domestic demand. However, the main culprit for the state of American external balance lies in the huge appreciation of the US Dollar that took place between 1980 and 1985. The US Dollar appreciation can be accounted for through the simultaneous operation of several factors. Firstly,

the force of the American economic recovery, along with the restored trust in the state's economic future, led to a huge increase in investments on the US territory. When it turned out that the domestic savings levels were not sufficient to satisfy the grand investment demand, foreign savings were attracted. Also, American mixed type of macroeconomic policy from the early 1980s- comprising restrictive monetary and expansionist fiscal policies- additionally contributed to the further strengthening of the US Dollar and the subsequent deterioration of the state of American external balance.

The expansionist fiscal policy resulted eventually in matching movements between the two deficits; namely both the current account deficit and the budget deficit were on the increase. For this reason, some analysts started talking about "twin deficits" even then. However, during the second half of the 1980s the two "twin deficits" had no longer identical movements. Whilst external deficit was on the decrease due to the depreciation of the US Dollar between 1985 and 1987, the budget deficit continued growing in the period 1987-1991.

### *3.2. Factors that account for the strong US Dollar in the late 1990s*

There are several factors that can account for the strong US Dollar from the second half of the 1990s. Firstly and most importantly, there was an unexpected and lasting labor productivity growth in America, which allowed both for a great progress to be achieved in American economy and the generating of positive expectations in relation to the further flows in American economy. The labor productivity growth was enabled through investing in new technologies and expanding of the so called *new economy*<sup>5</sup>. When the then chairman of the Federal reserves system Alan Greenspan realized that, he stopped increasing interest rates. Greenspan based this attitude on the belief that the prosperity wave recorded in American economy almost inflation-free was based on non-monetary circumstances. He referred to this set of circumstan-

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<sup>5</sup> The symbols of "new economy" were "dot com" companies that fundamentally changed the ways of conducting business, first in the US and later in the rest of the world. The technological progress rhythm was considerably increased. Two centuries before that, the world had already undergone the industrial revolution, the effects of which led central economic activities to move from agriculture to industry. The emergence of the "new economy" envisaged the change of some similar characteristics: central economic activity was no longer the production of material products but rather the production of ideas. The "new economy" is primarily characterized by great investments in the telecommunication and information technology sector. The "new economy" entails: electronic systems of the classification, selection, calculation, decision-making, designing, animation; automated production processes and robotisation; better use of human resources enabled by a better knowledge management, electronic trade, as well as a complete revolution in the technologies used in agriculture.

ces as “X factor”<sup>6</sup>. The manifestation of the “x factor”, both for Greenspan and other representatives of economic power, was a great enigma as in the economic history that far there had been few situations in which decreasing unemployment and inflation rates were recorded. The “X factor” was a bit more clearly defined later on. It entailed:

- cheap workforce resulted from intense immigration waves, primarily from Asia and Latin America, but also from Africa and Eastern Europe; this is an exceptionally important factor on the labor market as the continuous influx of cheap workforce kept cutting the wages, which, in turn, harnessed the inflation;
- low oil prices-up until 1999 when oil prices started soaring again;
- huge global movements of capital with a view to investing in the most profitable financial markets in the situation where the US market exerted prominent attraction;
- the effect of getting richer, which came as a result of the stock market going drastically up and served to balance the lack of private savings to a degree;
- the emergence of a “new economy” that primarily referred to the introduction of new (information) technologies in the US economy.

However, what is important to understand is that this labor productivity growth that resulted from the “x factor” manifestations and more than anything from the expansion of the “new economy” was linked exclusively to the US economy, not to the other developed countries’ economies. The productivity growth led to the increase in domestic demand, which then influenced the boost of American importation. The absence of similar tendencies elsewhere indicated that American exportation had not achieved the same growth rates, which, in turn, led to the American trade balance decline.

The intense growth of American productivity in the latter half of the 1990s created better perspectives for future economic developments, which then made the US more attractive for foreign investors who found the country a great place for investing their savings. That, in turn, led to the influx of capital to the US and contributed to the appreciation of the US Dollar. As it usually happens in a system of joined vessels, the stronger US Dollar is the main factor that explains the deterioration in the field of American trade deficit in the period. In line with this, it seemed at the end of the 1990s that the theory of great attraction of American economy and its unique position being an important factor that influenced foreign investments and consequently the increase in external deficit was gaining ground.

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<sup>6</sup> J. Stiglitz, *Los Felices 90 – la Semilla de la Destruccion* (original title: *The Roaring Nineties. A New History of the World’s Most Prosperous Decade*), Taurus, Madrid, 2003, p. 103.

The more intense growth and future development's better perspective resulted in the increase in investment spending in the States. Growing income, along with the favorable perspective for future economic growth, essentially considerably increase investments in real estate and lead to the reduction of households' savings. The result is the deterioration of private savings and investments ratio. It is quite clear that this is exactly what happened in the United States at the end of the 1990s. The real estate market going drastically up is at the same time the main objection put forward against the "cheap money" policy carried out by Alan Greenspan for the duration of his term as Federal reserves Governor. His firm belief in the "wonder of productivity" made him less wary of the dangers from too big monetary expansion. His policy allowed for the domestic demand growth to be quicker and more intense than that of the supply, which considerably contributed to the increase in the American external deficit. Today, even Alan Greenspan admits that his policy, whilst it was contributing to the maintenance of both the longest period of continuous growth in the US recent economy and history and low inflation rates, therefore low interest rates too, also resulted in investors' claiming less for the assumed risk, which, in turn, led to the real estate prices boom.<sup>7</sup> This all caused the creation of a bubble on the real estate market which will sooner or later lead to a drastic drop in real estate prices.

As for the budget deficit during the late 1990s, more intense growth of American productivity, economic growth, as well as the mentioned increase in real estate prices along with unreformed tax policy effected a revenue boost and fiscal balance improvements. It all resulted in the US budget recording a significant surplus in the period 1999-2000.

It is important to underline that at the pinnacle of economic boom in the 1990s (mid 1998), which came as the result of a great productivity growth, American external deficit stood at 1.5% of the GNP. As expected, the further economic growth went, the more external deficit was rising. However, the external deficit growth resulted from the increased investment spending. Also, loans that were arriving to the States came primarily from private sector. Public sector savings were rising as the budget was making its way slowly to the surplus. According to the so called Lawson doctrine,<sup>8</sup> there was no reason for excessive worry over the increasing external deficit in the United States during the 1990s. As for the investment spending that can, at least hypothetically, contribute to making higher profit in the future, taking loans in order to finance this kind of spending should not be a reason for concern.

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<sup>7</sup> "Monetary myopia", *The Economist*, January 14<sup>th</sup>, 2006, page 69.

<sup>8</sup> It is a doctrine according to which external deficit is unsustainable only if it was generated by excessive spending and financed through government taking loans.

### 3.3. Current account and budget deficit growth after 2000

The macroeconomic response to the recession in the United States in 2001 was marked by a swift decrease in interest rates to the lowest level in the past 50 years and turning largest budget surplus (around 2% of the GNP) into a big and growing budget deficit (approximately 4% of the GNP). This response not only changed the nature of spending that had been financed by the government taking loans abroad, but it also changed the very “quality” of such loans. When the investment spending diminished, which came as a result of the stock market bubble explosion, spending remained equally high as money was cheap and it was easy to take loans because of the growing prices of real estate. Also, American new presidential administration that had come in power in 2000 had carried out three consecutive tax decreases (in 2001, 2002 and 2003), which turned the government into the economy’s main debtor. Moreover, contrary to usual decrease in external deficits during recession, American external deficit showed no such tendency in 2001. On the contrary, it continued growing and from 4.5% of the GNI in 2000 reached 5.7% in 2004.

It is important to say that the continuing tendency of taking foreign loans was no longer generated by high levels of investment spending but rather by private (and growing) government spending. Considering that the Federal reserves continued its traditional policy of low interest rates, consumers were able to keep financing their spending through new waves of loan-taking<sup>9</sup>, made possible by soaring real estate prices. Similarly, it should be noted that external deficit moved from 1.5% of the GNP to around 6% of the GNP within only seven years’ period, whilst within even shorter period of time budget moved from the surplus of around 2% to the level of deficit amounting to around 4% of the GNP. Though growing, external deficit lost its investment character and adopted consumption character, whilst the main debtor switched from private sector (which is considered to bring all the right decisions in the conditions of proper functioning of the market economy) to the state. It stands to reason that American debt was more and more financed from abroad—in 1990 foreigners owned 20% of the government bonds, whilst the figure nowadays reaches approximately 50%. The situation is further aggravated by the fact that foreign private sector is less and less willing to invest fresh funds in the US. Whilst on the one hand the influx of foreign direct private investments (FDI) has dropped considerably (from 300 billions of dollars in 2000 to 30 billions in 2003 and 10 billions in 2004), on the other hand, official or public foreign financing of the American external deficit has significantly increased. Over the last 2 years, 80% of the American external deficit growth has been financed thro-

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<sup>9</sup> In total, there have been three new waves of loan-taking as ever-increasing real estate prices, and therefore mortgagees too, enabled new credits.

ugh foreign central banks' interventions. These are primarily Asian central banks which covered by themselves around 60% of the total growth. Chinese central bank financed approximately one third of the US external deficit in 2004. Therefore, what used to be borrowing in order to finance investments has now turned into borrowing to finance spending. Moreover, the state has joined private consumers in both spending and borrowing. Still, what is most concerning is the fact that private creditors have disappeared despite the American economic growth by 4% during 2003 and 2004. They have been replaced by public actors, primarily central banks. Even more interestingly, a great part of foreign loans coming to the United States these days originates from the Asian central banks. Though hefty funds for financing the American external deficit have arrived from the US strategic partners such as Japan, South Korea and Taiwan, China has become the most dynamic foreign creditor. Moreover, the central bank of China is turning more and more to some less traditional means of external deficit financing-namely, they are investing in the American real estate market, whereby contributing to further inflation of the bubble that reigns the market.<sup>10</sup>

So, is it possible after 2000 to still believe that there is no interrelation between American external and internal deficits whatsoever? Is it reasonable to believe that households and companies would have continued to save less and spend more through further loan-taking, if there had not been for such a grand budget deficit? The fact is that the increase in both spending and indebtedness rates caused further deteriorations in American external deficit whilst at the same time enabling American economy's continual growth. Isn't it easier to believe that, hadn't there been for a fiscal and monetary expansion recorded in the US as from 2001, companies and households would have been rather having tendencies to cut spending and increase savings? Still, would not that have influenced the generating of a deeper and longer recession in the United States?

#### 4. "Bretton Woods II"

When the dollar depreciation was underway as a result of the growth of American internal and external deficits, American economic administration's representatives started insisting on strengthening of the Chinese currency- the Juan. American political elite often stated (and they still are) that Chinese authorities were carrying out a "currency manipulation" by means of constantly maintaining the Juan at an unrealistically low level. According to this view, that is the only explanation for the Chinese large bilateral trade surplus when

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<sup>10</sup> M. Wolf, "America is now on the comfortable path to ruin", *The Financial Times*, August 18<sup>th</sup>, 2004; "Why the US current account deficit is a cause for concern", *The Financial Times*, August 25<sup>th</sup>, 2004

compared to the United States (reaching around 170 billions of US Dollars, or almost one third of the US total trade deficit). However, as the presidential elections were nearing in 2004, circles close to President Bush started quietly accepting that the Chinese intervention admittedly directed towards preventing the growth of the Yuan was at the same time the main source of foreign financing of the US growing internal and external deficits, to the point that it even represented a significant, though discreet subsidy to American consumption.

Whilst the United States still recorded large import of products from Asian countries, which was facilitated by the unlikelihood of the dollar devaluating against the Yuan and other Asian currencies, Asian countries accumulated significant reserves, as a counterbalance to the US import growth. It is interesting to note that these funds were being primarily invested in the US government bonds, which then in turn provided the main source of foreign financing of American external and internal deficits. The total volume of the world's foreign currency reserves was almost doubled (from 2 290 billions of dollars at the end of 2000 it reached around 4000 billions at the end of 2004), of which almost one half took place in Asia. Nowadays, almost two-thirds of the world's currency reserves are in the possession of Asian countries (approximately 2 260 billions of dollars), the major part of which is in the Eastern Asia. The National Bank of China on its own is financing today around one third of the American external deficit. Between 75% and 80% of Chinese foreign exchange reserves is invested in American government bonds. The increase in the accumulation of foreign exchange reserves in Asia financed around 75% of American external deficit in 2003; in 2004 the figure reached 60%, whilst over the same two years 80% of American budget deficit was financed from the accumulation of foreign exchange reserves in Asia.<sup>11</sup> This state of affairs contributed to the maintenance of American long-term interest rates at a level much lower than it would have been realistic to expect, which, in turn, stimulated American economy considerably more than it would have been the case with the low short-term interest rates as proposed by the Federal Reserve. Such support to American debt, along with relieving interest rates pressure, caused a further decrease in savings, continuing blowing of the real estate market bubble and the stimulation of spending that boosted further Asian exportation.

This form of conduct when China pegs its currency against the dollar whilst other Asian countries accumulate US Dollar reserves, coupled with the growing spending of the US government, growing external deficit and maintaining of a strong consumer boom in the States, have created a specific trade and financial link between the States and Asia and the link was dubbed “Bretton

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<sup>11</sup> N. Roubini, B. Sester, “Will the Breton Woods 2 Regime Unravel Soon? The Risk of a hard Landing in 2005-2006”, paper written for the symposium “Revived Breton Woods System: A new Paradigm for Asian Development?”, Federal Reserve Bank of San Francisco and UC Berkeley, February 4<sup>th</sup>, 2005 See: <http://www.stern.nyu.edu/globalmacro/>

Woods II” by a group of Deutsche Bank analysts.<sup>12</sup> The continuous Asian boom, enabled by strong export growth, became linked to the US expansionist monetary and fiscal policies as early as at the beginning of recession in 2001 whereby a huge international macroeconomic misbalance was generated. Intense economic growth of China, likewise supported by the strong rise of exports and low value of the Yuan that could by no means revalue against weak American dollar, proved, according to the Chinese authorities, crucial for creating new job opportunities for millions of the Chinese. Unemployment in towns is estimated to be around 8%, whilst there is a minimum of 150 million unemployed people in provinces.<sup>13</sup> This situation is creating a need for the accumulation of US Dollars in China which then have to be invested somewhere. By investing US Dollars in American economy China makes it possible for the US to finance its imports from China, along with maintaining long-term interest rates at a low level. Such financing coming from China maintains a high consumption level in the US which then stimulates both the American economic growth and creating of new job opportunities in Asia. On the one hand, savings in Asia are too high. On the other hand they are too low in the United States, which is then manifested through increasing external and internal deficits, showing the extent to which the States have become dependent on foreign sources of financing in order to maintain the current spending levels. According to some analysts, Bretton Woods II is considered to be long-term sustainable as it suits both the United States and Asia, and especially China.

#### 4.1. Weaknesses of the “Breton Woods II”

Despite various advantages of the so called Bretton Woods II system, as cited by many American and Asian experts, some of its negative aspects are necessary to be drawn attention to as well. Firstly, such system poses a great danger for the global free trade. Maintaining of the Breton Woods II only serves to increase American trade deficit towards China. This situation is then creating an impression in the United States that Chinese economic policy leads to the destruction of the US industrial sector, as well as closing of jobs that are now “exported” to China, especially given a great “delocalization” wave that swept across American companies. If the situation in which the value of the Yuan is underestimated continues that can cause the revival of the US protectionist reflexes that date back from the Monroe doctrine.<sup>14</sup> By means of this, adoption of significant regional trade agreements within the World Trade

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<sup>12</sup> M. Dooley, D. Folkerts-Landau, P. Graber, “The Revived Breton Woods System: Alive and Well”, Deutsche Bank, December 2004

<sup>13</sup> “Struggling to keep the lid on”, *The Economist*, April 29<sup>th</sup>, 2006, page 59.

<sup>14</sup> As it is known, the simplified essence of the Monroe doctrine could be expressed through the following statement: “America to Americans”.

Organization (WTO) would be jeopardized. Moreover, protectionist tendencies are increasingly present even in the EU where over the last three years the Euro has revaluated against the Euro and US Dollar by around 40%. For the time being it is the Euro that bears the brunt of balancing against the US Dollar, not Asian currencies that won't appreciate by any means.

Perhaps the world could survive the failure of the Doha round of negotiations.<sup>15</sup> However, going back to the protectionist policies globally, not to mention the possibility of a trade war breaking out, would certainly cause the “Bretton Woods II” system to fall in, grand crisis of the US Dollar and consequently the process of economic recession worldwide. Still, both in the EU and in America opinions that advocate the introduction of protectionist measures can be heard increasingly.<sup>16</sup> Secondly, the continuing accumulation of foreign exchange reserves is increasing both the risk of the “overheating” that can complicate overwhelmingly further growth of Chinese economy and the risk of recession in the whole of Asia, maybe even in the world.<sup>17</sup> The accumulation of reserves also stimulates the tendency (already present in China) towards excessive bank loans, which subsequently raise inflationary pressures and the overall economic “overheating”. Further, there is a possibility that participants in the “Bretton Woods II” project, other than those from the South-East of Asia, that is, those from other Asian countries and oil exporting countries, could decide to change their conduct and start undermining the system.<sup>18</sup> It is possible that these participants could start cutting down on their accumulation of US Dollars, that is, they could start diversifying the accumulation. The result would undoubtedly be the increase in the protectionist measures of the EU that would be fighting any further appreciation of the Euro, whilst at the same time China and Japan would be forced into even further US Dollar accumulation. And finally, only China and the United States could find themselves not knowing how to get out of the “Bretton Woods II” system. China can continue investing in American consumption with a view to opening new jobs in China, whilst the States can

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<sup>15</sup> The Doha round of negotiations refers primarily to the liberalization of the trade in agricultural products. If the objectives set at the beginning of the Doha round are to be achieved, then it is essential that the agreement is achieved by the end of 2006. The “Fast Track” clause available to American President Bush and enabling him to conduct trade negotiations without significant meddling from the Congress is expiring in June 2007. For the time being it is not realistic to expect the Congress to renew the clause as it is getting increasingly skeptical with respect to globalization. See: “Five minutes to midnight”, *The Economist*, April 29<sup>th</sup>, 2006

<sup>16</sup> See: “Protectionism in Europe” and “Isolationism in America”, *The Economist*, February 11<sup>th</sup>, 2006

<sup>17</sup> F. Bergsten, “A New Foreign Economic Policy for the United States”, in: *The United States and the World Economy. Foreign Economic Policy for the Next Decade*, Institute for International Economics, IIE, Washington, D.C., 2005, page 20.

<sup>18</sup> It is essential to reiterate that “Bretton Woods II” concept is a completely informal agreement and does not envisage any formal obligations whatsoever.

have a further increase in the external deficit striving towards a continuous economic growth. So both countries could end up as the system's prisoners, aware that stepping out of it could cause a global recession.

### 5. Can sad ending be avoided?

It is quite obvious and inevitable that there will be undoubted adjustments of the value of the US Dollar as soon as Asian financing of the US deficits comes to an end. In order to bring the current account deficit to a manageable level the Dollar would have to depreciate in the range between 15% and 30%. Such grand depreciation would then certainly influence the rise of prices in the United States, which, in turn, would bring about the rise of interest rates. All the policies currently available to the US administration (before all, restrictive monetary or restrictive fiscal policy) which could contribute to the decrease in the US dependency on the "Bretton Woods II" system, would at the same time undoubtedly lead to the American economic growth plummeting, possible explosion of the current real estate market bubble, as well as the increase in the burden of indebtedness on American consumers as a result of the rise of interest rates. These policies would also significantly influence the world's economy by bringing about recessional tendencies in China –the country representing the main driving force of the world economy today.

The world economy is quite certain to get out of the current *status quo*. Also, it is logical to expect that the way out of the *status quo* would be much more harmless if it were to be achieved through dialogue. The sharpness of necessary adjustments would be blunted through an agreement amongst world's major economic parties. If such agreement turns out to be impossible to achieve then consequences for the world economy could be dramatic. A possible solution to the current situation could be found in an agreement similar to the "Plaza agreement", when world's major economies agreed on the implementation of a set of special reforms that finally effected the desired adjustments.<sup>19</sup> On that occasion the States pledged to decrease its budget deficit, countries with great trade surplus, such as West Germany and Japan,

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<sup>19</sup> The "Plaza agreement" was signed in September 1985 by the ministers of finance of the US, Western Germany, Japan, France and Great Britain. The fall of the American dollar was decided upon (with the parallel rise of the Deutsch mark and the Japanese Yen). By means of this, pressure on American producers was relieved but that on producers from Japan, Germany and other parts of the Western Europe was increased. The devaluation of the dollar was agreed upon in order to renew the dynamism of American production, through the increase in exportation and its competitiveness on the global market. After 17 months, the same participants decided at a meeting held at the Louvre in Paris that the time had come to stop the devaluation of the dollar. See in: R. Brenner, *The Boom and the Bubble. The US in the World Economy*, Verso, London, 2002, page 127.

accepted to start stimulating demand within their respective economies, and everyone acquiesced to selling US Dollars on foreign markets.<sup>20</sup> Such scenario today would entail the US pledging to decrease its budget deficit, Europe accepting to carry out all of the reforms that would increase its economic stability and stimulate the European demand growth (especially in the light of the necessity for the decrease in the US demand) and Asia to adhere to flexible foreign currency rates.<sup>21</sup> There is a common agreement amongst economist that such a scenario would lead to best possible global results.

However, the economic history so far has shown such multilateral agreements to have always been difficult to achieve. Given the current strained situation in the international relations, it is not realistic to expect such an agreement to be achieved more easily this time either. Some economists hold that sheer considering of signing such an agreement is utopian and that the failure in its achieving would have much worse consequences than accepting a priori the impossibility of its accomplishment.<sup>22</sup> Bearing this in mind, it is realistic to expect that all relevant parties in the world economy will have to undertake unilateral measures that are to contribute to the painless macroeconomic global balancing. Still, it comes as no surprise that the US economy is in the best position for undertaking unilateral measures. What has to be expected from the US is to decrease its budget deficit. If President Bush's administration were to accept unilateral decrease in their budget deficit (it would suffice to treat the conducted successive tax cuts as *ad hoc* cuts, rather than a permanent measure and not to practically implement the proposed social security reforms), the American economic growth would undoubtedly be impaired, which then would effect slowing down of both Chinese and the world's economy. However, such slowing down would happen without drastic increase of pressure on the interest rates growth. In case the United States did not undertake anything, the pressure on the increase in interest rates would be much higher, and consequently recessional consequences would be harsher.

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<sup>20</sup> Some economists saw the "Plaza agreement" as the capitulation of Japan. The pillars of the then Japanese economic policy allowed the Yen to rise against the dollar from 250:1 in 1985 to 80:1 ten years later. Some economists still think that strong Yen is a main culprit for the excessive liquidity trap that overtook Japan during the 90s. Bearing this in mind, they claim a similar situation could befall China today, if it yields to the US pressures.

<sup>21</sup> Asian countries are finding themselves in a complicated situation: they are afraid to let their currencies' fluctuate freely against the US dollar, as they wish to stay competitive both amongst themselves but also towards the US. Given this, no individual Asian country is willing to approve of its currency rising, they would rather all other Asian countries bring the same decision. It is important to highlight it here that in case of the Chinese Yuan rise against the dollar, its real rising would not be remotely as significant if all other Asian currencies were to rise simultaneously against the dollar.

<sup>22</sup> S. Brittain, "A heretical view on the dollar", *The Financial Times*, January 20<sup>th</sup>, 2005

If the situation in relation with the global macroeconomic misbalance is that dramatic indeed then it would be reasonable to ask: why more stringent measures haven't already been undertaken? Why is the US budget deficit constantly increasing as if its top limit did not exist at all? Sadly, this question is not difficult to answer. Namely, the difference between the situation that would potentially result from adequate response to the issue and the situation in case absolutely nothing were to be done would not be felt too much in the developed market economies. However, the developing countries are much more sensitive to high interest rates. In other words, the main brunt of the global macroeconomic misbalance adjustments and the non-agreed stepping out of the "Bretton Woods II" system would yet again be borne by those who are in an unequal position anyway. Still, even Aristotle said long time ago that "the welfare of the humanity has got to be the objective of the science of politics".<sup>23</sup> *E pur si muove.*

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<sup>23</sup> Aristotle, *Nicomachean Ethics*, Book 1, 1094 b, pages 6-7



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## INTERCULTURAL COMMUNICATION IN INTERNATIONAL ECONOMIC RELATIONS – THE EXPERIENCE OF SLOVAKIA WITH LATIN AMERICA

**Abstract:** *Modern phenomena are becoming more and more complex and interdependent and their balance is weakening. This is the reason why students and researchers in the fields of economics and management should be aware of this multiple dependence between economic and other aspects of life in a society. One of the ways to strengthen the notion about sustainable development is to pursue holistic, interdisciplinary, and multidisciplinary approach, with the participation of various social sciences in university education and research. The experience of Economic University from Bratislava in the implementation of such approach in educational and research projects on Latin America is presented in this paper.*

**Key words:** *Slovakia, Latin America, intercultural communication, multidisciplinary approach*

### 1. Introduction

Rapid changes in the society, globalisation, internationalisation, and knowledge based society, the need to secure sustainable development of the planet; all these key words express the main features of the reality, in which we live. This general social framework has been setting new challenges for European Higher Education Institutions in the areas of Economics, Business, Management, International Economic Relations, and similar Fields of Study. The present article addresses two groups of important tasks:

The first one is related directly to the basic educational mission of the above-mentioned HEI types. Their present and future graduates – many of them in decision-making positions within political, economic, and entrepreneurial structures – influence by their behaviour the society's life. Therefore,

it is important how these present and future society leaders comprehend the society and how they react to its present and envisaged needs.

A high level of technical knowledge, competencies and skills in the given Field of Study is without doubt a *conditio sine qua non*. However, in addition to this, it is at the same time necessary to pay more attention also to some other educational aspects:

The phenomena of the present world are getting more and more complex and interdependent, and their balance more fragile. This is why Economics and Management students should be aware of this multiple interdependence between the economy and other aspects of the life of the society. One of the ways how to strengthen their sustainable development awareness is to implement holistic, inter-, multi- and trans-disciplinary approaches with participation of other social sciences and humanities into university education and research.

The present world is becoming global. Economics and Management students should comprehend the real content of this concept. This should be based on a better awareness of human life and societal realities not only in Europe, but also in other parts of the world. Various forms of internationalisation of university studies could represent a way to reach this goal.

Last but not least, the ethical education is of crucial importance, done both implicitly and by specific courses. Among the great variety of paths, which could be taken, different forms of implementation of Intercultural Communication (IC) and related educational contents – mainly the so called area studies (AS) – might help in achieving the above-explained educational aims, as well. These contents have, by its very nature, a strongly inter- and multidisciplinary character, they can help students understand societal phenomena in a holistic way, improve their intercultural awareness, and implicitly enhance their comprehension of responsibility.

The second group of tasks is related to the possibilities and opportunities for the increase of the general role of European Universities within the society's life. As institutions, whose core activities include creation and transfer of knowledge, Universities are called upon to be active players within the present knowledge-based society. Namely, international creation and transfer of knowledge and technology could constitute an efficient way of promotion for the dialogue between Europe and other parts of the world.

The ongoing process of creation of a strategic alliance between Europe, Latin America and the Caribbean represents an extremely propitious framework for Universities to achieve both goals. Using the example of a potential University Degree Course entitled *Intercultural Communication in International Economic Relations*, applied specifically to Iberian and Latin American countries, the author of this article intends to explain, why and in which way the education and research in the field of Intercultural Communication might be useful in these efforts.

A short review of Slovak perception and interpretation of Latin America, as well as of relations with this region, represents a starting point for the explanation of the *International Communication* concept to be applied within the University of Economics in Bratislava.<sup>1</sup>

## 2. A view to the history of Slovak perception and interpretation of Latin America

In Slovakia, the image of Latin America started to emerge from the shadows only a relatively short time ago. The first real Slovak encounters with this region only took place in the thirties of the last century. At that time Slovakia – being a part of the former Czechoslovak Republic – was a poor and underdeveloped country. The impact of the global economic crisis had been extremely powerful. Many compatriots were forced to abandon the country in search for a new life abroad. Many of them went to America, both to the Northern as well as to the Southern part of the continent. A lot of Slovak emigrants found their new home in Argentina, mostly in the Chaco region, and partially in other countries of the La Plata basin.

In fact, personal contacts between our emigrants and their families in the home country were the first powerful source of Slovak perception of Latin America. Later another two emigration streams towards the Latin-American region took place. Within the first of them, after the Second World War in 1945, people involved in the circles of power of the first Slovak State decided to leave the country for political reasons. There were also others, who did the same because they were worried about the possible future political development in the country. More than twenty years later, in 1968, when the so-called “*Prague Spring*” with its ideal of “*Socialism with the Human Face*” had been suppressed, the resulting political situation forced many Slovak citizens to live abroad. A considerable part of the emigrants of the latter two waves joined the already established Slovak communities in Latin America.

Other important sources of our perception of Latin America are the relations with the countries of that region. As a matter of fact, these contacts and links were rather poor until the middle of the last century. Regarding the history of Latin American images in our country, 1959 is a milestone. Leaving aside any political or ideological implications, it has to be stated that the Cuban revolution with its consequent socio-political changes, which occurred in this Caribbean country, opened the doors to a real boom of all kinds of rela-

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<sup>1</sup> The University of Economics in Bratislava, founded in 1940, with its approximately 14,000 students and 700 members of teaching staff, is at present the most important and prestigious Higher Education Institution in the field of Economics and Management in the Slovak Republic.

tions: commercial exchanges, economic cooperation, educational and cultural links, tourism, etc. Regarding the topic of this article, the so-called “Human Resource Mobility” is of special importance. Many professionals from Slovakia, similarly to other countries of the former “socialist bloc”, went to work to Cuba in various fields: economy, education, health services, science, culture, etc. On the other hand, Slovakia was receiving students, workers, enterprise trainees, teachers, etc. for study or work internships in our country.

As a consequence, one of the Latin American countries suddenly changed its image in the eyes of the inhabitants of Slovakia. Instead of a “very distant exotic country”, it turned into a real cooperation partner. The same happened with the perception of the Spanish language. Before, it was a pure luxury to study this beautiful language. This situation was easily understandable: before there were no relations with Spanish speaking countries, and no possibility to use the language. Now, for the first group of Slovaks, their efforts in learning Spanish proved to be useful.

Cooperation and contacts with Cuba also caused an increase in Slovaks’ interest in Latin America as a whole. Later, other countries of the region and other socio-political events called the attention towards this part of the world. Among them, for instance, the period of *Frente Popular* and the consecutive *coup d’état* in Chile in the 60’s –70’s of the past century, and – approximately a decade later – the socio-political evolution in Nicaragua have to be mentioned. In spite of this, the above events did not have such a spectacular impact on the Slovak perception of Latin America as our mentioned first encounters with Cuba.

Slovak perception of Spain and Portugal has a strong link to the topic, as well. The socio-political changes, which occurred in these countries in the seventies of the XX century, the processes of transition to democracy, and their European and Transatlantic integration, have all been followed with great attention. Later, after the fall of the iron curtain, the opening of our country to Europe and to the world brought along even more interest in learning from the experience of both countries. Of course, the Iberian Peninsula became attractive also for many other reasons: a rich history, culture, literature, art, and also because of being a popular destination for tourism, academic exchanges, etc. This gave rise to a second boom of interest in the languages and cultures of these countries. The favourable perception of Spain and Portugal increased the popular awareness of the Hispanic and Lusitanian world as a whole. This way, indirectly – but logically – the positive image of Spain and Portugal enhanced the interest in Latin American countries.

Last but not least, another immaterial factor needs to be stressed as a very useful and inspiring source of perception of Latin America. Namely, it is the impact of teaching/learning Spanish in Slovakia. The language was officially supported by our educational system mainly in the sixties as a consequence of growing relations with Cuba. It is true that later this support grew weaker, but

as a result, the number of persons, who got in touch with Spanish, with the Spanish culture, and became interested in the Hispanic world, increased considerably. In the 80-ies also Portuguese started to be taught, but in a considerably smaller scale. Until the present day, this language has not reached a share comparable to Spanish within the Slovak foreign language education system.<sup>2</sup>

A short summary of the perception and relations with Latin America on the eve of the Velvet Revolution of 1989 should mainly include the following facts:

The former Czechoslovakia had its Embassies in 16 Latin American countries.

Despite the existence of the principle of the monopoly of foreign trade, and even though the volume of trade was relatively modest, Czechoslovak commercial offices and also some enterprises were active in the region.

Spanish – as one of the most influential “sources of perception” of the region was taught as a foreign language in 6 non-philological Faculties (e.g. those oriented towards Economics, Engineering, Agriculture, etc.) and also at some high schools; graduates of Hispanic Philology of the Faculty of Philosophy and Arts of the Comenius University were performing their valuable professional activities as Spanish teachers, translators, journalists.

All the previously mentioned experience, contacts, relations, and mainly the direct encounters with the Latin-American region caused that the number of persons, for whom this part of the world ceased to be a “*terra incognita*” was gradually growing. These were mainly the graduates of Spanish Philology and Linguistics – and later those of Portuguese – as well as professionals, students, teachers, who spent periods in Cuba and, to a smaller extent, in other Latin American countries, Slovak diplomats in the region, employees of enterprises, which cooperated with Latin American countries, journalists, translators of Hispanic and Lusitanian literature, and also those graduates of different non-philological Schools, who learnt Spanish as a foreign language during their university studies, etc. A lot of these persons became convinced about the importance of relations with Latin America and they were spreading interest in this part of the world.

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<sup>2</sup> Spanish Philology was introduced into the curriculum of the Faculty of Philosophy and Arts of the Comenius University- in 1954; the Portuguese in 1980

### 3. Present relations of the Slovak Republic with Latin America

In 1993, after its formation as an independent country, the Slovak Republic – being a succeeding State of the former Czechoslovakia – continued the good tradition of relations with Latin America.<sup>3</sup> The emerging country has established diplomatic relations with all the countries of the region of Latin America and the Caribbean (with the exception of three Caribbean countries). The country's priorities in the field of foreign relations, as might be expected, were oriented mainly on the issues of European and transatlantic integration processes. In addition to its unquestionable pro-European policy, it was important for Slovakia to develop relations with others parts of the world, among them also with Latin America.

Nevertheless, the evolution in this field shows that after 1993 the Slovak presence in Latin America has been gradually decreasing. An expressive example of this statement is the fact that at present there are only four Slovak embassies in the region: in Argentina, Brazil, Cuba, and Mexico.<sup>4</sup> All the others have been closed for economic reasons. Regarding the Latin American embassies with accreditation for Slovakia, almost all of them have their seats abroad: the majority in Vienna, two of them in Budapest, and two in Berlin. The only Latin American Embassy located in Bratislava is that of Cuba. The weak presence of Slovak Embassies in Latin America is partially counterbalanced by the growing number of the Slovak Honorary Consulates in Latin American countries. Nowadays, their total number is 18. It is also some promising development, that various Latin American countries have established their Honorary Consulates in the Slovak Republic.<sup>5</sup>

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<sup>3</sup> Analytical materials from the Ministry for Foreign Affairs and the Ministry of Economy of the Slovak Republic, as well as the below mentioned articles have been used as sources of data regarding the present relations of the Slovak Republic with Latin America and the Caribbean:

- Berényi, J.: Foreign Policy of the Slovak Republic and Latin America
- Seko, P.: Obchodná a hospodárska spolupráca Slovenskej Republiky s Latinskou Amerikou
- Seko, P.: Eslovaquia y sus relaciones políticas con América Latina en el contexto de su membresía en la Unión Europea.

<sup>4</sup> The seats of the Slovak Embassies in Latin America and their areas of competence:

- Buenos Aires (Embassy accredited for Argentina, Chile, Paraguay, Peru, Uruguay)
- Havana (Embassy accredited for Cuba, and Caribbean countries)
- Mexico City (Embassy accredited for Mexico, Belize, Guatemala, Honduras, Costa Rica, Nicaragua, Salvador, Panama, Colombia, Venezuela)
- Brasilia (Embassy accredited for Brazil, Ecuador, Guyana, Surinam)

<sup>5</sup> For the time being, seven honorary consulates of Latin American countries have been established in the Slovak Republic, namely those of Colombia, Peru, Chile, Nicaragua, Salvador, Brazil, and Costa Rica.

Other important facts, which can illustrate the present situation in the field of Slovak political relations with the region, are the following. Several visits at the highest level and other important political contacts including consultations on the level of Vice-Ministers have taken place in the recent years.<sup>6</sup> Slovak Republic has achieved the status of Permanent Observer in the Organization of American States (starting in April 2002); our Ambassador to the USA represents the country in this organization. After its accession to the European Union (May 1<sup>st</sup>, 2004), the Slovak Republic has taken part in the Summit of the European Union, Latin America and Caribbean, held in Guadalajara, Mexico (2004). The country has also been taking part in bi-regional negotiations between the European Union and MERCOSUR, Grupo Andino, Central America, and in bilateral negotiations of the EU with Mexico and Chile; Slovakia is also a member of the working group for Latin America - COLAT (since May 2004).

Also in the field of economic and commercial relations, Slovakia has succeeded to all the bilateral agreements with Latin American countries. Later, after a revision of all its agreements, Slovakia established new ones with its most important commercial partners, namely with Brazil, Mexico, and Argentina.

After the accession of Slovakia to the EU, our economic relations are further developed within the framework of the European common policy. In accordance with this, attention is paid mainly to the cooperation with big Latin American integration blocs, mainly MERCOSUR and CARICOM.

With regard to the topic of commercial relations, it has to be stated that the participation of Latin America in the Slovak foreign trade could be hardly considered satisfactory. The volume of mutual foreign trade is low. It is true that when considering only the absolute numbers, the development is showing a slight increase in the last years. But the relative participation of the region in the overall Slovak foreign trade is extremely low and rather stagnating. Brazil, Argentina, and Mexico are most important Latin American commercial partners. Nevertheless, the volume of our mutual commerce is relatively low, as well.<sup>7</sup>

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<sup>6</sup> (a) From Latin America to Slovakia, the visits of the President of Brasil E.H. Cardoso (February 2002) and of the President of the Parliament of Chile A.Zaldívar Larraín (2000); from Slovakia to Latin America, the visits of the President of the Slovak Republic Rudolf Schuster (to Argentina, Brasil, Chile in July 2001) and of the President of the Slovak Parliament J.Migaš (Mexico and Cuba in May 2002)

(b) At the level of Secretaries of State, from Slovakia to the region, visits to Mexico, Argentina, Chile, Uruguay (1995), to Cuba (1996), to Panama, Costa Rica, Cuba (2000), to Bolivia, Paraguay, Uruguay (2001), to Mexico (2003), to Argentina, Chile (2004)

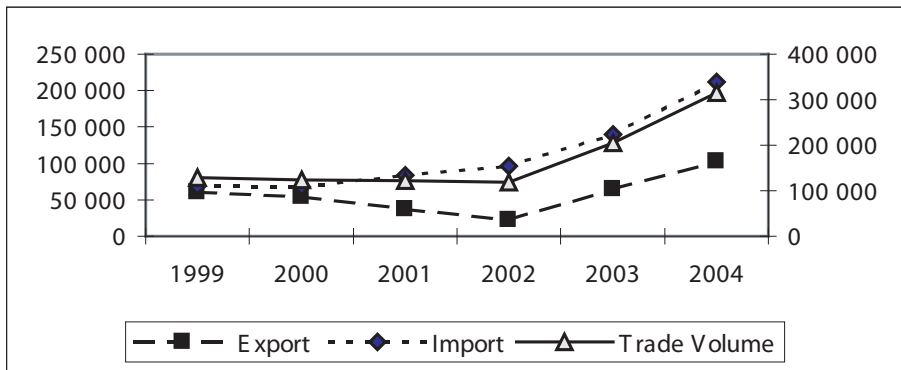
(c) At the Ministry of Foreign Affairs of the Slovak Republic, consultations on the level of Vice-Ministers from the following countries have taken place: Cuba (1996), Chile (2001), Mexico (2000, 2002)

<sup>7</sup> As an illustration, the mentioned countries rank as low as 38 to 223 among our commercial partners.

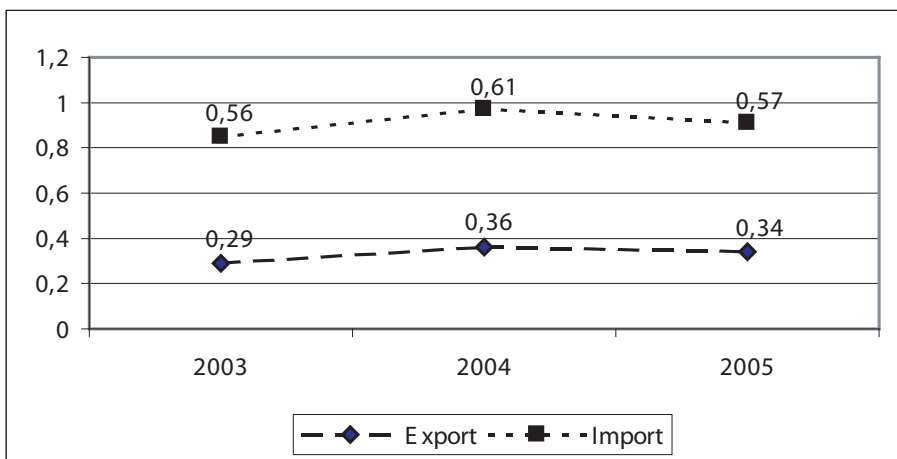
**Table 1:** Evolution of the Foreign Trade of Slovak Republic with Latin America and Caribbean in the years 1999-2004 (Thousands of USD)

Year	1999	2000	2001	2002	2003	2004
Export	60 352	54 092	37 235	22 654	64 846	102 800
Import	69 089	68 219	84 085	96 466	139 630	211 800
Trade Volume	129 441	124 311	121 320	119 120	204 475	314 600

Source: *Foreign Trade Statistics of Slovak Republic*, Bratislava, 2005

**Graph 1:** Evolution of the Foreign Trade of Slovak Republic with Latin America and Caribbean in the years 1999-2004 (Thousands of USD)

Source: As for Table 1.

**Graph 2:** Participation of Latin America in the total Foreign Trade of the Slovak Republic in the years 2003-2005

Source: As for Graph 1.

Other forms of cooperation have not yet been developed. In Slovakia there is only one important foreign investment from the region that of the Brazilian company EMBRACO in the eastern part of our country.

In the opinion of the analysts of the Slovak Ministry of Foreign Affairs, the main obstacles for a more intensive development of economic and commercial relations are the geographic distances between both regions and the lack of mutual knowledge.

Regarding relations in the field of education and culture, for a long time the mutual contacts and exchanges were rather sporadic. The same could be said about the cooperation between universities; three Slovak universities have signed some framework cooperation agreements with their partners in Latin America.<sup>8</sup> Unfortunately, because of the lack of necessary financial support, the academic cooperation cannot be developed as desired.

However, in spite of all the above facts, a qualitative leap to a more intensive, clearer and more realistic image of Latin America has taken place in the eyes of Slovak citizens. This is mainly because of a more favourable general societal context, i.e. Slovak openness to Europe and to the world that gives many more possibilities to travel abroad, rapidly increasing personal contacts with all kinds of visitors from all over the world, an unlimited accessibility of mass media channels.

Such better conditions opened a wider space for initiatives and activities of the so-called “subjective” factors: A big variety of stakeholders are promoting and organizing academic and cultural activities. Among them are Spanish and Portuguese teachers, university departments and units, as well as various clubs; associations and other NGOs oriented towards the Iberian and Latin American world<sup>9</sup>, amateur groups of Latin-American music and dance, etc. Numerous activities of Latin American embassies – as well as those of the Embassy of Spain and Aula Cervantes – are also spreading knowledge about the culture and society of this region. Contacts with our compatriots and their associations have been intensified.

Spanish and Portuguese, the languages that are the real communication bridges between the two continents, have achieved better positions within the language-teaching offer in Slovakia. Especially Spanish has been growing rapidly. At present, there are even seven bilingual Slovak-Spanish high schools

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<sup>8</sup> The University of Matej Bel in Banská Bystrica, the Slovak Technical University, and the University of Economics in Bratislava concluded agreements with their partners in Chile, Mexico and Argentina.

<sup>9</sup> Among the NGOs, mainly SEILA – The Slovak Association for Relations with the Countries of Iberian Peninsula and Latin America, – founded in 2000, is actively organizing valuable activities in cooperation with the Ministry for Foreign Affairs of the Slovak Republic and with the Embassies of Latin American countries. The SEILA has its seat at the University of Economics in Bratislava, the President of SEILA is Miroslav Behúň, the Honorary Consul of Colombia.

in Slovakia. In this regard, our country occupies the second place within Central and Eastern European countries. The number of learners of this language at all the levels and all forms of formal and informal educational systems has increased considerably. The result is that nowadays, teaching or learning Spanish is not perceived as anything “strange” anymore. However, a crucial point should be stressed: as of now, there are still insufficient possibilities to use the language for professional or study purposes.

Despite the above mentioned positive changes in the Slovak perception and interpretation of Latin America, the general awareness of the necessity of strengthening relations with Latin America in Slovakia – and probably also in other European countries – is not strong enough. Particularly the potential for economic co-operation has not been discovered within the relevant decision-making structures and, as a consequence, Latin America is still remaining considerably far from our priority interests.

#### 4. Introducing Latin America through learning Spanish language

Experience drawn from teaching Spanish as a foreign language at the University of Economics in Bratislava<sup>10</sup>, represents an eloquent illustration of how perception and interpretation of a region (Latin America) could change and in which way this changes influence the attitudes towards it. The following extract from a student essay about the perspective of cooperation with Latin America can serve as a useful starting point:

“In the last year of Grammar School I had no idea what I would do in the future (...); by chance I passed entrance exams for a bilingual (*Slovak-Spanish*) High School ... I thought that later I would change for another school ... but the result was that I liked it ... now I am trying to find a job (*in addition to my studies at the University*) in a company where I could make use of my Spanish...the possibility to use Spanish was also the reason why I applied to study International Relations... (*Regarding commercial and economic relations with Latin America*)... there are some bananas in our shops, some coffee from Latin America...for the moment I cannot recall any specific idea about possible areas of cooperation ...but I am sure that it is possible to find several possibilities ... I would be very glad if could do something for it...”

This quotation represents the essence of the following – explicit or implicit – messages resulting from conversations with students (or graduates) of the University, who have learned Spanish as a foreign language during their studies:

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<sup>10</sup> At the University, several foreign language courses are provided. University graduates are supposed to be able to communicate in at least two foreign languages, and at the Faculty of International Relations even three.

Firstly, regardless of how they learned Spanish (by chance or as a deliberate free option) most of them cannot find sufficient possibilities to use the language in their professional lives. The reason is that the economic cooperation of Slovakia and Spanish speaking countries in the economic and entrepreneurial field is rather poor.

Secondly, many of them are actively searching for these opportunities, as they want to use their Spanish, because they “like” the language, or because they have gotten interested in the reality of Spanish speaking countries.

The same message about the emerging “pro-active attitudes” can be seen also in their behaviour. Many of these University graduates, working in important positions (diplomacy, institutions of public administration, private and public enterprises), show more understanding for different projects related with Latin America (or Spain) than other people in their professional environment. Moreover, there are also cases when these economic and business career graduates, who are supposed to be very “pragmatic”, try to find possibilities for their commercial activities with Latin America despite the fact that this option seems to be very distant from a pragmatic solution.

Also the history of Spanish as an optional foreign language within the University curriculum can serve as another example of changing perception and interpretation of Latin American realities.

Teaching Spanish language at the University of Economics in Bratislava has a long tradition. It was introduced into study plans in 1940, the same year when the University was founded. In spite of this, for many years, students did not manifest much interest in applying for courses of the language and the number of Spanish learners was almost insignificant. Further evolution of learning Spanish as a foreign language at the University, as well as in whole Slovakia, is a reflection of big social and political transformation in the external environment. Briefly, the first decisive qualitative break occurred as a result – although belated – of the already mentioned relations with Cuba, and the second one after the Velvet revolution on the threshold of the new century. Of course, the interrelation between the “interest in learning Spanish” and the relevant “societal changes” (e.g. development of relations, openness to the world) was not direct neither automatic. In this respect, the role of the above mentioned “subjective factor” was especially significant.

In the eighties, following a decline of the authorities’ support for Spanish, negative tendencies appeared. The prevailing conviction that the world is – and forever will be – bi-polar led some decision-makers in the sphere of Higher Education to set up new rules for teaching/learning of foreign languages. Only the languages of the so-called “super-powers” – English and Russian – were considered worthy to remain in the university study plans. It was necessary to protest and argue against these measures in order to “defend” the positions of

all other foreign languages taught within the educational system of that time: French, German, and also Spanish. These efforts were successful.

But startlingly, similar dangerous tendencies regarding linguistic pluralism in the higher education system appeared in the first years after the democratic changes, which occurred in the country in 1989. This time, maybe the reason was an emerging vision of a uni-polar world, or as a result of simplifying pragmatism, according to which it would be sufficient to teach/learn only English. Once again, activities and arguments of Slovak language teachers – among them those of Spanish – succeeded to stop these tendencies.

As a result, also at the University of Economics it has been possible to maintain and even increase the number of offered foreign languages and enforce linguistic policies, which now provide students with a free choice of language courses according to their individual needs and interests.

Regarding Spanish, its ratio among other foreign languages taught at the University started to grow gradually since the late sixties of the XX century. From an initial number of 3-4 students, who used to apply for Spanish courses in each academic year at those times, this quantitative indicator has at present reached approximately 300 per academic year.

Also, a considerable qualitative change has taken place regarding the perception and interpretation of Spanish and the Spanish speaking countries. In this respect, mainly various European projects, in which the University has cooperated with partner institutions from Spain, have to be mentioned as a milestone. It was the first time in the University history, when students were given the possibility to listen to lectures and take part in seminars and workshops within the area of their professional interest (Economics and Management) taught in Spanish by teachers and other professionals from Spain. Moreover, these international projects allowed students to use their knowledge of Spanish during their study periods or practical placements in Spain. Contacts of University and Faculty administration with their Spanish partners (and later also with Portuguese) have also played an important role.<sup>11</sup>

The University's public opinion about Spanish has been changing slowly. It has started to be considered as something more than just a "beautiful" and a slightly "exotic" language. Suddenly, it has turned into a useful means of communication for study purposes. One thing, however, is especially important: Learning Spanish has helped students to get more information not only about Spain, but also about the Spanish-speaking area as a whole. And what is more,

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<sup>11</sup> Within the European projects supported by TEMPUS, Leonardo da Vinci, Socrates and other European Union programmes, the University has cooperated with the following partners from Spain: the University of Granada, Complutense University of Madrid, University of Alcalá, University of Vigo, Chamber of Commerce and Industry of Madrid, Chamber of Commerce, Industry and Navigation of Granada; in Portugal our University partners include ISCTE Instituto Superior de Ciências do Trabalho e da Empresa, in Lisbon, and University of Coimbra

in some cases, this approximation of the Iberian and Latin American world motivated students to start learning Portuguese and pay attention also to the Lusitanian world.

The effects of this changing perception can be observed, among others, in the growing number of graduate and doctoral theses related to different aspects of the socio-economic reality of Spain, Portugal, and Latin America. Only thanks to this changed atmosphere and the support of the University management board has it been possible to establish -in 1998 – a specific Centre for Iberian and Latin American Studies (CEILA) whose explicit mission it is to promote this orientation at the University.

### 5. Starting points for the creation of a strategy

The history of Slovak relations with Latin America, perception and interpretation of the region, as well as the experience of the University of Economics in Bratislava has clearly shown some seemingly banal aspects.

In addition to all the objective external factors (such as the geo-political aspects, availability of resources, geographic distance, economic, social, and political situation, etc.) also subjective and immaterial factors play an important role. This is why the attitudes of individuals and groups towards cooperation and relations with various target areas (such as their support, indifference, or rejection of different co-operation projects) must be taken into account when trying to foster relations with a region (in our case, with Latin America). At the end of the day, a prevailing part of the so-called objective conditions are being created or changed by human decisions and activity.

Development of relations with a country/region generally motivates people's interest in a deeper knowledge about the given civilization, society, its culture, and even in learning the language, and vice versa. Direct contacts with the reality of the partner country/region (academic and work-related mobility) are especially enriching in terms of a better mutual knowledge and understanding. Generally speaking, Latin America has been perceived in Slovakia positively; its peoples and cultures have been considered as somehow alike and close to our idiosyncrasy. Thus, the starting points for our intercultural communication seem to be favourable. The similar could be stated about other European countries emerging from the former eastern bloc. Some features in the previous socio-political developments – namely the fact that neither Latin America neither the mentioned group of European countries has ever constituted “centres of power” – could explain that at present there are no barriers caused by sensations of superiority or inferiority within their intercultural communication. However, the conviction about the pragmatic importance of mutual relations has not been developed enough.

## 6. The Complex Character of the Intercultural Communication Concept

Nowadays, the expression *Intercultural Communication* (IC) is a frequently used term. In fact, it is really in vogue, both as an object of scientific interest and research, as well as a central topic in various types of educational activities. This statement has its logical basis: in the present global world, contacts and relations between individuals, groups, and institutions belonging to different cultures are to a greater and greater extent becoming our daily business.

On the other hand, in the educational practice, the concept of IC is – in more than just one case – presented in too simplified a manner. Sometimes it is reduced to phenomena such as forms of greetings, some specific customs or norms of behaviour. Of course, it is useful for students to get acquainted with all this. However, such a simplified approach might even have a negative impact. Firstly, sometimes it presents superficial cultural phenomena, which are changing more or less rapidly. The main reproach, however, is the fact that it may lead to the “petrification” of existing prejudices instead of a serious interest in the culture, country or region in question.

In reality, Intercultural Communication is a complex notion, both as phenomenon and as an object of scientific studies. The complex character of IC as a phenomenon is clearly and easily understandable. The very meaning of the two key words “communication” and “culture” shows different ways of their interpretation. The phenomenon of “social communication” might be understood in the wider sense of the word “as a complex and multiple social interaction” between persons or groups. In the narrower sense of the word, “communication” can be conceived as the most important tool for the above-mentioned social interaction.<sup>12</sup> Also the phenomenon of *culture* might be understood in different ways. For the sake of this article, let us take into account its two possible meanings.<sup>13</sup> In the narrower sense of the word, culture relates to the

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<sup>12</sup> Among plentiful of definitions of the term “social communication” the above-mentioned first interpretation of the notion could be supported, for instance, by the following quotation: “Communication can be understood as an alternative behaviour, as a process of interaction”. Kern, H.: *Prehled psychologie*, Portál s.r.o. Praha, 1999, p. 240.

The second interpretation has its reference, for instance, by Nový, I., who defines the “social communication” as “a major tool or means (of social interaction)”, “a process by which people transfer a great variety of information and experience”; Nový, I.: *Schroll-Machl, S.: Interkulturní komunikace v řízení a podnikání 2. vydání*, Management Press, Praha, 2001, p. 8, (Quotations translated from Czech by the author of the present article)

<sup>13</sup> The concept of “Culture” can be studied at three levels:

1. The first level refers to the research on culture in the attributive sense of the term, as an universal human phenomenon
2. The second level of cultural phenomena is represented by their study in the distributive sense, at the level of sub-cultures; it means, not in general terms, but in relation to the specific socio-cultural systems, which could be identified in time and in space.

belongingness of a person or a group to a certain nation, country or ethnicity. In the wider sense, culture can be understood as a multiple belongingness of a person or a group to different sub-cultures conceived as such according to a big variety of socio-cultural criterions, e.g. social class, gender, age, profession. It is obvious that in the latter sense of the word, almost all communication could be considered intercultural. As a consequence, for the sake of a clear delimitation and definition of the object of study for research and as a topic for education, the first narrower meaning of the word – the one related to such terms as nation, country, and ethnicity – is usually taken into account within the concept of Intercultural Communication.<sup>14</sup>

The strong interdependence between culture and communication has been shown in the fifties of the last century in the founding work of this emerging scientific field in which its author Edward T. Hall claims that “Culture is Communication”.<sup>15</sup> At present, both culture and communication constitute central categories of different social sciences and humanities. The tendencies within the conceptualisation of both terms confirm the basic Hall’s thesis.<sup>16</sup>

Since the appearance of the first modern definition of culture<sup>17</sup>, an endless list of its interpretations has been developed. The difference between the early

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3. The third level is that of the individual person; it is the analysis of culture and personality in a specific socio-cultural context.

A.Vodáková, O.Vodáková, V.Soukup, Eds., “Sociální a kulturní antropologie”, *Ediční rada Sociologické pojmosloví svazek 3*, Sociologické nakladatelství SLON, Praha, 2000, pp. 89-90.

<sup>14</sup> This step, of course, is only an inevitable and necessary abstraction of the intricate whole. Therefore, both in research as well as in education, the second wider meaning has to be always taken into account. The previous statement may appear too banal, but an insufficient holistic view of the issue of Intercultural Communication, with all its interdependent components, may lead to serious misunderstandings and misinterpretations in research, education, as well as in communication practice.

<sup>15</sup> For instance, in the introduction to *Silent Language*, E.T. Hall summarizes the core content of the book stressing the interconnectedness between culture and communication by saying: “Trager and I developed a theory of culture based on a communication model (...) which provides its theoretical underpinning”. Hall, E., *The Silent Language*. Anchor Books. Doubleday, 1990. P. Introduction xi.

<sup>16</sup> The term of “culture” is mainly the study object of the so called “Theory of Culture”, which has arisen as a synthesis of two anthropological schools: Cultural Anthropology developed mainly in the USA, which considers culture to be a “typically human non-genetic phenomenon shared by the members of a collective”, and Social Anthropology, a school developed mainly in United Kingdom which, in comparison with the above-mentioned approaches, stresses more the role of social structures.

<sup>17</sup> The first scientific definition of the term “culture”, whose author is E. B. Tylor (1871), is including within this concept, for instance, the knowledge, religion, law, moral, customs, competencies, and habits. In: *Sociální a kulturní antropologie*. K vydání připravili A.Vodáková, O.Vodáková, V.Soukup. Sociologické nakladatelství SLON, *Ediční rada Sociologické pojmosloví svazek 3*. Praha, 2000, p. 11-12.

concepts of culture and the relatively recent ones is essential. Now, within the concept of culture the role of profound mental strata – symbolic and cognitive systems to which also languages belong – have been underlined.<sup>18</sup> Also the concept of “communication” has undergone important development since first synthesis within theories of communication and inform has been produced in the sixties of the past century. But, for all that, the most important and valuable communication systems and tools for human communication are languages. Language is “the central part of culture, the nucleus of all symbolic systems”.<sup>19</sup> This is the reason why the science of language – the linguistics – also belongs to the central study fields related to Intercultural Communication.

### **7. Interdependence between international relations and intercultural communication**

To answer what is the place of intercultural communication within education and research in the field of international relations, we have to explain the relationship between intercultural communication and international relations. Globalisation means, among others, that the number of stakeholders, who play a relevant role in the creation of intercultural perception and interpretation has been growing very quickly. Of course, it is the governments, states, parliaments, and authorities, which establish frameworks and “rules of the game”. There are, however, also masses of individuals, who come into contact with other cultures and other countries through a big variety of channels (internet, television, broadcast, reading, tourism, academic exchanges, job mobility, etc.). Other collective stakeholders may even establish various kinds of international links and relations (private industries, NGOs, other institutions, etc.). The processes of emigration and immigration are creating other important sources of intercultural encounters in the interior of the individual countries. The bearers of culture are establishing increasingly closer and frequent contacts. Moreover, it is to be expected that these kinds of informal and formal intercultural contacts will be increasing their intensity and will influence mutual perceptions and interpretations of different cultures for better or for worse. As an example, let us consider, with regards to the first group, for instance, tourism,

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<sup>18</sup> For instance, one of the most influential schools, the so-called “Cognitive Anthropology”, which studies interrelations between the language, culture and cognition, conceives the concept of culture in a considerably narrow way as “... the forms of things that people have in mind, their models for perceiving, relating, and otherwise interpreting them.” Goodenough: 1957

<sup>19</sup> Murphy, R. F.: Úvod do kulturní a sociální antropologie, Sociologické nakladatelství SLON, Praha, 2001, p. 38; It is an example of many similar statements formulated within cultural and social anthropology.

cultural and academic exchanges, and, regarding the second one, the phenomenon of international terrorism, drug trafficking and internet hacking.<sup>20</sup>

Independently of the conception of the social communication, in its wider meaning as a complex social interaction or in a narrower sense of the word as the most important social interaction tool, we should assume that the concept of intercultural communication is strongly related to international relations. In fact, in the first case, it expresses the very process of establishment, development or termination of social and interpersonal contacts (interaction, relations) between entities (persons or groups) pertaining to different cultures; in the second case, it is strongly interrelated with the entire process.

According to their current definitions<sup>21</sup>, international relations are “relations between countries, nations or states, which have a form of mutual acceptance (peace) or confrontation (war). In the peace the international relations are performed by diplomacy. They need a supporting political background based on international agreements (/bilateral and multilateral) and in international organizations. International relations might have a form of economic and cultural relations, but they have always-political character.”

In comparison with this international relations concept, intercultural communication is a wider notion. In terms of its area of social activity, it is not limited to political relations between countries. In terms of its participants (actors), it is not limited to official representatives of States, countries, governments, or other official institutions within international relations

As a conclusion from the above statements it is possible to claim that International Relations – as a phenomenon, as a research object and as an educational topic – is now strongly connected with Intercultural Communication. It is also evident that in the present global environment the outline of clear and unquestionable limits between both concepts is becoming a rather difficult and intricate matter. Therefore, within different study programmes related to the Study Field of International Relations the Intercultural Communication Field is fully justified.

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<sup>20</sup> In addition to the stated changes, Lanús, J.A. points out a substantial shift regarding the prevailing themes in international preoccupations of governments and of the world community moving from traditional topics towards the collective and individual problematic of the human being (such as, e.g., human rights, help for refugees, woman rights, humanitarian assistance for victims of disasters and civil conflicts, democracy, etc.) In international agendas – with respect to the world governance – the importance of “social” aspects has been gradually growing. As the author claims: “The human person has become the protagonist of international relations”.

Lanús, J. A.: *Un Mundo sin Orillas. Nación, Estado y Globalización*, Buenos Aires, Emecé editores S.A., 1996, p. 189-190.

<sup>21</sup> *Slovník spoločenských vied*. SPN Bratislava 1997, p. 145.

## 8. Intercultural communication in international economic relations – The educational concept

The University strategy of implementation of new contents and approaches related to IC +AS into its educational practice consists in two action lines:

- To design and implement a specific Degree Course;
- To strengthen internationalisation and inter- and multi- disciplinary approaches within the University educational process.

### *8.1. Designing IC + AS educational concept*

The starting point for the design of the IC+AS educational concept consists of the assumption that at present, the philosophy underlying international and intercultural communication between stakeholders should respect the so-called “win-win” strategies. Nowadays, trying to suppress the legitimate interest of the counterparts (independently of the negotiation level, content and aims) cannot lead to an equitable and satisfactory result. Rather, it might provoke long-lasting problems, tensions, etc.

Of course, the previous statements presuppose a certain indispensable simplification of the matter as well as an artificial reduction of the reality. Nevertheless, it has been getting more and more evident that a need of a firm ethical basis within the international (economic) relations practice is no more an idealistic dream, but a real, urgent and pragmatic necessity.

This is why, in the field of international (economic) relations, or, more generally speaking, in the present economic practice – which is par excellence, intercultural and international – efficient communicators, negotiators or mediators are needed. These specific university graduates and professionals within international (economic) relations or other similar fields should be able to perform successfully in all kinds of communication activities with international partners. The concept of a mediator is currently defined as a specific profession, usually including a considerable expertise in Law; it is a person, who “mediates or intervenes in a problem, quarrel, etc., trying to find a solution”. However, the role of a mediator in international economic relations could be understood also in the wider sense of the word.<sup>22</sup>

A professional in international economic relations (Business Management, International Trade, International Finance, Political and Economic Diplomacy) being at the same time an efficient communicator actively searching for

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<sup>22</sup> As defined in current dictionaries, for instance in “The world book dictionary”. Edited by: Barnhart, C. L.-Barnhart, R. K. World Book, Inc., 1992, p. 1289.

Mediate: to come in to help settle a dispute; be a go-between; act in order to bring about an agreement between persons or sides. Mediator: a person or group that mediates.

win-win strategies within all kinds of international negotiations can be taken for an intercultural mediator in international economic relations or in international economic practice.

Therefore, in general terms, the main aim of the foreseen Master Degree Course at the University would be to prepare the graduates to become excellent communicators or even mediators with international partners from a specific chosen region. The academic profile of its graduates would be the result of a combination of International Economic Relations (or other fields within Economics or Management in the international dimension) and relevant courses related to Intercultural Communication and a given Area Studies (e.g. Iberian and Latin American countries).<sup>23</sup>

The definition of the general aim influences the design of all components of the Degree Course. In the proposed Master Degree Course, the Intercultural Communication is conceived in its wider sense as a “complex social interaction” between actors/participants identified with different cultures within a specific professional area. Nevertheless, the attention is paid also to the Intercultural communication as a means of that “complex social interaction”. As a result, the content and approaches of Degree Course will have a strong inter- and multi-disciplinary character. In addition to the core content within the field of International Relations, the study program will contain courses from several social and human sciences in order to provide students mainly with: good theoretical comprehension of the concept of IC; solid knowledge about the social, political, economic and cultural reality of a given region, both from a historical and a current perspective; capacity for critical thinking by analysis, commentary and interpretation of discourse about phenomena, processes, and tendencies in the socio-political, economic and cultural reality of the given region; competence and skills in the research methodology within intercultural communication and area studies; theoretical basis in the field within communication for specific professional purposes together with the related communicative competence and practical skills in the given language; comprehension of the importance of ethical principles within international economic relations.

Regarding the specific Degree Course – which represents the topic of this article – one aspect is to be stressed. As we could see by the introduction of Slovak perception and interpretation of Latin America, the image of Spain and Portugal, and relations with these countries, have a direct impact on the perception and interpretation of Latin America. Therefore, our course *Intercultural Communication in International Economic Relations* takes into accounts both Iberian as well as Latin American studies.

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<sup>23</sup> According to the new Slovak Higher Education Act, the Study Program could arise as a combination of two Study Programs from two different Fields of Study (e.g. International Economic Relations + Languages and Cultures).

## **9. Intercultural communication in international economic relations – The research concept**

Having in mind the extreme complexity of the notion of IC+AS, it is clear that the possible research topics and approaches are virtually unlimited. As we were able to see upon the reviews of the experience of Slovak international relations with Latin America, as well as from a brief introduction of basic notions of Intercultural Communication, one of the central and decisive concepts within the IC processes is that of perception. This determines, positively or negatively, the whole process of intercultural communication.<sup>24</sup>

Because of this, mutual intercultural perceptions between potential stakeholders in international economic relations have turned into the central object for our research. The hypothesis goes that all kinds of intercultural experience, and mainly that related to learning of languages and the reality of other countries, leads to the creation of a more adequate perception of a country/region, and might stimulate active interest in various forms of international cooperation. The research object would be the study – within the target group constituted by students of Economics and Management, as well as professionals in relevant positions within entrepreneurial and public administration sphere – of two variables: on one hand, their intercultural experience (such as learning languages, taking courses in intercultural communication or area studies, practicing tourism, taking part in international mobility, etc.) and, on the other hand, their perception of the selected regions (countries) and their attitude toward a cooperation with them.

The central questions to be answered can be summarized as follows: how and to what extent does this intercultural experience, and especially different forms of education directly oriented towards the development of intercultural competence, influence perceptions of other countries/cultures/regions, attitudes towards international cooperation and value orientation.

### *9.1. The orientation values*

Later, this previous idea led to the conception of an integrated multidisciplinary applied research project within social sciences and humanities. The general objective of this policy-oriented project is to create a systemic approach to foster an efficient entry of Slovakia into the processes of international creation and transfer of knowledge and technology with selected partners (countries, regions). For Slovakia, as well as for other European countries, generally speaking, the knowledge transfer from those specific scientific areas in which Latin American research is achieving high quality levels and a joint generation of knowledge

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<sup>24</sup> Perception is conceived as “a point of departure as well as an important part of social communication”, Nový: 9

with Latin American researchers could strengthen European competitiveness in science and research. Favourable conditions for the above-mentioned cooperation regarding both interrelated spheres: knowledge and technology transfer and the increase of general educational levels. In addition to the favourable starting points for intercultural communication, there are also other important objective prerequisites. The educational systems in this group of European countries have been reaching high quality levels even in the previous regimes. Therefore, they could provide to the region their highly qualified and skilled human resources, as experts for different spheres in the society life (health services, education, agriculture, and others), teachers for all educational levels, as well as trainers for vocational training required by entrepreneurial sphere.

## 10. The University of Economics action plans

In 2001 the leadership of the University decided to establish the International Programs Institute (IPI), whose mission consists in supporting the international dimension of all the University activities, developing specific innovative approaches within education and research, contributing to the promotion of the university international projects and in strengthening cooperation with external stakeholders (institutions, enterprises, etc.) in the country and abroad. In order to fulfil its general purpose, the IPI performs educational, research, information, and cultural activities. The Institute educational and research tasks consist in developing the above presented multidisciplinary study programs, courses in area studies and intercultural communication, as well as the related research projects.

At present, CEILA – Centre for Iberian and Latin American Studies forms a part of the institute. Its tasks consist of the performance of the above-mentioned activities applied to the studies of the area of the world expressed in its denomination. The foundation of similar centres oriented at other regions is foreseen. Regarding the specific issue of relations with Latin America, some relevant facts, activities and achievements are worthy to be mentioned.

Firstly, The University of Economics in Bratislava has signed framework bilateral agreements with two Latin American Universities.<sup>25</sup> Secondly, CEILA, being a member of CEISAL<sup>26</sup> (Consejo Europeo de Estudios Sociales de América

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<sup>25</sup> The University has signed agreements with Universidad de La Serena, Chile and Instituto Tecnológico de Monterrey, Mexico; with the latter HEI, the University of Economics in Bratislava cooperates in organizing a regular summer school for Mexican students.

<sup>26</sup> CEISAL-Consejo Europeo de Investigaciones Sociales de América Latina (European Council for Social Studies of Latin America) is a non-governmental organization, founded in 1971, operating within the UNESCO. Its members are 43 centres, institutions and associations of Latin American Studies from 18 European countries. The CEILA – Centre of Iberian and Latin American Studies of the University of Economics in Bratislava is currently a member of the Directive Committee of the CEISAL.

Latina) and of its Directive Committee, is taking part in different activities of this NGO. Authorized by CEISAL, CEILA organized the IV European Congress of Latin American Studies held in Bratislava in 2004.<sup>27</sup> Thirdly, very important is the cooperation agreement with the Cervantes Institute according to which an AULA CERVANTES has been established at the University. This institution – whose mission is to spread Spanish language and culture in Spanish – that is, the culture of all the Spanish-speaking countries, is of great importance.

On the basis of the above-mentioned ideas, projects, and results within education and research, the University has submitted, together with other prestigious Slovak universities and institutes of the Slovak Academy of Sciences, an ESF project aimed at the support for integration of Slovakia into the international creation and transfer of knowledge and technology.<sup>28</sup> A common Centre of excellence, integrating relevant activities, should create a systemic basis in order to achieve this general objective. Thus, it is foreseen that the centre will consist of the following units:

- Information unit, the main task of which will be to run an information system about the potential Slovak supply and demand for creation and transfer of knowledge, and for its matching with international cooperation partners;
- Research unit performing a multidisciplinary research in the three areas as explained in the previous chapter;
- Educational unit offering a compact modular program for a due preparation of different stakeholders to participate in international transfer of knowledge (research methodology in social sciences, intercultural communication, languages, international project management);
- Communication unit, which will serve as a platform for contacting and matching of domestic and international partners (universities, research institutes).

Integration of relevant activities needed for the strengthening of international co-operation, as well as integration of a high-level specific expertise of each project partner, represents the added value of the project.

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<sup>27</sup> The IV European Congress CEISAL of Latin American Studies was held at the University of Economics in Bratislava on 4-7 July 2004 under the auspices of the Office of the President of the Slovak Republic. The Congress represented a multidisciplinary forum in the fields of social and economic sciences and humanities. It hosted more than 600 scholars from 35 countries of the world.

<sup>28</sup> The project A Multidisciplinary Network of Excellence for the support of the entry of the Slovak Republic into the International Creation and Transfer of Knowledge and technology has been submitted in the spring 2006. The project partners are: The University of Economics in Bratislava (co-ordinator), the University of Comenius, the Slovak Technical University, two Institutes of the Slovak Academy of Sciences, Slovak Academic Association for International Cooperation, Association of Deans of Economic and Managerial Faculties, and international Association MILSET.

## 11. Strengthening Dialogue with Latin America within the European context

Nowadays Europe is stressing its openness to the co-operation with other parts of the world. Therefore, the conditions for developing a dialogue with Latin America seem to be favourable. Firstly, it is due to the unquestionable cultural affinity of both parts of the world, but also due to political steps at the highest levels, which have created a stimulating framework for the enhancement and strengthening of mutual relations. The willingness to support these processes was expressed at the summits of Europe, Latin America and the Caribbean held in Rio de Janeiro (1999), Madrid (2001) and Guadalajara (2004).

Especially declarations related to the common will to build a “strategic alliance” between the two parts of the world constitute an inspiring and meaningful vision. In spite of the well-known ups and downs within the development of this process, it is expected that the next summit in Vienna (2006) will propose further steps in achieving these aims. Especially important are objectives related to the cooperation in the field of higher education, research and science. Political declarations of the summits have shown a compromise for the establishment of interregional cooperation in the field of higher education, development and to promotion of an action plan aimed at the creation of a Common Area of Higher Education and Research, and for support of the process.

In order to help the realization of these ambitious plans, some tools within various European Union programs have been created, (for example, within the 6<sup>th</sup> and now 7<sup>th</sup> Framework Program for the Support of Research and Science are *Erasmus Mundus*, *Alfa*, *Alban*). Nevertheless, given the strategic importance of the challenge, the material support for the dialogue in the field of Higher Education and Research cannot be considered as sufficient. This statement has been expressed in the Declaration of Guadalajara<sup>29</sup> in which the Universities of Latin America, the Caribbean and Europe confirmed their endeavour in supporting the process and, at the same time, made a call to Heads of States and Governments to study the possibility of launching, in occasion of the Vienna summit to be held in May 2006, a new action corresponding to the importance and the impact of the challenge.

The experiences of the University of Economics of Bratislava also confirm that for fully starting a real cooperation with Latin American Universities an efficient support from European Union education and research programs is inevitable.

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<sup>29</sup> Declaration from Guadalajara of the Universities of Latin America, the Caribbean and Europe. Signed in the Ibero.-American Library “Octavio Paz” in the City of Guadalajara, Jalisco, México, May 27<sup>th</sup>, 2004

## 12. Searching for sustainable interregional University co-operation

As already stated, our potential for economic, commercial and other co-operation with Latin America has not yet been adequately used. The geographic distance between both regions and the consequent lack of knowledge about the societal, cultural and economic realities create a kind of viscous circle hindering the full development of our relations with Latin America.

It is not easy to overcome these barriers, which originate a long series of practical problems. Official commercial offices cannot cope with all the activities needed for a more substantial development of economic relations with the region. Considering all this, various entrepreneurial projects without an efficient and continuous communication can be hardly achieved.

On the other hand, also the development of relations between Slovak and Latin American universities is jostling against serious and hard-to-overcome obstacles, namely the lack of financing. Sources coming from sponsors or other similar funds are usually short lasting. If we want university co-operation in the form of student and teachers, and researchers' mobility to be regular and efficient, it is necessary to search for other solutions.

It seems that the key could be found in the word *synergy*, and the interrelation between university tasks and intentions, with those of the society: with enterprises and institutions of public administration sphere. Universities could help to break the above-mentioned viscous circle through an intensive student mobility, which would be aimed not only at the university study, but also at practical placements in enterprises and institutions, so that they internships would support interregional relations.

Kind of specific supporting international cooperation university units – let us call them “liaison” centres in partner universities from both sides – could represent a way to channel this process. Its tasks would be to provide different services for individual enterprises, entrepreneurial groups, institutions, etc. for supporting their commercial and other economic projects in geographically distant territories. Students on internships could perform a wide range of useful activities (translating, interpreting, accompanying delegations, communicating with potential partners, working on other projects and tasks, such as market analyses, etc). In these conditions the enterprises and institutions involved would be more likely to contribute to the student subsistence costs or to cover them entirely. This way, the development of academic mobility could help in the development of economic and other relations. Common action would be interesting and useful for both parties: students would receive a unique occasion to get to know new distant countries, to improve their language skills, to widen their knowledge and cultural horizon, and also to acquire experience from practice. Enterprises and other institutions, on the

other hand, would receive a real help by establishing and developing relations with their partners.

A similar principle could be used for mutual teachers and researchers mobility. They could work in common international research teams on different research projects ordered by entrepreneurial or public administration spheres according to their real needs. The mentioned university centres could create a corresponding educational background offering incoming and outgoing students a large scale of courses aimed at the improvement of their intercultural awareness (languages, area studies, intercultural communication, etc.)

In this respect, the enhancement of the dialogue between European and Latin American universities would represent a powerful “point of departure” also for the European Union policies aimed at the supporting of linguistic and cultural diversity.

If an intensive cooperation between European and Latin American Higher Education Institutions, including an effective approximation of the Common Areas of Higher Education and Research took place, the European universities – cooperating with relevant external partner enterprises and institutions – could turn into a kind of “engine” supporting interregional transatlantic cooperation.

However, for the commencement of this process, a powerful European University action encouraging interregional University-Enterprise-Society cooperation would be needed. It is to be expected, that gradually this mechanism would continue to function by its inner logic and turn to a sustainable cooperation between its parts.

### 13. European language policy and its relation to the interregional dialogue

The European Union has been postulating, through various official documents, the imperative of maintaining and developing the European cultural and linguistic diversity. Several measures have been adopted and different programs designed for the support of teaching/ learning of a big variety of European languages, including the “small” ones (of course, the attribute of “small” or the opposite “big” is used only in terms of number of speakers of the language in question).

The goals are ambitious and – in a mid term horizon – also realistic. In addition to the mother tongue, every European citizen is supposed to speak at least two languages. The results of these efforts, however, would be long-lasting only under the condition that several European languages would be really utilized as means of international communication in prestigious communication situations such as University lectures, international project cooperation, scientific conferences, and all kinds of similar educational and research activities. Because of this, one of the suitable ways for protection, maintenance

and development of the European cultural and linguistic diversity could be opened through an efficient promotion of the “big” languages, representing the major prevailing European linguistic groups. These “big” languages (for instance, German, French, Italian, Russian, Spanish, Portuguese, and others) would represent a real support and a kind of “bridges” towards other languages – even the “smaller” ones of the given group.

The most propitious arena for the implementation of a policy to support big European languages is the Higher Education. Introduction of a kind of linguistic plurality within education and research is a fully feasible and realistic aim.

The European academic exchange programs can contribute to this aim. They represent very good and convincing reasons for teaching several courses or even entire degree courses (study programs) in foreign languages. Complementary courses and modules in area studies about different countries and regions could be prepared, as well.

This could be the way. But it will only become real if teaching/learning of several “big” European languages is backed by pragmatic needs, by a real societal demand, and by co-operation with the entrepreneurial sphere. The motivation would be extremely powerful if it were related to international cooperation within the creation and transfer of knowledge, technology, or within another kind of international cooperation. This would be the decisive factor.

In this respect, the enhancement of the dialogue between Europe and Latin America represents a powerful point of departure for the international spread of European languages beyond the limits of the old continent. If the previously mentioned intensive cooperation between European and Latin American Higher Education Institutions, including an effective approximation of the Common Areas of Higher Education and Research, took place, the affluence of students and faculties would be a motivation for the preparation of programs and courses in Spanish and Portuguese, as well as for teaching/learning these languages. Similar effects would occur for the Latin American partners regarding other European languages.

In this way, Universities could contribute in a decisive way to the support of the linguistic and cultural European heritage.

## 14. Conclusions

Within the present global and knowledge-based society, Higher Education Institutions can become active players, and even leaders, supporting positive tendencies within the social, economic and cultural development of their countries and regions. The education and research in the field of Intercultural communication might contribute to the promotion of international co-operation, mainly by creating more favourable conditions for international creation and transfer of knowledge and technology.

The dialogue between Europe and Latin America is creating an especially favourable framework for Universities to achieve this. Interregional university relations and cooperation in research and education, as well as academic mobility would bring along several positive effects. A systemic approach to the common creation and mutual transfer of knowledge and technology, in cooperation with the entrepreneurial and public sphere stakeholders, would be useful in itself. Moreover, direct contacts with the reality of the partner region would have an important educational impact on both sides; it would help to shape the graduates profile as open-minded people, with a better comprehension of the meaning of sustainable development and the importance of intercultural understanding and co-operation. It would bring along, as an important added value, a contribution to the linguistic policies for the sake of protection and development of European linguistic and cultural diversity, and, at the same time, a contribution to spreading common ethical values.

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## GLOBALISATION AND ECONOMIC UNDERDEVELOPMENT

**Abstract:** *Parallel with the accelerated scientific and technological progress, as its opposition, the gap between developed and less developed countries as well as between the rich and poor people within the borders of many countries is growing. In the coming years, the scientific thought owes to explain the cause and effect links between economic gain obtained by globalization and the poverty growth in the world.*

**Key words:** *Globalization, the ideology of globalism, economic underdevelopment, poverty*

### 1. Introduction

The beginning of the third millennium is marked by dramatic social and economic changes that are drastically redesigning the world. The common denominator of various theoretical approaches and opinions on new social and economic processes is that they all have as their basis the development of science and, more than anything else, the IT development. By expanding IT networks and developing communication and transport means, a global infrastructure net has been created which brings time and space closely and inextricably together. The new understanding of time and space leads to a new approach towards the planet and people on it. Forming of nations was related to the development of printing press and techniques which enabled people's literacy on a massive scale and consequently their linking by the language and letter criteria. New, global society is being created on the wings of electronics (computers, satellites, and telecommunications) which enables the creation of a global community through the Internet and other global telecommunication networks.

Parallel with the accelerated scientific and technological progress, as its opposition, the gap between developed and developing countries as well as between the rich and poor within the borders of many countries is growing. In the coming years, the scientific thought owes to explain the cause and

effect links between economic gain obtained by globalization and the poverty growth in the world.

## 2. Political economy of the globalisation

Endeavouring to determine the “globalisation” concept its definition is most often linked to the economic and financial processes spreading throughout the planet, whilst other aspects of global processes remain neglected. There is a tendency to limit the globalisation process to some statistical indicators of the economic growth and prosperity<sup>1</sup> on the one hand, and to the ever increasing gap between the rich and the poor<sup>2</sup> on the other. It should be stated that there has been an undoubted statistic growth in trade and financial transactions on the planetary level but there is also a huge disproportion when compared to the real GDP (Gross Domestic Product).<sup>3</sup> However, it is also an undeniable fact that this growth has not brought about any significant drop in differences between the rich North and poor South, as the poorest 20% still have more than 50 times smaller income than the world’s richest 20%.<sup>4</sup> Moreover, a contradictory process is underway that sees an increase in poverty even in the increasingly richer North.<sup>5</sup> Due to a huge number of statistical parameters theorists are not always able to spot some processes that are not easily measurable by the exact statistical instruments, and these are primarily changes in the social and cultural sphere.

Changes mentioned here have nothing to do with the McDonald’s restaurants global chain or GMC global dealer network (General Motors Company), but they can be rather characterised as fundamental social changes and shift-

<sup>1</sup> In the period 1950-1998 the world’s GDP per capita rose from 2114 to 5709 US dollars. H. van Den Berg, “Does Annual Real Gross Domestic Product per Capita Overstate or Understate the Growth of Individual Welfare over the Past Two Centuries?” *The Independent Review*, Vol. VII, No. 2, 2002, p. 190.

<sup>2</sup> Between 1960 and 1997 the income gap between the world’s poorest 20% and richest 20% rose from 30:1 to 74:1. UNDP: *Human Development Report*, Oxford University Press, New York – Oxford, 1999, p. 3.

<sup>3</sup> Daily volume of financial transactions in 2005 is estimated to have been in the range between 2, 4 and 3 trillion of US dollars. ([http://www.tradingforexmarkets.com/inter-market\\_trading\\_forex\\_markets.asp](http://www.tradingforexmarkets.com/inter-market_trading_forex_markets.asp)), whilst, according to the World’s Bank estimate, world’s GDP for the same year was 61 billion dollars; [http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP\\_PPP.pdf](http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf)

<sup>4</sup> UNDP: *Human Development Report*, Oxford University Press, Oxford – New York, 2005, page 36.

<sup>5</sup> For example, between 2000 and 2004 19 federal states in the US saw a significant statistical increase in poverty and 13% of the US overall population lives in poverty. M. Mather, “New Data Reveal Widespread Disparities in U.S. State Poverty Rates”, *A Population Bulletin on the American Community Survey*, 2005

ting to a new epoch of which we are contemporaries. Global means of communication enabled not only economic efficiency increase, traffic of goods and transfer of finances, but they also contributed to the creation of a global community in which people can find out what is going on in any other part of the planet at any moment and what the cultural life is like in London, Paris or New York. "Global citizens" can monitor the situation created by the ozone layer holes and assess the effects of potential ecological catastrophes throughout the planet. Owing to modern means of communication remote contacts are not expensive. There are even paradoxes such as the fact that communication via Internet between Belgrade and Frankfurt is cheaper than any phone call of the same duration made from Belgrade to any other town in Serbia. Mobility of people and massive migrations, especially those of highly educated people, serve to create interpersonal relations that turn into global networks of professional and other social groups. It is not a rare occurrence that people have closer relations with someone who is physically thousands of kilometres away than with people from their immediate surroundings. The described situation created many communication communities the networks of which form the basis of a new global society that is emerging. The new born community has all the characteristics that used to determine a nation and state and cultural space. However, the newly-founded links do not allow for any moulding within the existing borders, their space is the whole planet.

Ronald Robertson offers a most objective definition of globalisation by saying that globalisation means: "...expanding and deepening of social relations and institutions through time and space, in the environment in which everyday activities are increasingly influenced by events from the other side of the globe and where local groups' and communities' actions have a prominent global resonance".<sup>6</sup> The majority of objective academic papers see globalisation as fundamental social, economic and cultural changes on global level which contribute to the feeling of the world's unity and raising awareness about the planet as a whole. Globalisation is a long-term process that intersperses and models all countries' internal and foreign policy, determines all economic and financial parties' business conditions and redesigns every individual's world. However, globalisation is often identified with internationalisation, liberalisation, universalisation, Westernisation and other similar processes which either predated globalisation or exist only as a part of the process of globalisation. Undoubtedly, the listed processes, together with some others, encourage and boost (and some of them even hinder) global processes. Still, the simplification and limitation of globalisation to only one of its components is unacceptable. A main characteristic of all the mentioned processes is that they take place amongst countries as political and territorial units, whereas globalisa-

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<sup>6</sup> R. Robertson, "Globalization: Social theory and global culture", A. Milardović, Ed: *Globalizacija*, Zbornik, Pan Liber, Osijek, 1999, p. 35.

tion represents with its all-encompassing nature a relation without borders and distances. That is why a clear distinction should be made between: *global economy and international economy, global politics and international politics* etc. This supra-territorialism is close to supra-nationalisation, which leads us to globalisation being defined as a process of an increased interdependency amongst some important aspects of human activities. As it is not all about linking on the world's level but also about regional links, supra-nationalisation becomes an apt term as it presumes establishing of more supra-national levels crucial for proper functioning of the modern human community.<sup>7</sup> To an extent, globalisation offers more space and opportunities for the realisation of individual potentials in cooperation with other participants in the process, whilst at the same time makes us more vulnerable and sensitive to the problems that might result from other participants' weaknesses and faults.

The approach of a German theorist Michael Syrn can contribute largely to the considerations about the complexity of globalisation. Syrn sees globalisation as a phenomenon less important than denationalisation. His argument for this attitude is the fact that many social interactions are not global; neither can it be talked about globally-bound development everywhere. The border of the newly-created social space is the brink of the world OECD<sup>8</sup>, which 10 most important developing countries can be added to. Syrn corroborates his reasoning with the information that 70% of the world's trade takes place in the OECD countries, and another 14% in the developing countries. Therefore, 84% of the world's trade takes place in the countries which 28% of the world's population live in. Investment-wise, this means that as much as 91% of all foreign direct investment is placed in the mentioned countries. However, Syrn admits in the end that there are processes that given their all-encompassing nature could easily be labelled as global. He especially accentuates changes in opinion and ecological problems.<sup>9</sup>

There is a presumption built in the very foundation of globalisation that nothing that happens in the world is just a local event, but rather that all the

<sup>7</sup> R. J. Samuelson, "Deflation: The Global Economy's Downside", *The Washington Post*, 4. September 2002; <http://www.washingtonpost.com/wp%2Ddyn/articles/A34846%2D2002Sep3.html>

<sup>8</sup> OECD (*Organization for Economic Cooperation and Development*). OECD members are currently: Australia, Austria, Belgium, Great Britain, Czech Republic, Denmark, Finland, France, Greece, Holland, Iceland, Ireland, Italy, Japan, South Korea, Canada, Luxembourg, Hungary, Mexico, Germany, New Zealand, Norway, Poland, Portugal, US, Turkey, Spain, Switzerland and Sweden.

<sup>9</sup> Denationalisation means moving the limits of condensed social functions across national borders. "Social denationalisation can be realised in the form of a relative increase in the intensity and scope of cross-border processes of exchange and production in the relevant branches of economy, ecology, mobility, communication and culture." M. Cirn, *Upravljanje sa one strane nacionalne države*, "Filip Višnjić", Beograd, 2003, pp. 48-56.

inventions, victories and catastrophes are an integral part of the one and the same world of ours. Global society is not a mega-national society that absorbs and then dissolves all individual national societies, it is a world's cluster characterised by diversity and, not necessarily, integration. This society is established and then maintained through different forms of communication which keep it in the form of a coherent whole. The awareness about the world's interrelation and interdependency is being raised, sensitivity to the problems of remote countries is being intensified, old identities are being abandoned and new accepted.

### 3. Globalism ideology

One (some would say the only) good side of communism was that it imposed constant wariness upon capitalism and forced it to take care of people. But when its ideological enemy was defeated, loose from all bridles, capitalism regressed to its grimmest fundamentalist foundations. Globalism, as an ideological concept of arranging global relations and based on the glorification of free market mechanisms, is laden with risks. Owing to the prevalence of the non-conservative liberalism in the international practice, many decisions essential for the future of humanity are brought by trans-national corporation (TNC) management and international organisations such as: International Monetary Fund, World Bank, World Trade Organisation and NATO. They operate in a democratic vacuum where there are no clear rules or a system that would enable citizens to take part in decision-making processes.<sup>10</sup> Another illogical feature of the new system lies in the fact that opening of markets for developed countries' services and goods is insisted upon whereas various non-customs obstacles are employed to prevent the developing countries to export their products and services to the developed.

Gelner wrote in 1992: "Communism was not destroyed by the society or chastity. It was destroyed by consumer mania and Western militarism, the explosion of morality and openness in the Kremlin, along with an apt propaganda of the Western values"<sup>11</sup> Ex Eastern Bloc member countries, wishing desperately to shake off Moscow influence, neglected the fact that on the other side there was another empire the logic of which hardly differed at all.

The globalistic ideology puts to the fore the creation of the world's market of goods, services and finances as only values of globalisation. Thus, all other, not less important aspects of globalisation are sidelined. This approach is favoured by neo-liberal ideologists who reduce the multi-dimensional nature of globalisation merely to its economic aspect. By means of this, what is striven

<sup>10</sup> R. Darendorf, "Od proizvodljivo sti do tiranije – samo korak", Ž. Ivanović, Ed.: *Ka carstvu dobra ili apokalipsi – Pro et contra*, "Filip Višnjić", Beograd, 2003, p. 224.

<sup>11</sup> J. Steele, "Novi vazali", Ž. Ivanović, p. 188.

for is the maintenance of the current world's system that favours the rich and does not allow the poor a chance to dispense with poverty. By such approach to globalisation, ecological, cultural, political and social aspects are subordinated to the maintenance of the existing world's economic system. It can be freely stated that even in those countries where these theories originate from, state administration boils down to company management logic. State, society, culture and foreign affairs are increasingly becoming inferior to the imperialism of economising.<sup>12</sup>

The fact that thus organised countries currently dominate the world's economy does not indicate the correctness of the neo-liberal ideologists' attitude. As complex a system as a state is cannot have the maximisation of profit as its main operational goal. The policy of total privatisation which has resulted in some catastrophic consequences is defended by the allegation that state still exercises too much influence on economic flows. Privatisation of energy resources, drinking water and human genes casts a doubt over basic human rights and the essence of living. The decline of health care, education system, children protection mechanisms, problems with electricity and public transport all indicate that privatisation in these areas can bring more harm than benefit. Any continuing insistence upon privatisation in public sector at any cost shows clearly that official politics has become merely a technical function of big capital.

The level of economic liberalisation has become the main criterion when deciding upon the nature of modern countries and whether they are democratic or not. It stands to reason that the development of democracy is teamed with certain economic liberalisation. However, economic liberalisation devoid of appropriate democratic institutions that would acknowledge cultural and other characteristics of the local community is almost certain to achieve effects opposed to democratic ideals. Citizens' and community's interests cannot be reduced to merely their economic component. These constitute a complex field of human strivings that should be accompanied by "reasoning and calculating with respect to the manners in which these interests can be realised".<sup>13</sup> Economic and technological element of interests should form only a means to achieve goals, that is, to achieve the realisation of the sense of existence of people and their communities. It is truly tragic for community and individuals who make it if economy and technology become the very essence of their existence.

The strongest argument for imposing the trans-national corporations' (TNC) operating model as the best is high profit rates they achieve. TNCs are no longer merely representatives of big business and a successful organisational model; they have become pillars of a specific, neo-liberal ideology. TNCs have also become an important political factor, either through favouring political like-minders or by influencing the creation of an environment

<sup>12</sup> S. Huntington, *Sukob civilizacija i preustroj svjetskog poretka*, Puljko, Zagreb, 1997, p. 228.

<sup>13</sup> H. Alvert, *Strasti i interesi*, "Filip Višnjić", Beograd, 1999, p. 54.

in which their rules will dominate. Business alliances are being formed and these comprise representatives of big capital in the area of media, finances and production. Personnel are being trained by means of various foundations and scholarships with a view to promoting and implementing the free market model. Imperialistic type of TNCs, such as the Microsoft, presents their interests as the US interests. In 1999, at a meeting of ministers in Seattle, seats on the domestic board and the American delegation were sold to representatives of corporations, so that there was more discussion on the conditions that needed to be fulfilled in order to move the Microsoft's production to China than on the issues of human and labourers' rights.<sup>14</sup>

As opposed to globalism, globalisation is a complex process comprising a series of processes that are simultaneous and that should result in linking national countries and their sovereignties by means of trans-national mediators. Separating politics from economy is not merely an ideological issue between left-wing supporters and liberals. This phenomenon makes inroads into social relations of the so called *civil society*, starting from the family and local community to the state and global society. By reducing economy to economising and statistic indicators, without any economic development social strategy, human community (on both national and global levels) is regressing to the pre-history of ordered social relations. Lacking a new paradigm of social development, the policy of cutting working expenses is being introduced; pressures are being exercised to the effect of decreasing standards in the environmental area and reducing social subsidies.

#### 4. Deepening of the gap between the rich and the poor

Worldwide enforcing of universal standards inspired by the ideological concept of globalism has aroused resistance with the majority of people. Many people see Western universalism as a form of Western imperialism towards the rest of the world. The current chasm between the rich and the poor is a major problem. Instead of a decrease in the number of poor people and raising their living standard being the primary effects of globalisation, the situation that has resulted from globalisation is such that the poorer South is ever increasingly and considerably frustrated. Underdeveloped countries' population is in the position to compare daily via mass media the depth of their poverty to the welfare of the North.<sup>15</sup> Also, we are all bearing witness to the fact that periodic

<sup>14</sup> R. Kutner, "Uloga vlade u globalnoj ekonomiji", V. Haton, E. Gidens, Eds.: *Na ivici, živeti sa globalnim kapitalizmom*, Plato, Beograd, 2003, p. 196.

<sup>15</sup> Average gross income per capita in 20 richest countries (37.898 US dollars) is by 178 times higher than the average gross income per capita in 20 poorest countries (213 US dollars). Calculated by: World Bank: "GNI per capita 2004, Atlas method and PPP", *World Development Indicators Database*, July 15<sup>th</sup>, 2005; <http://www.worldbank.org/data/databytopic/GNIPC.pdf>

economic crises most often get resolved to the detriment of the underdeveloped part of the world, usually through a huge disproportion between the soaring price of capital and plummeting prices of primary products (except oil).

Huge social differences make favourable soil for the proliferation of organised crime and terrorism which recruit their followers from the poorest strata. Poverty is often linked to low education levels, which renders the poor easy prey for the sacred war ideologists. The most drastic forms of expressing the mentioned phenomena are suicide bombing attacks for the execution of which perpetrators are promised eternity in heaven. On the other end of the spectrum, owing to the synergy of genetics and informatics, there is a new notion of the so called *cybernetic eugenics*<sup>16</sup>, which stems from the absolutisation of profit as the imperative for success on the global market. Through a complete commercialisation of the human body and spirit, as well as all other living organisms on the planet, the creation of ideal beings that are to replace the existing *imperfect forms* is set as priority. Informatics and genetics are thus becoming more and more instruments of hegemony, taking over the place of nuclear potentials.

Positive economic effects of globalisation entail the optimisation of the use of production factors worldwide and, theoretically, the achievement of the ideal *economies of scale*. In theory, production factors (natural resources, capital, technology, labour, information, as well as goods and services) in global economy circulate freely around the world. However, this free movement of resources in order to achieve the ideal of optimisation manifests itself in practice detrimentally to the majority of people. Manipulators move their finances from a place where these are worth less to locations where they are more expensive; producers build their factories in those places where production factors are the cheapest, that is, in the underdeveloped countries. By means of this, profit is made not only from the difference in the cost of labour but also from low (or non-existent) labourer and environment protection standards, low level of human rights protection and badly organised unions (unwritten but tacit ban on unions' activities). Profit is also made from the exportation of old and long outdated technology. In the globalisation environment there are practically no domestic markets; they are all parts of a unified global market. Domestic producers' privileges are limited by international conventions. It is often quite different in practice where the developed impose liberalisation in those areas where they have monopoly whilst they at the same time try to enforce protectionist measures in order to ensure interests of their producers in agriculture and other highly intensive and prolific branches.

<sup>16</sup> In 1860 F. Galton proposed the principle of artificial selection to be carried out through the elimination of the least capable. By means of this he wanted to institutionalize combat against the so called human species degeneration. P. Virilo, *Informatička bomba*, Svetovi, Novi Sad, 2000, p. 134.

“The system is not operational on the human level”, said in 1999 James Wolfenson, president of the World Bank. More and more unequal distribution of income has definitely degraded all social expectations from the economic growth. In the period 1960-1977 the ratio between TNCs’ managers’ and workers’ salaries rose from 39:1 to 254:1. This cannot be justified by any economic arguments; it stands to reason that it is down to ideological affiliation.<sup>17</sup> Social tasks of the neo-liberal type of capitalism have not been fulfilled. Many people still live out of the system; they listen to the stories about democracy but do not find them worth voting. In essence, what is needed is a model that will successfully combine the best aspects of both market and social oriented activities. There are no universal rules to be recommended for use in searching for such a model.<sup>18</sup>

In the neo-liberal type of countries there is an ever increasing chasm between the well paid-those who reap all the benefits of the current system, and the rejected. To this effect, the relation between statistic indicators for the US and Sweden is illustrative, as these two countries are implementing completely different logics in their respective internal social and economic organisations. Whilst the US advocates an orthodox liberal organisation of state functions, Sweden represents a successfully implemented model of the so called Keynesian economic model of the state of prosperity. Average income in the US went up by only 10% (from 32,522 to 35,864 dollars) in the period 1970-1999. In that same period average income of managers in 100 biggest American companies went up from 1.3 million of US dollars (39 average salaries) to 37.5 million dollars (more than 1000 average salaries). In 1998, 13 000 richest families in the US had 300 times bigger income than average families. Contrary to this, life expectancy is three years longer in Sweden than in the US, infant mortality is twice lower and illiteracy rate is far under that in the States. Only 6% of the Swedish population lived on less than 11 dollars per day in the 90s, whereas in the US the figure is 14%.<sup>19</sup>

The US, as a typical OECD representative, is a very striking example that goes to substantiate the theory of positive effects of the state of welfare. The leader of the holy neo-liberal alliance was able to experience the positive effects of the state of welfare concept on their own example. This concept was being implemented in the US between 1950 and 1975, during which period the number of poor households dropped by 9.4%.<sup>20</sup> Switching to the neo-liberal conservative model in 1975-1991 led to the increase in poor households by 2.4%.

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<sup>17</sup> Dž. Fo, L. Majšel, “Nejednakost i globalna ekonomija”, in: V. Haton, E. Gidens, Eds., *ibid.*, pp. 124-126.

<sup>18</sup> J. K. Galbraith, “The Rush to Capitalism”, *The New York Review of Books*, Vol. 37, No. 16, October 25<sup>th</sup>, 1990; [http://www.nybooks.com/articles/article-preview?article\\_id=3469](http://www.nybooks.com/articles/article-preview?article_id=3469)

<sup>19</sup> P. Krugman, “Američka noćna mora”, *Ž. Ivanović*, p. 232-235.

<sup>20</sup> Poverty threshold was calculated according to 50% of the average income.

Statistics show even more shocking results from Germany: in 1973 the number of poor households dropped to the lowest level ever and stood at 5.5%, and then up till 1991 it rose to 11.5%. Despite the fact that data from 1991 referring respectively to Germany and the US are hardly comparable as German figures were influenced by the unification effects, they still prove the general trend. When talking about poverty in the OECD world, it should be borne in mind that relative indicators are used, that is, that poverty cannot be identified with indigence. In 1991 the threshold of poverty in the FR of Germany was at the level on a par to today's 7500 euros.<sup>21</sup>

Isolation from society, as the main characteristic of neo-liberal capitalism, is present on grand scale. The US example illustrates tellingly the model that is being imposed globally: 15% of the overall population live below the poverty threshold (including 25% of children), 5,5 mil people have criminal past, roughly 2 mil out of which are currently imprisoned.<sup>22</sup> Illusions similar to the silicon valley one are unsustainable in the climate of poverty and striving for sheer survival; the situation is getting not only ethically increasingly burdened and debatable but also politically and socially unmanageable. Whilst the capital concentration process is underway in the western countries, even in those branches where small enterprises traditionally prevailed, big companies are being broken down by privatisation in the East. Domestic and foreign buyers (private entrepreneurs) do not buy whole companies but rather only their best parts, and at bargain prices. The effects are obvious: average economic efficiency is on the decrease and the society is losing a great portion of produce. Workforce is degraded: staff trained in various industrial jobs get forcibly transferred to other areas-usually services. Through this, huge resources invested in human capital are lost. At the same time, the production repertoire of their closed down factories is imported from the Far East where a level of exploitation akin to slavery is in place. Regional misbalance as shown in the Table 1 serves to uphold the theory on unequal relations between regions and unfair distribution of the world's gross national produce.

<sup>21</sup> Cirn, *ibid.*, p. 115.

<sup>22</sup> M. Kastelas, "Informaciona tehnologija i globalni kapitalizam", in V. Haton, E. Gidens, Eds., *ibid.*, p. 90. For the sake of objectivity it should be stated that new statistics show there has been a drop in the poverty rate to 13% (18% of children is below the poverty line). M. Mather, "New Data Reveal Widespread Disparities in U.S. State Poverty Rates", *A Population Bulletin on the American Community Survey*, 2005

**Table 1:** Selected regional parameters as indicators of the world's misbalance

Groups of countries and regions	Participation in the world's population in percentages	Gross national product expressed in billions of US dollars	PPP (Purchasing Power Parity) as percentage of overall in the world
World	100	30,610	100
Developed countries	15.4	24,560	57.1
G-7	11.5	20,290	45.4
EU-15	6.2	8,500	20.0
Asia <sup>a</sup>	52.0	2,040	21.6
Latin America	8.5	1,990	8.4
Eastern Europe <sup>b</sup>	6.7	910	5.9
Middle East and Europe <sup>c</sup>	5.1	680	3.9
Africa	12.2	420	3.2

a) Without: Hong Kong, Japan, Singapore, South Korea and Taiwan; b) including Russia and other members of the Alliance of Independent Countries; c) including Turkey.

Source: "World in Figures", *The Economist*, London, 2002, p. 25.

Table 2 shows the workings of the debt trap which the developing country have fallen into. When everything is added up, then it becomes clear that paying off an interest-rate credit leads almost to a negative balance within the observed period of time. It also should be stated that through various forms of embezzlement a great part of resources received as donations or credits end up in private pockets.

**Table 2:** External debt of the "third world" countries between 1990 and 1998 calculated in billions of US dollars

Region	Debt in 1990	Debt in 1998	Debt Repayments (principal + interest) 1990-1998
Latin America	475	736	722
East Asia and the Pacific	286	698	525
Eastern Europe	221	434	331
Other peripheral countries	491	596	369

Source: B. Ilić, *Informatičko društvo i nova ekonomija*, Publik, Beograd, 2003, p. 156.

In order to achieve as large profits as possible, big capital destroys ruthlessly every obstacle in its path: state, national, cultural, ethical. Big capital is amoral and a-national; with a view to getting multiplied it stops at nothing and is ready to undermine the foundations of the civilisation, to bring to power and topple governments, to oust heads of countries. By accentuating economic and technological development a new matrix of dependency and

dominance is created and the gap between the developed and underdeveloped countries is heightened.

For example, world's brand "Adidas" had in 1997 in its possession a factory that participated in its overall production with merely 1%, all the rest was based on the production agreed with Asian partners. These data could even be interpreted as a positive trend if their one and only motive were not profit maximisation. In Asian free zones a working day lasts 12 to 16 hours; contracts are signed on the one-off basis and wages are often below the real life expenses. The production in free zones is in no touch with local economy, taxes are either minimal or non-existent, unions are often forbidden and the police and army are always ready to quell every sign of social combat or unrest.<sup>23</sup>

In many factories that produce for the most renowned TNCs people work over 90 hours per week and get paid on hourly basis, sometimes even 13 dollar cents per hour. Just as a comparison, average retail wages per hour in the US and general average rate of wages reached over the same period amounted to 8, 34 and 12, 26 dollars respectively.<sup>24</sup> The accommodation is below any remotely acceptable level, with more than 10 people sharing a dormitory. Once they have paid for food and accommodation employees are often faced with insufficient disposable income, without having even enough money to pay for their trips back home. It should be noted that, after some resonant public scandals about humiliating working conditions, TNCs relocated their production and undertook all measures so that the new factory locations stayed anonymous. Namely, it has become now much more difficult to prove links with a certain free zone.

One Italian worker described picturesquely consequences of the current economic logic by saying: "...It is great that I can afford to buy a pair of cheap Chinese shoes to my kid now. However, it is not great that I lost my job when our boss moved the factory to China. In other words, I have no money for even cheap shoes now-that's globalisation for me!"<sup>25</sup>

By insisting upon economic growth no matter what (macro-economic stability, trade liberalisation and privatisation) Washington consensus<sup>26</sup> has brought about some catastrophic results in transitional countries. Destroying the old social-economic system without building a new one first, teamed by the nepotism-marred privatisation resulted in the spread of inequality and the increase in poverty in these countries. As a rule, Ex-East Bloc countries experienced a drastic drop in gross domestic product, and the majority of them still have not gone far beyond its level from 1989. Having realised the demise that the imposed models were bringing along and under the pressure from experts, the approach to transitional issues changed in 1997 when so called Post-Was-

<sup>23</sup> N. Klajn, *Ne logo*, Samizdat B92, Beograd, 2003, pp. 257-271.

<sup>24</sup> *Ibid.*, p. 547.

<sup>25</sup> Daily paper "Danas", March 1st, 2004, page V

<sup>26</sup> <http://econ.bus.utk.edu/washington%20consensus.pdf>

hington consensus was reached and now was taking more into consideration enhancement of living standards, educational and health care systems, adherence to the sustainable development concept and a more fair distribution of social welfare.<sup>27</sup>

Bearing in mind the mentioned facts Galbryte says: "...the primary and absolutely indispensable requirement is that each individual in a good (...) society should have a basic source of income. If this is not possible through the market system, then state is to provide it. Let's not forget, there is nothing that limits citizens' freedom more than a complete absence of money."<sup>28</sup>

Neo-liberal concept accentuated differences between the rich and the poor even further. By cutting income tax in OECD countries tax rates dropped by 20% on average, but at the same time lowest tax rates were raised by around 2.5%.<sup>29</sup> In line with Regan and Thatcher logic, social reforms in the 70s and 80s transferred the brunt of expenses to the poor. Regan explained such tax policy by saying that capital owners, if exempt from paying taxes, would enhance their investments in production and scientific-research work. However, the only thing that happened in the meantime was an increase in managers' salaries and acceleration of the process of both moving working places to the south-east of Asia and other regions with cheap workforce and moving capital to "capital havens".<sup>30</sup>

## 5. Requirement for a new social-economic paradigm

In time, concentration and centralisation of capital results in technological expansion and great investments in research projects of technical sciences. High profit rates brought by new technologies bring about a disproportion in the development of technical and social sciences. State institutions and public controlling mechanisms are lagging behind the technological monopoly holders. Instead of being beneficial for the civilisation, new tools brought along with the scientific and technological progress can cause serious harm and destruction unless they are accompanied by appropriate philosophical support. Misbalance between the technological development and mental apparatus that could create controlling mechanisms over machines (lest they should not rule people!) can cause a new civilisation downfall. The problem arose when new technological developments by far surpassed the preceding technological generations and social and cultural controlling mechanisms started lagging behind drastically.

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<sup>27</sup> J. E. Stiglitz, "Beyond the Washington Consensus", *Transition*, Vol. 9, No 3, June 1998

<sup>28</sup> J. K. Galbraith, "The good society", *Guardian*, January 26<sup>th</sup>, 1994, p. 2.

<sup>29</sup> M. Cirn, *ibid.*, p. 101.

<sup>30</sup> The estimate is that on average 50% of the capital is either moving to tax havens or transiting them.

In such conditions, ecological and environmental degradation ensued, but also geo-political aggression came to the fore, threatening by means of waging Orwell type of wars to turn into a general geo-political chaos.

It is a widespread belief that American atomic bombing of Hiroshima and Nagasaki was not a necessity but rather an *in vivo* experiment. It remains an open question as to what sorts of experiments on the current level of scientific development we can be exposed to without even being aware, let alone with our acquiescence. The fact is that all the greatest scientific discoveries have stemmed from laboratories that were under the auspices of the Ministry of Defence. The 20<sup>th</sup> century could be justifiably labelled as a century of scientific militarisation. For the purpose of national security unlimited funds were secured but at the same time ethical considerations were put aside. It is a difficult burden for the 20<sup>th</sup> century science and it exudes an extended influence over the new millennium too. There is a danger of the military-industrial stratum changing the very form of war-waging as its power has drastically increased and brought it to the state controlling position. In his farewell speech back in 1961 American president Eisenhower pointed out the danger military-industrial lobby was posing to American democratic values.<sup>31</sup>

The modern social reality is being determined by the general effects of new scientific rules that refer to natural processes. These abstract and often mathematically strictly formulated concepts of the new scientific thought are being translated into technological, economic, cultural, global and other direct and indirect social influences. They effect, as indicated by the leading 20<sup>th</sup> century scientific thought advocates, some permanent reconfigurations on the modern social life. Modern scientific and social reforms should serve to release the society from nominally declared values of the past capitalist developmental phases, give the empty declarations some concrete contents and elevate them to a higher level, never achieved by the former civilisation developmental phases. The motivation and capitalist system's institutions, such as Newton's mechanistic concept, remain just a part of the original inheritance transferred in quality-wise varied forms of modern social dynamics. Through the current social condition prevalence, other concepts have survived too, such as: *the end of the history, imperial position of a global super-power and capitalism's open society*, but these remain only as inert concepts of a finished, outdated period of the capitalist social development.<sup>32</sup>

Major breakthroughs in science cannot be neglected any more within the current social thought. On many counts the year 1989 can be compared to 1789. Scientific and technological advances, the end of the Cold War and incipient processes in the world's relations' globalisation incite to thinking

<sup>31</sup> Farewell Radio and Television Address to the American People by President Dwight D. Eisenhower, January 17th, 1961; <http://www.eisenhower.archives.gov/press.htm>

<sup>32</sup> B. Jevtić, *mimio*, 2006

about social perspectives. Preparations for the 21<sup>st</sup> century society are being discussed along with the necessity of the spiritual revival of modern society. The problem comes from the fact that discontinuous social development considerations are still burdened by the traditional, conceptual social frame. Some representatives of the social thought are of the opinion that role models for necessary modern reforms are the Gregorian England and tsar-period of Russia restoration policies, as these delineated basic operational directions of the 19<sup>th</sup> century Holy Alliance.<sup>33</sup>

Paul Kennedy holds that there remains an insurmountable gap within the scientific revival of society - a kind of *black hole* of the philosophical universe. The understanding of the modern societal dynamics is not consistent with conceptual system of the restored scientific thought that forms a basis for the modern view of the world and current social metamorphosis. The interpretation of social processes and elaboration of Kont's *social physics*<sup>34</sup> are lagging behind major achievements of the contemporary scientific thought and social advancement. There is a new social context that has not received a proper scientific and philosophical foundation yet. There are still some major conceptual differences between the new scientific thought and current social practice on the one hand, and social thought on the other. Consistent development of social theory based on the modern scientific understanding and social practice evolution, comes as a following, higher developmental phase of the current scientific and social reform and presents a grand responsibility for the entire contemporary scientific community.<sup>35</sup>

The current social dynamics is determined by specific scientific and social influences that lie in the modern world foundations. Contacts with the quantum reality determine the basic social movements. Unavoidable laws of the discovered depths of natural reality transform all areas of modern life and herald new major social changes. Converting quantum and other scientific principles into powerful social instruments serves to model a new historical era. In order to reach potential directions of further development the society should master a new, powerful potential. This potential is turned towards the future by the modern society. Along with the accompanying labour movements, the traditionally liberal capitalist influences are losing the strength of a basic driving force all around the contemporary world. They remain as a narrower, traditional part of life which has been transferred from the previous into a new phase of civilisation development. Together with reforms of cultural values and social life globalisation, modern crossroads of scientific

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<sup>33</sup> S. Weinberg, *Dreams of a Final Theory, The Scientist's Search for the Ultimate Laws of Nature*, Vintage Books/Random House, New York, 1993

<sup>34</sup> O. Kont, *Kurs pozitivne filozofije – dva uvodna predavanja*, Kultura, Beograd, 1962, p. 17.

<sup>35</sup> P. Kennedy, *Preparing For the Twenty – First Century*. Random House, New York, 1993

and microbiological development and technological inputs are putting on the agenda the request for an appropriate interpretation of social reality.

A. Fontain wrote: "Communism spectre" has disappeared from the horizon, but social stability and economic prosperity have never been so far apart. Liberal capitalistic utopia has vanished as it was of the a-historical nature. In such general conditions the conclusions about the end of the "hundred-year ideological war" making Hegel's end of the history prophecy come true were drawn prematurely. Overall, all-encompassing revival of contemporary reality is announcing new social perspectives.<sup>36</sup>

Traditional economic and social concepts of liberalism, state of welfare or world order cannot respond adequately to the fundamentally new effects of scientific influences on society. Harmonisation of the reorganised scientific thought development with social theory is an ensuing, higher, general phase of *the second scientific renaissance*. The elaboration of the contemporary social advancement theory is a major role and responsibility of the scientific community. Scientists were aware of the sin of Hiroshima and Nagasaki. They also remain liable for non-existence of a broader scientific concept of social development and social revival inception that would be in line with modern conditions. The integration of the current reforming concepts of physical reality with social processes is supposed to determine a social sense and civilisation perspectives of the second scientific age. The necessity for a comprehensive review of the dominant social concept and the creation of a new social paradigm is called for.<sup>37</sup>

The tension stemming from the deepening of differences between the levels of economic and social developments worldwide is manifested through extreme forms of terrorism and diversionary activities. The attacks performed against the World Trade Centre and the Pentagon are sorts of extreme warnings against unacceptable, major and increasingly accentuated differences and gaps in the levels of development and living standards in the modern world. These diversionary activities are recent events in the world's history and the prevalent belief is that after September 11<sup>th</sup> 2001 nothing is going to be the same in New York and Washington – from the everyday life to global strategies.<sup>38</sup>

Events in New York and Washington from September 11<sup>th</sup> 2001 are considered to have marked the end of the international powers' relations from the previous period and announced the overhaul in international relations. It is only through a new developmental concept of global economic dealings that the world economic stability and dynamics can be reinstated. North-Atlantic countries are facing an extended instability and are directed towards a new

<sup>36</sup> A. Fontain, *Apres eux, la Deluge, D Kabul a Sarajevo 1979-1995*, Fayard, Paris, 1995

<sup>37</sup> Editorial: "Science a technology policy", *Science*, Vol. 267, No. 5197, January 27<sup>th</sup>, 1995, p. 435.

<sup>38</sup> N. Čomski, "Ciljevi i sredstva", in: Ž. Ivanović, Ed., *Senka Rima nad Vašingtonom, Pro et contra*, "Filip Višnjić", Beograd, 2002, pp. 109-119.

definition of economic and social priorities. Relations with other countries need to step out of the frames inherited from the cold-war period. Russia has a new role in the post-imperial phase, whereas China is turning into a super-power. India is becoming a global actor and is amortising hugely destabilising influences on the Euro-Asian territory.<sup>39</sup>

Attempting to become more open towards society, modern science has lost its neutrality. Its academic detachment characteristic for the classic period in the scientific thought development has disappeared. Science has penetrated all areas of social life but it has lost its vanguard role and has neither strength nor authority for redirecting social flows anymore. Amongst such conditions, the scientific community's responsibility for choosing main developmental directions and consequently their general social effects remains an open question.<sup>40</sup>

The epoch of capitalism is leaving a troublesome bequest to the 21<sup>st</sup> century society. In the decades marked by the exponential growth of technological, economic and cultural changes opportunities were missed to adhere to such changes on the paradigmatic civilisation level too. Social researches were allocated only one thousandth part of one per cent of hefty funds that were being invested in military researches and gaining command over increasingly destructive death instruments. Even in those rarely recognised social research projects that were conducted occasionally sharp and objective criticism was lacking. Obsession with the hundred-year ideological war between two opposing social systems made facing the historical challenges concerning the need for comprehensive social reforms unfeasible.<sup>41</sup>

Prominent achievements of the new scientific thought and unimaginable opportunities of certain social creations accentuate the necessity for overcoming the crisis in social relations. In the current society marked by modern scientific dynamism changes that exhibit few similarities with traditional, political, technological and social models of the world's functioning are achieved. Sociology and social theory are facing an imperative demand for researches that are supposed to provide a theoretical basis for the emerging global society.

Increasing the importance of the conceptual system and methodological principles of the social thought is left to the scientific community that is expected to contribute to finding a rounded system of a contemporary social and scientific theory. Grave historical consequences resulting from the conformist adherence to the strategic nuclear weapon race and the production of increasingly destructive death instruments should serve as a warning. Equally dangerous is the threat of the modern science becoming inferior and subordi-

<sup>39</sup> H. Kissinger, "What Next", *Los Angeles Times*, Los Angeles, Novembre 6<sup>th</sup>, 2001

<sup>40</sup> Z. Bronowski, *A Science of the Future, Essays in Natural Philosophy*, The MIT Press, Cambridge – London, 1978; W. Hemil, M. Ordan, *Science a Future Choice*, Clarendon Press, Oxford, 1979

<sup>41</sup> B. Jevtić, *ibid.*

nate to one-sided, outdated social views and options. D. Flanagan finished his renowned essay on the science at the beginning of the 20<sup>th</sup> century with the following: "The dangerous shine of mania. When society is a maniac."<sup>42</sup> The author is disturbed by science being in the service of thermo-nuclear war preparations which jeopardise life on the Earth. Such Flanagan's views represent a warning against similar disconcerting threats that could have a come-back to the contemporary life scene. These threats are being re-announced by the conceptual inertia of social theory at the turn of centuries when new social perspectives are opening.

Inert advocating of traditional and outdated social conceptual systems which block modern social reforms is emerging in the form of a new conformity and new reformation that is harmonious with the outdated social concepts. Scientific community's biggest responsibility is to contribute to the creation of a social theory based on new scientific principles. The interpretation of grand and speedy social changes, together with the release of a major reformist potential of the modern society, call for appropriate contribution from entire scientific community. It is now expected to contribute to the creation and social understanding of modern civilisation processes.

## 6. Conclusion

Global changes bring about a fundamental reform of civilisation premises and cannot be accounted for by the traditional economic and social theories. They are not limited merely to the shift in social formations but also refer to a fundamental U-turn in the development of humanity. The need for a new paradigm in social theory stems from a new global practice, which is, in turn, linked with so far biggest changes in living patterns that have already started. Hence it follows that creation of a new paradigm of social sciences depends on the anticipations of the modern global reality. This process started a couple of decades ago through a critical analysis of social development and is linked to studying modern scientific and technological revolution and its social consequences. Theoretical quest for a new paradigm is reflected through the appearance of post-industrial, technotronic and informational theories.

In case current tendencies in the development of technology and conflicts resume and with a view to achieving social consensus in relation to resolving the rampant tensions and problems of the modern world possible scenarios on all levels of social organisation should be presented. What should be borne in mind in the process is that it was not before people found out ways to control natural instincts and bridle destructiveness that the advancement of civili-

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<sup>42</sup> D. Flanagan, *Flanagan's version a spectator's guide to science on the 21 century*, "Alfred A. Knopf", New York, 1988

sation was achieved. The adoption of cultural and ethical norms and raising awareness should contribute to a more humane and rational relation to the community and surroundings

The main question that requires answer in the globalisation environment is: to what extent can state and current international institutions guarantee security to people? Risk assessment has got to be conducted from both political and cultural viewpoint. Denationalisation of security has resulted in the classic inter-state sources of conflict being reduced to merely a possibility. However, other, non inter-state forms of jeopardising, are gaining significance. The classic view of security as a state function on the one hand, and the state itself being a basic pillar of the force sufficient to jeopardise international security, falls short of explaining the new conditions. Globalisation leads to the creation of a world's dynamic society that surpasses security results achieved so far under the system of national countries. Security can no longer be identified merely to the perseverance of the physical integrity of individuals. Security infringements are not only conscious infliction of injuries and abuse of the means of physical violence. Carrying out of any activities the execution of which poses risk, that is, activities that carry huge risk potential also means security infringement. Security jeopardising also entails all those situations when there is conscious and purposeful creation of conditions that carry risks of either explosive public reactions or the destruction of the planet's biosphere. For this very reason turning of globalisation into an ideology is constantly highlighted as a risk factor that can potentially lead to, or has already led to the negative homogenisation of population, which certainly is not one of the positive effects of globalisation. The lack of institutional mechanisms and legislation on a par with modern practice is also potentially destructive to the entire planet's security. Ideologisation teamed with the absence of relevant institutions leads to the feeling of rejection with the majority of population. There is an explosive potential of socially inspired conflicts that can manifest themselves as various forms of fundamentalism and terrorism.

Modern civilisation's basic problem is finding a right model of development management together with a model of anticipating developmental tendencies. Upon choosing a developmental strategy adherence to moral norms and social values is an absolute prerequisite. Ethical progress is becoming an issue of the humanity survival. Common foundations that can lead to social agreement (solidarity) sufficient to overcome national, confessional and civilisation barriers (in Huntington's sense) should be established. Neo-conservatism that expresses itself through the neo-liberal ideology glorifies the type of individualism that verges on egoism. The major ethical problem is surpassing isolation and shutting into individual worlds, along with raising people's awareness on their interrelations and interdependency (this is usually indirect but cannot be avoided). The combination of private interests and activities can result in a more fair

and free society, but only providing the compliance with ethical and moral standards. Market type of self-regulation cannot work without ethics. The theory on the existence of equal starting positions and opportunities is utterly debatable; does it really depend solely on us whether we are going to make use of opportunities or not? The so called *free arm of market* logic can easily undermine basic civilisation premises and destroy life on the Earth because of profit.

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## ECONOMIC DIPLOMACY IN THE CONDITIONS OF GLOBALISATION: COMPARATIVE ANALYSIS

**Abstract:** *Diplomatic services worldwide are exposed to the globalisation process. This process has induced the need to adjust economic diplomacy to new international circumstances. The paper analyses the way in which diplomatic services of France, USA, Japan and Canada have responded to the challenges of modern economic diplomacy. What is common to all these diplomatic services is their understanding that success in economic diplomacy is a key factor these days for the overall successful performance of a country on the international scene.*

**Key words:** *France, Japan, Canada, US, globalisation, economic diplomacy*

### 1. Introduction

Foreign policy decision-making and organisation vary from country to country. This difference has more to do with form than substance, it is more about make-up nuances than real issues, it manifests itself more in specifics than in general picture. The function of Ministries of Foreign Affairs (MOFA) in different countries is not the same either, but it is similar with respect to their respective organisations, especially in the structure of individual missions or offices. Similarly, internal organisation of individual MOFAs and staffing levels in individual services differ from one country to another. Also, different countries value a diplomat's effort, work and efficiency in different ways. The less developed and more primitive a country is, diplomats are essentially less appreciated, that is, in these cases subjectivity overweighs objective criteria.

Starting from the classic notion of diplomacy, it can be said to be organisation-wise structured through various MOFAs' activities. Diplomats are state officers who represent their countries and adhere strictly to established working rules in the process of advocating their respective national interests and performing the allocated tasks. This system, founded by the creation of

modern diplomacy after the Westfall Peace Treaty in 1648, lasted for several centuries and remained relevant even after the two World Wars, though a bit changed due to the then so called blocs inspired divisions.

However, diplomacy has seen a long history of adjustments and amendments. As any other gigantic organisational entity, it has been adapting itself slowly but persistently and contributing considerably to the main ideas and essence of its existence. This was well spotted by Pavle Karović as early as in 1936 when these processes were in their infancy stage: "The times when diplomacy and foreign policy had only one selfish goal, that is to protect interests of an individual country, have passed. Nowadays, it is becoming a prevalent idea that all countries are linked amongst themselves, that events in one country affect those in another, that benefits of cooperation, good relations and peace are beginning to be appreciated. Diplomacy, wherever it might be, is working towards and striving more and more to link national interests with global interests of the international community."<sup>1</sup>

Over the recent decades economic diplomacy has been significantly influenced by general macroeconomic changes in the world and increasing emergence of non-state factors and entities, then information revolution and (or) processes of European and other integrations. The following changes can be accentuated and laid out as crucial:

- Sovereignty is no longer exclusively governmental scope; its one part has been handed over to supranational bodies. The European Union example goes to prove it convincingly. On the other hand, there has been a fragmentation in the sense of transferring parts of sovereignty to sub national units, as is especially evident in federal states (Canada, Australia etc).
- Control over a state's territory has become less a source of and a field for the exercise of power, that is, the notion of power has been relativised. Transport and telecommunication companies have stripped governments of the right to monopolise them. The power as exercised by B. Gates, G. Soros, Islamic Jihad or Bin Laden is not based on territory-controlling, but rather lies either in the information management domain or has to do with controlling fanatic followers, whereby governments' capacities to respond adequately to global challenges are being diminished.
- Classic forms of war-waging have given way to the new forms of quiet wars.
- International law (or regulations that impose themselves as such), supported by the public (tailored public opinion) exercise an ever-growing influence over some countries and are capable of overpowering and toppling regimes. In the name of human rights protection, jeopardised human environment or the right to self-choice some governments have

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<sup>1</sup> P. Karović, *Diplomacija*, Geca Kon a. d., Beograd, 1935, pp. 113-117.

been ousted. Non-interference in other countries' internal affairs has been replaced by a conditional "right to interfere".

- The media and public clout is becoming more and more pronounced: television mega-companies such as CNN, CBS, humanitarian agency *Amnesty International* or Court of Justice have had a direct and undisputed influence and affected events and public opinion worldwide; this subsequently ends up influencing governments that either under the mentioned influences, or even independently of them, make decisions that encroach upon other countries' internal issues.

Such changes have resulted in some novelties in diplomacy, its structure, organisation and operational activities and patterns. It has brought about a gradual development of new structures, procedures and ministries' competencies within the boundaries of the diplomacy's scope.

## 2. France: between preserving its political prestige on the international scene and strengthening its economic presence

French Ministry of Foreign Affairs is one of the oldest in the world. It was founded in the 14<sup>th</sup> century, in the time of renaissance. Since then, it has gone through various phases, amendments and adjustments.

The ministry – *Quai d'Orsay*<sup>2</sup> – has faced most recently several important issues, some out of which are of general nature and applicable to others too, whilst others are specific, characteristic and relevant only for the ministry in question. Topics relating to the changed international conditions fall in the first category. The second category comprises issues with respect to the country's past colonial status, or, more to the point, its relation to the former colonies.<sup>3</sup> Another area of interest is concern for fellow-humans in the "Third World" countries.

According to the 1958 constitution, foreign policy is President of the Republic's prerogative. Prime minister also has certain influence in the area but it is considerably lesser than president's. Apart from them, the only other person in charge of the conduct of foreign policy is Minister of Foreign Affairs appointed by the President. The minister has a limited independence in decision-making.

The current structure of the diplomatic service has resulted from several waves of reform that were started in 1958. On the very top and below the

<sup>2</sup> Popular name of the French Ministry of Foreign Affairs; named after the place where it is based.

<sup>3</sup> France is paying a special attention and care to its relation with former colonies. Apart from regular summits held every two years, the Ministry not only continues to maintain active diplomatic relations but it has also provided significant technical and other assistance.

minister there is a secretary general who is accountable to the minister for functioning of the ministry. He has two assistants who are respectively in charge of geographical (there are four regional directorates) and functional sector (two directorates for international organisations and EU). There are other two independent sectors covering scientific-technical and cultural cooperation which are of service to both foreign citizens and the French temporarily resident abroad. Sectors for support are: administrative sector, legal, media, information and protocol, along with other special units (analysis and planning, general inspector, archives and similar).

French diplomacy has one of the thickest diplomatic nets and includes: 151 embassies, 17 permanent missions, 4 missions within international organisations and 116 consulates. The diplomacy employs 12,519 French nationals (data from 2000).

As for economic issues within the Ministry, this area is within the remit of the Unit for economic and financial relations and General directorate for cultural and scientific-technical cooperation. Legal sector also has its scientific department. Economic and political departments are actively engaged in dealing with economic cooperation issues.<sup>4</sup>

Only 1% of the French national budget funds are allocated to diplomatic service (15 billions of French francs in 1996). Ten years ago and with a view to achieving a more efficient allocation of funds a coordinating body was formed- Interministerial Committee for the Coordination of Funds Abroad (CIMEE). This body coordinates the work of all French organisations abroad as well as the distribution of resources allocated for their needs, along with putting together some future services and their funds, their rationalisation and producing annual reports.<sup>5</sup>

The cohesion between all French missions and organisations abroad has been cemented lately, with the Ambassador's position being explicitly accentuated in the sense that they are seen as representatives of France and accordingly, their Head of mission responsibility in the execution of foreign policy has been underlined.

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<sup>4</sup> The Ministry, that is, its representatives in embassies, is responsible for the development of trade, export and status and role of the French economy abroad. Their activities include regular reports on their work, as well as information on economic tendencies and other relevant events in the economy of the country where they serve. Most recently, at the beginning of the century, the priority of their work has switched towards the collection of operational and strategic information, especially in the countries whose development is promising or in those who could potentially pose threat. Operating at 165 locations in 120 countries, they are certainly more than qualified and equipped to cover essential issues of interest and carry out specific tasks, all in service of the French economy.

<sup>5</sup> P. Lorot, Ed., "Introduction a la Geoeconomie", *Economica*, Institut Europeen de Geoeconomie, 1999, pp. 91-123.

For the duration of V Republic, especially as from 1993, the President's influence in diplomacy has subsided, though their headship remained undisputed in the sense that they are still seen as foreign policy main tailors. The Ministry has switched from a strict hierarchical structure to a less rigid and more transparent organisation that now has more powers with respect to the information circulation and speedier harmonisation of opinions. Still, initiative-taking wise this has had some negative sides too. Over the recent years the accent has been put on maintaining French influence and significance as an international factor and preventing loss of manoeuvring space when compared to the States.<sup>6</sup> Also, special importance has been attached to the EU issues.

France was amongst the first countries to deal in a serious manner with economic diplomacy issues and their regulation by state in order to penetrate other world's markets. This has visibly come to the fore with the development and acceleration of global processes and a growing need for the French economy to join world's economic flows and makes a competitive party amongst the increasing influences of the world's most powerful economies. At the beginning of the 1990s, more precisely in 1994, representatives of all structures (scientific circles, companies and representatives of state services) took part in the formation of so called Planning Commission, thereby generating the first draft project of the status and the direction French economy was going to take abroad. In 1995 a separate body was founded-a seven-member Committee for promoting competitiveness and economic security which was initially chaired by the French PM and later by the French minister for economic and financial affairs. The Committee was tasked with tracking all global economic novelties and estimating and establishing French main rivals. It was directly linked to the General Secretariat for National Defence (governmental body accountable to the premier). The Committee provides services and supplies French companies with all necessary material that is assisting them in their performance on foreign markets.<sup>7</sup>

French economic diplomacy's main task is to help national companies' functioning. It forms joint Commissions in order to achieve this, especially in those countries that still retain powerful public and state-run sectors (earlier in communist countries). Further, whenever it is possible and if necessary even at the highest state level, French political top establishment goes to unimaginable lengths to exercise influences that will be helpful for the French performance and position. French President, then PM, Minister of foreign affairs have repeatedly addressed their foreign counterparts (in person, in written form, or otherwise) lobbying for French companies to be tasked with some jobs. French President Jacques Chirac especially has often headed groups of French entrepreneurs in their visiting other countries. Export credits for improving sale on

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<sup>6</sup> S.y Cohen, *Les diplomates – Négociers dans un monde chaotique*, Editions Autrement, Collection Mutations, No. 213, Entretien avec Hubert Vedrine, pp. 70-79.

<sup>7</sup> P. Clerc, *Economic Intelligence*, Université de Presse, Paris, 2002

foreign markets are also at the disposal of the French economy. The assistance France has been extending to all francophone countries is constant and in the service of the promotion of export.

Therefore, French diplomacy is not only endeavouring to protect French political and economic interest abroad but also to turn political scores into economic benefits. Situated in between companies expecting help and its concrete political intentions, French diplomacy has got to know how to rule globalisation and draw advantages from it in the course of performing its set tasks.

### **3. Japan: from economic diplomacy to gradual valorisation and other forms of diplomatic activities**

Japanese Ministry of foreign affairs was founded in 1869, along with Japan becoming more open towards the world. The accession to the UN in 1956 was a definitive turning point for Japan's position in the international community

This same year, for the first time ever, this country's basic foreign policy principles were made public and published in so called "Blue book", and since then these principles have been republished at the end of every year. However, they have not changed, from clearly defined economic priorities with respect to copying and taking over world's advanced technologies in the first years following the World War II to the placement of their own technologies and overall economic expansion over the last couple of decades. They can be summarised as follows:

- Attaching importance to the UN activities;
- Cooperation and coordination with democratically-oriented countries;
- Maintaining its identity of an Asian country.

Due to the worldwide conditions in the course of the Cold War Japan was not able to meet the obligations stemming from the first principle entirely, but the other two principles have always been adhered to no matter what. Also, under the burden of the Second World War legacy, for a long time Japan stayed aside regarding all political and security related issues. This left its diplomatic service a considerable leeway to dedicate itself to economic issues and joining the so called "Breton Woods" system and other international organisations such as IMF, OECD etc. Shortly after the war Japan became very attractive for all these organisations as it had become world's third economic power with the GNI of 100 billions of dollars. It comes as no surprise that Japan continued making its way to the world's economic pinnacle by building proper relations with the Western countries and countries from both its close and distant surroundings to emerge world's second economic power as early as at the end of the 1970s. Oil crises happening in the 80s caused Japan directing itself to

the “Third World” countries as well so it strengthened its trade relations with African and Middle countries.

Japan has been fostering its economy in a planned way. It formed National organisation for collecting and disseminating economic information needed by companies the work of which is coordinated by the scientific information centre and Japanese external trade organisation (JETRO). Ministry of external trade and industry finance these organisations’ functioning. The system is based on several tracks of information exchange amongst the state, industrial companies, banks and other business and academic circles. The exchange takes place within three circles: state consultative committees, professional associations of businessmen and scientific bodies. All these circles are linked in their efforts to collect information on global scale and subsequently exchange the collected information amongst themselves.

However, diplomacy could not keep up with Japan’s sudden and intense ascent and its involvement in international flows. The budget diplomacy was allocated shortly after the war (it took up 0.1% of the governmental expenses, which was ten times less than before the war) did not change significantly either over the following couple of decades, whilst the country’s global obligations and the need for Japan to justify its status in the international community called for something different altogether. As the diplomatic service was expanding, especially during the 1980s, the funds allocated to it were growing too, but so did the number of Japanese missions and staff worldwide. These are the current figures: 191 missions worldwide, out of which 113 embassies, 7 permanent missions and 71 general consulates. The Ministry employs 2006 officers in Japan and 3,159 abroad, that is, 5165 people in total (data from 1989). The budget grew to 7.5 billion of dollars in 1996, which is half US diplomatic budget. Apart from economic issues that have been its top priority, Japanese diplomacy accentuates the following areas: developmental assistance and consular activities with a view to extending help to a growing number of Japanese people who work abroad.<sup>8</sup>

Reforms at the beginning of the 1990s aimed at harmonising overlapping areas within the government and coordinating them from the PM cabinet. Also, links were strengthened and demarcation line was blurred between internal and foreign affairs so that similar tasks from these areas were merged. Three PM sub-cabinets were formed and each was in charge of one of the following areas: economy, politics and security. It was a sort of headquarters from whence different governmental sectors’ activities were coordinated and a coherent fore-

<sup>8</sup> The changes in the Japanese diplomacy stemmed from the challenges brought along with the 90s and the need to step out of the one-track attitude with respect to economic issues. This could be expected as Japan, being the world’s second largest economic power, not only felt compelled to raise its voice in other spheres as well but its international status imposed it too. The focus was also more directed towards security, political and humanitarian aspects.

ign policy was tailored and launched. The intention was to avoid repeating any of the earlier mistakes made through the lack of coordination amongst governmental departments when everyone led their own, relatively separate or even completely independent policies. The coherency of the Japanese global policy has continued ever since and is extending to the new millennium.

Changes that have happened in the Japanese economy over the last fifteen years have resulted in its diplomatic service and other relevant ministries role and position somewhat losing their significance and eroding proportionately to the private sector becoming increasingly independent in its foreign dealings. Yet another consequence of these changes is strengthening position of international financial and other institutions which induced decision-making processes to be partly transferred from national level to international forums. This refers more than anything to IMF, OECD and APEC- Asia-Pacific economic cooperation forum.

To sum up, Japanese economic diplomacy model has four main features:

- Planned approach to establishing starting grounds for the realisation of the set goals;
- Strong centralisation;
- Efficient coordination;
- Maintaining balanced activities in major world markets' segments.

In short, challenges set in front of the Japanese diplomacy over the last fifty years can be summarised as: the need to respond to the augmentation of diplomatic web proportionate to the increase in assumed global responsibilities; to coordinate foreign policy priorities in order to avoid past mistakes and running the policy on two tracks; to identify Japan's new role in response to fast global changes and world's expectations with regard to Japan's position in international relations.

Public influence is crucial in the sense of giving support to the Japanese diplomacy, its role and status. In line with the Western preferred values, during the latter part of the last century Japanese diplomacy attached particular importance to the human rights and refugees issues. It formed a special department to deal with these issues. As a result of this, a coalition between business community and diplomacy ensued, especially in the light of Japan's blossoming investments and export activities worldwide. Whilst Japanese companies used to study foreign markets on their own and decide on their relative activities with respect to potential foreign partners, investments and transfers of HR and other technologies, they have lately started embarking on consultations with diplomatic representatives.<sup>9</sup>

Japan is an export-oriented country whose foreign economic activities are organised through associations that make up the National coalition of eco-

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<sup>9</sup> B. Hocking, *Foreign Ministries: Change and Adaptation* MacMillan Press, 1999, pp. 105-117.

conomic organisations (KEIDANREN). Through this organisation Japanese companies influence the government and its foreign economic and political path. Exportation planning has been established. Prime minister is at the head of the powerful High economic council in charge of exportation. Carrying out the decisions brought by this body is the Ministry of trade and industry's jurisdiction. The Ministry relies on the support from the International trade coordination association. The Association members are usually deployed to Japanese diplomatic missions worldwide. Japanese export priorities are increasingly becoming transitional and developing countries so that Japan has developed over the recent years good relations with African, Mid-Asian and Middle Eastern countries where more and more of its products end up (on the top of its long-established priority and most important rival, the US). There has been an unimaginable leap in the financial and trade exchange between Japan and Middle Eastern countries (monetary flows increased by 65% between 1998 and 2003) and recently also between Japan and Latin American countries.<sup>10</sup>

#### 4. Canada: an example of the openness of diplomatic service

Canada's experience in respect to the changes and adjustments of its diplomatic service is somewhat specific. Over the last three decades this country's diplomatic service has been changed and amended several times. The reasons are numerous: as from the external point of view, events on the international scene have brought changes to its foreign policy, made it more complex, with multiplying parties and growing thematic richness-namely, there has been a switch from the dominant political and security-oriented system to economic and social issues now coming to the fore. At the same time, overall circumstances have been changing: countries' interdependence, globalisation, new distribution of power etc.

On the other hand, it was evident that some new interest groups on the domestic scene, primarily business circles, non-governmental organisations and local authorities, have had started slowly but decisively gaining ground for claiming their interests. New assessments concerning diplomatic activities started flowing in with the emergence of these new interested parties. Changes in some state bodies and the diplomatic service itself ensued. These changes referred also to the foundation of some new directorates such as: environmental, human rights, energetics and similar. These simply forced their way forward by expanding their jurisdiction horizontally towards new areas of work, that far out of diplomatic scope. The biggest clashes amongst different parties happened precisely within these new spheres.

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<sup>10</sup> The Ministry of Foreign Affairs of Japan: *Diplomatic Blue Book, 2001*, Chapter II: Japan's Foreign Policy in Major Diplomatic Fields, pages 35-95; <http://www.mofa.go.jp/policy/bluebook/>

Under such challenges the Canadian diplomacy had to find means and paths to adapt to the emerging realities and adopt new models and strategies in line with new conditions, both within the very service and outside, where it was facing booming ambitions of various para-state and societal groups. During the term of Canadian PM P. Trudeau<sup>11</sup> vertical restructuring was carried out, by means of which Ministry of foreign affairs was added some new sectors and directorates to, all of which were either taken over from or combined with relevant economic ministries in the area of trade and industry. The expansion was done with a view to attaching greater weight to trade objectives within the international domain, then to highlighting export, increasing the country's capability to adapt to the changed global economic conditions and contributing to the sector's efficient integration within broad economic context. The diplomatic service was thus strengthened and it at the same became an integral part of new governmental tendencies: government's presence in diplomacy increased and a group of people worked on uniting foreign and trade policies within same goals. This yielded obvious benefits, not only in the form of newly-gained resourced but also through increasing the service's prerogatives and powers with respect to some issues that had been forcing their way more and more in international relations and forums. By means of this, economic diplomats' position within the Ministry was significantly improved. Their share in decision-making and their influence in government had become crucial.

On the other hand, structural changes were effected with respect to the diplomatic service's organisation too. The directorate for coordination of federal and regional tasks was formed. Involving talented francophons in the service resulted in the ethnical symbiosis in foreign affairs, along with reaffirming the service's organisational pattern and giving proportionate shares to relevant, hot topics in everyday activities. Some neglected issues from the previous period (cultural diplomacy) were now given their proper place on the priority list. Canadian regions' not always compatible and harmonised interests and attitudes were slowly gaining their respective significance and subsequently their proper places in the foreign policy approaches: trade policy made the diplomacy more directed and focused on some concrete targets and tasks at hand- such as economic, cultural and social promotion of Canadian interests.

This organisational reshuffle precisely served to improve the diplomatic service and made it capable and equipped to face potential challenges and other participants on the diplomatic scene. The greater volume of participants (both internal and external) increased competitiveness and brought considerable mess to internal business dealings. The exclusiveness Ministry of foreign affairs used to have in running these activities was dangerously questioned with strengthening the role of alternative services that found themselves in

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<sup>11</sup> Pierre Elliott Trudeau, Canadian PM with two mandates: 1968-1979 and 1980-1984

political decision makers' immediate vicinity (the cabinet, along with leading politicians-PM and their trusted officials).

Another tendency came from the opposite side-external side. Namely, as a number of international gatherings on economic and other issue happened during the 80s, their legitimacy was possible to be achieved only through attendance of as great number of agencies and institutions as possible (for example CIDA- Canadian International development agency). This, in turn, called for strengthening vertical processes of integration. The attitude of the state towards various groups and associations was changing and this was made further possible by the "societalisation" process that granted these groups easier access to foreign policy circles and consequently enabled their direct influence in decision-making. For example, during Canadian-US negotiations on free trade in the 90s, 15 consultative bodies took direct part to the effect of presenting their views and proposing ideas.

Advancements in vertical integration were more visible on social plane. Contrast between the earlier closed system and this new, open approach to decision-making became obvious with the majority of relevant issues (such as human rights, environmental issues, social justice etc). Discussions are now held and decisions made in a new manner, with a broad palette of vertical and horizontal participants present. For example, at the UN conference on environment and development (UNCED) held in 1992 a great number of Canadian NGOs took part, the practice that continued at conferences in the years to come: World conference on human rights in Vienna (1993) and International conference on population and development in Cairo (1994).

This resulted from an unceasing pressure exerted on decision makers and governmental circles' resignation to the need to negotiate with various social and other groups that asked for participation upon decision-making.

Strengthening of the tendencies to render political and economic decision-making processes more society-coloured came as a result of the ever growing privatisation and state's diminishing role. Credit for the mentioned societalisation and the inclusion of new parties in political decision-making went primarily to liberal tendencies and state's governing circles which, with these goals in mind, formed two separate parliament committees with broad powers in the course of public sessions, and when in 1994 National forum on foreign affairs was founded the process was finalised. In 1995, a great number of businessmen, academic circle and other professions' representatives joined the Forum. By means of this, a broad dialogue on foreign policy was made possible. Canadian NGOs now had opportunity to take part in decision-making processes. However, the role of societal groups in decision-making should not be overrated. The increased NGOs' attendance in foreign affair and economic discussions did not have the same consequences for businessmen. Such great number of participants caused some doubts and dilemmas in governmental

circles, especially regarding the level of expertise and capabilities necessary for precise decision-making. Shortly afterwards, in order to relieve the pressure coming from the great number of participants in decision-making processes and dilute the influence of these joint parliamentary bodies, Consultative Board for Foreign Affairs was founded.

During the mandate of J. Chrétien<sup>12</sup> a great stride was made towards foreign affairs' return under the diplomatic wing. The name was changed to the State Department for foreign affairs and international trade and key diplomatic positions were given to experienced diplomats. Also, unlike to other ministries, diplomatic service's budget was increased in 1995 by 74 million or 5%, that is, from 1.32 to 1.4 billions of Canadian dollars.

With the emergence of new countries on the world's scene after the dissolution of the Soviet Union and Yugoslavia, the number of diplomatic missions was increased to 121 in 1997 (there were 110 missions in 1981). New embassies with low staffing levels and relatively modest resources were opened- for some of them computers and local employees were sufficient.

Internal reorganisation of ministries was conducted as well. It was achieved through discussions on methods of its implementation-centralised or decentralised.

The Deputy Minister's role, that is, the role of the state secretary (Deputy) of the minister of foreign affairs was considerably bigger than in other countries. The impression was made that the service's structure is too unwieldy and heavy at its top and that decision-making was not pyramidal: therefore, the differentiation of working tasks was conducted. The number of Deputy Ministers' subordinates was cut (from the starting twelve, the number of Deputy Ministers was reduced to seven). The most important element of the organisational structure in the sense of the service's programme management became directorates run by directors general. From a classic diplomatic service Canadian Ministry of Foreign Affairs was thus turned into a modern institution, realistically organised and efficient.<sup>13</sup>

Does it then mean that diplomatic service was turned back to its traditional frames with J. Chrétien? That is correct. Namely, under the influence of systematic global changes diplomatic service was given a greater importance to without at the same time going back to old systems. In these changed circumstances it was simply given the role of a coordinator and main filter for establishing Canadian foreign political and economic interests. By relying on achieved results as indicators for further activities Canadian foreign policy was taking on tasks imposed by circumstances. The new policy meant that Canada had redirected its focus to comparative advantages (peacekeeping initiatives, for example) as well

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<sup>12</sup> Jean Chrétien, Canadian PM in the last decade of the 20<sup>th</sup> century.

<sup>13</sup> A. Cooper prema: B. Hocking, Ed., *Foreign Ministries, Change and Adaptation*, MacMillan Press, 1999, pp. 40-53.

as to the tasks necessary to be accomplished in order to fulfil national economic interests and enable access on foreign markets. Such remodelling of Canadian foreign policy particularly manifested itself through the government's tendency to prioritise trade diversification over human rights issues.

### 5. United States of America: valorisation of its role as a world's political, economic and military power

The US foreign policy seems to have been adapting to the changes in the international community more quickly than others, which is the first and basic reason for its new appearance at the beginning of the century.

Another reason, equally important as the first one, is shifts in state priorities that were especially triggered by some significant and major events in the world when foreign political approach is most often revised anyway. The States have engaged recently in numerous activities on both economic and political planes in order to confirm their supremacy in international relations.

And the third reason lies in diplomacy's adaptations to current trends in the country, whether these are of objective nature – change of public opinion, interest and other groups, or, subjective – novelties with respect to the role and status of diplomatic service, usually in relation to other organisations and institutions that take direct or indirect part in international relations, but also different views on state interests and political decisions.

Traditionally, President has a paramount role in the creation of foreign policy in the US. President decides on key foreign affair issues and foreign economic relations (introduces tax relieves, approves law projects, is entitled to veto laws brought by the Congress). Besides him, key roles rest with the State secretariat (State Department – SD)<sup>14</sup>, The Congress and various committees. Key figure of the establishment is State secretary, amongst other things owing to the fact that some American presidents doubled as state secretaries (Jefferson, Monroe, Adams, Madison, Marshall) and also that effectively after Deputy PM (who is also the Senate chairperson) state secretary is legally the top person representing the Cabinet. Also, SD is the first executive service decreed by the 1789 Constitution. Its strong rivals are Defence Secretariat, National Security Council (NSC) and the Congress. These all have a direct role in the formulation of foreign policy. There is one factor that is not to the SD advantage: namely, it is the structure of its staff which is seen as elitist (opposite to a high level of populism and pluralism in American culture), iso-

<sup>14</sup> Besides the President and the Congress, *State Department* or State secretariat (for foreign affairs) is the most important link of the foreign policy and economy. It includes Trade and business activates office as an initial contact point for American companies seeking assistance and support from the SD. Its task is to make way abroad for an efficient performance of American business.

lated (insufficiently specialised to respond to a growing number of requests coming from the increasing volume of foreign affairs participants) and unable to adapt to the government's internal demands (it has been organised in such a way that it remained isolated from other federal services, detached and completely outside of their plans and potential joint projects).

The fourth reason that accounts for the service's refreshed looks is the gradual divergence and demarcation between the foreign affairs and other priorities, which is particularly present with the American voters turned more towards internal issues (salaries, taxes). This resulted in American presidents Clinton<sup>15</sup> and Bush (at least till September 11<sup>th</sup> 2001) not paying that much attention to the foreign policy as it had been the case with American presidents who had been in power during the Cold War.

Fifth, both the public and the government have started dealing in a more serious way with the role of administration in achieving national goals, various matters have come under scrutiny, such as who and how could be able to undertake the necessary measures, what technical and other resources they should be employing in the process etc.

Several questions were raised within the SD reform efforts. Which area should be given priority-multilateral or bilateral issues? How should embassies be arranged, what are their roles and organisation? What is the configuration inherited from the Cold War period? How should sectors, directorates and organisational units be organised in order to respond to current needs? Is the current bureaucratic working method compatible with the existing circumstances? Which of the information-management systems applying to the directorates' and other professional organisation units' work is the right one?

Perhaps the most visible and striking change in embassies' working systems was the foundation of 20-odd representative offices in newly-formed countries. The States had in total 240 missions (162 embassies, 77 consulates and 10 other missions) at the end of the last century.

The most important change in the organisation of the diplomatic service was transferring the responsibilities lying with Deputy State Secretaries who up till 1995 had been accountable directly to the Secretary and their Deputy, to sub-secretaries. A sub-secretaries' committee for global issues was formed with a view to enhancing the multilateral sector which had always been in the bilateral sector's shadow; several other services were also reorganised, such as human rights service, service for refugees, criminal, narcotics and other matters.

The actual number of job holders was also cut down. Namely, in September 1996 SD employed 13,183 officers, out of which 7,936 diplomats and 5,247 administrative staff members. This number was being reduced constantly; jobs were being merged, so that over the last decade around 225 officers on

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<sup>15</sup> Bill Clinton (William Bill Clinton) was the US president between 1992 and 2000, when George Bush Jr. replaced him.

average were made redundant per year. The number of people who got promoted was reduced as well, especially relating to promotions to high-ranking posts-ambassadors and similar.<sup>16</sup>

The most recent initiative for the modernisation of the diplomatic service was taken in 1996, when “Strategic management initiative” was launched with a view to enhancing work efficiency. It was based on new IT investments and some other novelties to be introduced but, sadly, it did not indicate the practices that should be discontinued. The conclusion was that the most important thing was to invest in IT systems, as this area was the most convenient for introducing novelties.

Another novelty was the creation of regional centres with a task to support foreign representative offices’ work. Several such centres were formed: one based in Miami intending to supply the entire diplomatic net necessary for the Middle and South America whereby staffing levels reductions at embassies would be enabled.

However, after September 11<sup>th</sup> the accent was shifted to the security component, work intensity and numbers of staff at US embassies in the Middle East were increased.

Due to such restrictive policy, the diplomatic service’s expenses in 1996 were lower than in the previous years and stood at 2.5 billion of dollars. If annual funds allocated to other agencies included in the US promotion worldwide (AID, USAI, ACDA) are added to this figure then it becomes much bigger and amounts to 18.5 billion of dollars. The expenses languished at this same level for a while to reach 20 billion of dollars towards the end of the century.

American economic security doctrine lies on three pillars. The first is support to American interests abroad, the second has to do with the foreign companies’ illegal practices prevention and the third covers the foreign powers’ economic espionage combat. The doctrine was initiated by President Clinton when he came to power in 1992. He claimed that old political-security rivalries from the Cold War period had been sidelined and that economic rivalries had replaced them. This was the crucial moment in the shift of American strategy which brought to the fore economic components whereby these were equalised with the military-political element of the US foreign policy. Towards the end of the decade, on the eve of G. Bush coming to power in 2000, the concept was modified to the effect that American companies’ promotion and their performance abroad was now prioritised over combating economic

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<sup>16</sup> Attempts from ten years ago to create individual programmes in organizational units did not show as particularly successful, whereas the most recent changes have proved a solid foundation for a kind of insight in embassies’ direct activities. These changes refer to annual report writing, embassies’ working plans, making detailed report on their activities in the current year, plans for the following year and resources needed to achieve these plans.

espionage.<sup>17</sup> The new American attitude indicates to an important turn that is accounted for by a steep growth of trade deficit and its influence on unemployment. The estimate is that on average 13 million staff in the sector deals directly with the export.

The States are particularly interested in maintaining their leading role on the international-economic level, intensifying their presence in world's major energy producers' vital economic zones, then promoting further liberalisation of the world's trade flows (they are heavily engaged with the WTO), completing the conversion of American continent into a free trade zone (NAFTA expansion) and establishing a free trade zone with Asian and Pacific countries. The States have also picked up their activities with regard to the south-east Asian countries with a view to becoming indispensable and placing their products on this significant world's market. American economic diplomacy model at the end of the 20<sup>th</sup> century had as its strategic goal the incessant expansion of free trade horizons and globalisation in terms of the world's economy.

US economic diplomacy's specific and characteristic working mechanisms are trade missions comprising groups of businessmen who gather in order to analyse countries and their industrial potentials, together with big companies. A number of US ministries and departments have their representatives abroad where these people operate either within embassies or independently.

Analysts see US missions within the UN and other international organisations having become very important levers in achieving US economic diplomacy's goals, especially since the States imposed their supremacy amongst these organisations. Their goal is to use their influence with a view to having certain decisions brought that are to advantage for American views. This tendency has especially manifested itself over the last several years when no important decision in international economic forums (IMF, WTO, SC) has been made without the US agreeing to it. The decisions have often been taken under the direct US influence or upon their initiative. Thereby, the US economic diplomacy has proven very successful in the protection of its national interests that are most often projected as universal values.

There is also a common body within the economic diplomacy's structure which formulates views on all important foreign-economic issues- this is International economic policy council the jurisdiction of which is to unite all the recommendations on foreign business projects upon the suggestions coming from relevant departments, embassies and US major companies. The US president doubles as the Council's chairperson. The Council was founded in the 90s, when the States started losing their status as a leading economic power, that is, when Japan caught up with them in its technological development. Shortly afterwards, in 1993, the Council launched *national export strategy* that

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<sup>17</sup> D. Lucas, A. Tiffreau, *Guerre économique et information*, Gibert Jeune, Ellipses, Paris, 1994, pp. 198-200.

was supposed to enable linking of different economic policy entities and different attitudes towards foreign markets, primarily big countries' markets such as Mexico, China, India, Brazil, Argentina, Korea, South African Republic etc. Further, the Scientific and technological policy office was formed and its role was to ensure the country's leading technological role to be reinstated, which was the biggest challenge for national interests. Towards the end of the 1990s, by means of introducing new technologies the States reasserted their technological leader's rights

American economic diplomacy's system is of centralised nature and focused on outward activities in its endeavours to accomplish American economic interests.<sup>18</sup>

Over the last couple of years the IT component has also become a focal element. Wherever they see their interests big companies delegate their representatives within the US missions worldwide. In 1996 Congress brought a special regulation-*Act on future financing of state services* which started being implemented as from 2000. Given the cuts in the budget, the question of the type of relation between the Congress and the diplomatic service has been raised increasingly, along with the service's relation with the relevant Department of Defence (DOD), Central Intelligence Agency (CIA), National Security Council (NSC), and Agency for International Development (USAID), Agency for public relations, Arms control and disarmament agency (ACDA) etc.

Generally speaking, American diplomacy's strategic goal, and especially its economic diplomacy's goal, is to open new working posts in the country as a result from the increased American presence abroad. More than 250 trade agreements realised over the period 1970-2000 enabled the augmentation of US trade volume by 25 times. This, in turn, resulted in opening 16 million new vacancies.

## 6. Concluding remarks

Economic globalisation changes relations between governments and businesses and poses in front of diplomatic services concrete tasks with respect to the need to strengthen competitiveness and respective countries' performances on foreign markets. New phenomena on the world's scene have not marginalised countries' roles in political matters but they have certainly put them on a different plane from the one they assumed a couple of decades ago. Apart from an ever-increasing number of interested parties, there are now also a growing number of questions and issues that both the state and other non-governmental

<sup>18</sup> P. Lorot, Ed., "Pourquoi la Geoeconomie, Institut Europeen de Geoeconomie", *Economica*, propos recueillis de P. Lorot, entitule Etas Unis: la "diplomatie de negoce", Paris, 1999, pp. 103-118.

entities voice their opinion on; along with new techniques and forms of economic and trade negotiation, the border between politics and what is not politics is changing too. Economic diplomacy has not been immune to these changes either and it has had to adjust too. Business and scientific circles representatives are taking more and more active role in it and are enriching its contents.

In essence, globalisation has brought new forms in relation to the attitude of political structures towards processes of making foreign political decisions. There are two systems in place regarding this. In countries cherishing the Anglo-Saxon tradition decision-making is usually limited to a narrow circle, which is PM's or President's cabinet. Decisions are formulated on different levels and within different organisations that influence the formulation of final decisions made by a country's political elite. In the French system for example, the influence of such structures is considerably smaller but they are still significantly present. This is a novelty that made economic diplomacy more efficient and ordered by some functional principles. What also should be considered is the ever-growing influence of important regional organisations (EU, NAFTA, ASEAN) which even a part of the state decisions' sovereignty is being transferred to. Therefore, the pyramid foundation can be said to be expanding with respect to the number of participants who could potentially influence the decision-making process. When decision-making takes place within narrower circles and is under influence of strong lobbying centres of power present in the form of influential economic groups, primarily big capital-related, then these groups of people, either through indirect activities or direct influences on the Cabinet members, can considerably direct and model decision-making processes.

At the same time, diplomats' role in its broadest sense is changing with regard to economic promotion activities (diplomatic activities are now undertaken also by big companies, interested parties etc). They are becoming increasingly oriented to their interrelations and links, whether they operate in either public or private sector.

When dealing with modern diplomatic services' role one of the central points becomes the question of whether diplomatic services need information component in the first place. Given that information travel more quickly by media (CNN etc) such question has been rightfully raised. However, as diplomatic information's essential nature is analytical, their sustainability and long-term usage, providing they are succinct and of good quality in the first place, are indispensable. Also, IT technologies have contributed largely to the creation of new realities in international relations.

What is important to state is that economic diplomacies of the world's major powers have become integral parts of their respective ruling structures that actively work on them: so economic diplomacy is no longer only a part of the relevant Ministries' jurisdiction (Ministry of foreign affairs, Ministry of

economy etc) but also an active part of the top establishment. There is another related element that has become important in these considerations concerning diplomacies. It is becoming increasingly evident that its role has become crucial regarding its status of a coordinator of all activities directed towards the rest of the world. Its role serves to reflect the volatile and unpredictable nature of political milieu within which governments operate, in the conditions of relativised borders between public and official spheres.

Diplomatic services' respond to challenges seems to have been two-fold: internal-towards governments and within governments and their structures, and external-outside governmental circles, by making links with domestic interested parties and business groups. In line with this, diplomatic services' linking with NGOs and other groups has resulted in a new relation of powers, that is, new allocation of roles and coordinating activities. This particularly relates to the EU. In some cases the gaps and differences amongst international activities participants have been diminished. The example of Japan is very illustrative: in this country Ministry of internal affairs joined their resources with Ministry of trade and industry in order to increase the country's economic presence worldwide. Thereby, the diplomatic service's role was highlighted in the sense that diplomacy became an important factor in regulating these bodies' interaction.

On the current level of development, the coordinating role of diplomacy and diplomatic services cannot be overstated. This role is especially underlined regarding the coordination between certain governmental segments, between governments, then between governments and international bodies and between official and unofficial representatives and individuals. Diplomatic services have got to adapt to this and find their proper role amidst the changed circumstances. However, this is not always the case, especially with less developed countries.

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## RESTRUCTURING – KEY TO A COMPANY’S RECOVERY IN IMPERFECT MARKET ECONOMY CONDITIONS<sup>1</sup>

**Abstract:** *The main goal of the paper, given the current economic climate characteristics, is to indicate the importance of restructuring of domestic companies in these “imperfect market conditions”. By creating its own developmental routes, Serbian economy is endeavouring to build up consistent restructuring programmes whereby current business and developmental problems will be overcome, joining the world’s market flows ensured and realistic foundation for a successful recovery created.*

**Key words:** *Serbia, economy restructuring, company restructuring*

### 1. Introduction

Judging from both positive and negative experiences of the countries undergoing transition, it can be concluded that Serbia cannot advance its economy in the long run without a thorough restructuring and involving in global economy flows. It is a prevalent opinion that a successful transition cannot be achieved without foreign capital influx, establishing relations with international financial institutions, as well as finishing the privatisation process that will bring about the increase in securities trade on financial markets.

Nowadays, Serbia is seeking to finalise the liberalisation and privatisation processes and to create economic macro stability, which is a prerequisite for entering the second transition phase. Whilst the majority of countries in the region endeavour to strengthen their capabilities to ensure public services financing and create healthy business environment when dealing with the institutional infrastructure development problem, an issue absolutely crucial

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<sup>1</sup> *The paper is a part of research on the project “Strategic options for incorporating Serbia in the world’s economy flows”, financed by the Ministry of Science and Environment of the Republic of Serbia (MNTR).*

to be resolved in order for the market economy to operate properly, Serbia is considerably late on its way on this path. In essence, market economy has come down to a limited market of goods and services, without capital market, profitable companies and workforce. Also, underdeveloped market institutions, helped by the government and political factors, have been seriously hindering market patterns expression and a stronger market orientation.

The results achieved in the previous year show that conditions for a more efficient and intense transition process implementation have been created. Integral parts of the reforms done in the country so far are: development of the institutions crucial for advancing small and medium enterprises, accelerating privatisation process, keeping the budget deficit in check, economy and banking sector restructuring and rehabilitation, domestic accounting system harmonisation with European standards, trade liberalisation etc.

Transition from one economic system to another, a market type one, foresees restructuring of economic entities in all segments of their existence. The source of these changes are market type business principles and methods, which brings to the fore the need to master all the necessary knowledge and skills that make a basis for an efficient realisation of the management and other executive functions

Under the influence of a string of limiting factors that have been in evidence over a long period of time and that have endangered business existence of a number of domestic companies, a need for their restructuring has arisen. Regardless whether these companies have already finished or are on the point of beginning privatisation, it is necessary that processes of diagnosing, recovery and revitalisation of those segments which are regarded as suitable for revitalisation based on the company's general developmental orientation on the one hand, and its political and economic business philosophy on the other, should be undertaken. Therefore, companies' business policy basic orientations' programming and their operational realisation are the main purposes of restructuring.

Transition companies' restructuring surveys show that restructuring of privatised companies is faster than of the non-privatised ones. This concerns both cost-related and revenue-focused restructuring. Whilst the first phase, that is, cost-related restructuring, regards decrease in activities, the second phase entails investing in those segments that can enable development and achievement of comparative advantage. As a result, there is a marked difference between capital investments (premises, equipment) and investing in particular areas of a company (research and development, marketing, management, human resources), of which the latter can have a more prominent role than investing in physical capital itself in the phase of pre-privatisation activities.

Given that the domestic economic climate's main feature is companies' operating in so called imperfect market conditions characterised by crisis symptoms, a need is arising to consider possibilities for overcoming the existent dif-

faculties and continue operating business in such conditions. Therefore, the restructuring strategy importance will be reinforced in the period to come by a further strengthening of the domestic companies' market orientation and the continuation of the privatisation process. This entails comprehensive business policy changes, along with the simultaneous implementation of a series of measures the prime purpose of which is to overcome the acute crisis condition.

## 2. Restructuring – companies' recovery factor

Condition of crisis a company can find itself in is one of the common reasons for undertaking restructuring activities. As every crisis and crisis conditions have their sources, the crisis can be identified in the following areas: proprietary relations, managerial functions, development, market, staff, finances, production. In order to resolve crises and critical conditions a planned and coordinated approach to the influences affecting certain business system segments and its flows is called for.

There is a great number of causes and symptoms of a crisis. Some of the most common include: loss of market, sales decrease, profit decrease, consumers' distrust, financial loss, drop in investments, drop in staff's morale etc. A condition of crisis is closely linked to management and company's operating failings.

There are a huge number of domestic companies in which illness and crisis symptoms are remarkably evident. These should be identified and rated by the symptoms manifestation frequency, using a sample system of financial and accounting data analysis within the selected companies. A prerequisite for establishing crises' causes is the identification and diagnosing of illnesses' and crises' symptoms. Recovery strategy elements' structure and measures and activities to be undertaken depend on crises' symptoms recognition and definition.

Domestic companies face various problems that can lead to a condition of crisis and, though multiple, these can be classified in several most prominent:

- Insufficient company investments problem;
- Institutional peculiarities:
  - *Bankruptcy and liquidation procedures* (bankruptcy and liquidation legislation does exist but it is not being adhered to in a consistent manner)
  - *Banking system and its role*;
  - *Employeeism* – a situation when employees, despite the privatisation or corporate processes already under way, retain a disproportionately huge influence, with hefty business implications.<sup>2</sup>

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<sup>2</sup> Research results on the following project: "Company recovery strategies in the Republic of Serbia economy crisis business conditions (2000-2005)", MNTR, 2005

Not every crisis can be successfully resolved in a company. Failure can then put the company in two main groups of situations: 1) situation where there is a possibility to ensure the company's survival or where even a complete recovery is an option and 2) situation where there is no hope for the company. Recovery strategies are specific, unique and cannot be repeated, which largely hampers efforts towards their grouping. Depending on a crisis' depth and the extent of the undertaken recovery measures, a selection of the strategic recovery options is to be done. This relates to the research of conditions necessary for the use of strategies directed towards expense cuts, assets decrease, increase in income, or their combination, along with endeavouring to improve cash flow.

A successful recovery strategy has to comprise several elements and measures which contribute to crises causes' removal. It is necessary to use researching to establish appropriate measures for certain groups of unsuccessful companies, such as: management policy changes, organisational changes, expense cuts, financial strategy shifts, marketing policy improvements, new products and services focusing, investments, external growth strategies etc.

Republic of Serbia economy crisis causes are deep as our country has found itself over the last fifteen years under the influence of political, economic, financial, technological, legal and social forces that have had uncontrollable and dramatic effects. The mentioned influences have brought about a rapid weakening of the country's economic position. Low work productivity, witnessed mainly in production, uneconomical businesses and marked investment inefficiency have been unable to ensure the necessary spending and accumulation for the further development. As a result, we opted for taking excessive foreign loans. An increasing number of companies were finding themselves in the capital loss zone.

Company's insolvency is one of the prerequisites to initiate its restructuring process. This is corroborated by research results according to which the situation of incurring excessive debts is a key factor that causes a company to enter a crisis. Table 1 illustrates the rating of the factors' influence.

**Table 1:** *Causes of crises in Serbian companies undergoing restructuring*

CAUSES	COMPANIES (%)
Excessive indebtedness	76.47
Inadequate financial management (lack of working capital)	64.71
Market loss	52.94
Unfavourable external conditions (state legislation, sanctions, bombardment, bad position of a particular economic branch)	47.06
Outdated technology	35.30
Managerial crises	17.65
Inadequate organisational structure	17.65
Other	7.10

Source: Privatisation Agency's internal data, Belgrade, 2004

For comparison purposes, we present here the *Society of Practitioners of Insolvency* results on the causes for British companies' insolvency (see Table 2).

**Table 2:** *Causes of crises of British companies*

Cause	Company (%)
Market loss	35
Inadequate financial management (insufficient funds, lack of working capital / cash)	3 2
Managerial crisis (fear, optimistic planning, careless book-accounting, lack of information, technological failings)	23
Excessive indebtedness	10

Source: Survey results of the *Society of Practitioners of Insolvency*, London, Great Britain

As there are a great number of companies that find themselves in a crisis whilst at the same time operating in a developed market economy environment, various surveys have been conducted with a view to analysing the order of occurrence of the factors that effect crises. Market loss comes first, whilst in our companies this factor comes in third. Inadequate financial management takes second place in both cases, with one difference in our case where a percentage of these companies is twice as high. In Great Britain, which we took in this example as a developed market economy representative, excessive debt is a cause for crisis in 10% of companies only; whilst in our companies it is a burning issue!

Crisis is a dynamic occurrence that goes through various phases in its development. According to the so called Fink model, the crisis "anatomy" can comprise four different stages:

- 1) Prodromal stage,
- 2) Acute stage,
- 3) Chronic stage,
- 4) Crisis resolving stage.

Prodromal stage is a warning stage. Just like an illness, a crisis identified in this stage can easily be treated, even prevented. Establishing the existence of a crisis in this stage can be complicated though. However, cause detection followed with no action leads irrevocably to the acute crisis stage. The symptoms call for an immediate action in this stage. As a matter of fact, acute stage is referred to as a no-turning point in which crisis happened, with the main objective being damage limitation. Its main characteristics are great speed and intensity

Symptoms are always clear and constantly present during the chronic phase. This is a turning point stage. For some companies this stage can mean the beginning of recovery but for some others it denotes beginning of the end. Chronic phase is sometimes dubbed *crisis situation clearance phase* or *post mortem phase*. Namely, not every crisis can be resolved successfully by a company. There are always two alternatives: recovery or liquidation. For some

companies this is a recovery period, period of self-analysis, introspection and cure. But at the same time it can be a period of a financial downfall, management fluctuation and other operational problems. Exiting a crisis means that “the patient” feels better. It is every company’s objective during a crisis to reach this stage.

In order to define directions to be taken in order to diminish a gap between the domestic and the world’s practice, knowledge, findings and experiences concerning company revitalisation are of crucial importance. Crisis studying and working on the strategies for its overcoming in the management area is of recent origin. Considering recovery issues as integral parts of restructuring in the developed market economies is somewhat different in the transition countries. What is common though is the fact that failure, business problems, crisis and illness are all inextricable parts of a company’s existence throughout the world. The number of unsuccessful and failing companies is far bigger than the one of thriving ones. It is only the recovery strategic options that differ.<sup>3</sup>

When formulating a successful recovery strategy and its elements, some relevant recovery factors must be taken in consideration, such as: symptoms, causes and the intensity of crisis, economy branch characteristics, cost and expense structure, but one must at the same time bear in mind the company’s current strategic and operational health. Therefore, recovery strategies entail combining a greater number of current and operational measures.

A recovery strategy’s justification and efficiency can be assessed based on an appropriate and well-developed business efficiency criteria system. Given the domestic market volatility, along with the expectations and the imperative to make our companies accessible and eligible for developmental enterprises, contemporary recovery strategies presentation contributes largely to rendering domestic companies capable of responding realistically and quickly to all environmental opportunities and threats, of making use of the available resources in a rational way, creating new projects and programmes and assuming necessary risk for the undertaken actions and measures.

Restructuring and recovery issues are important subjects in various theoretical and empirical surveys in the developed western countries. Thus, results of a comprehensive empirical survey conducted at the end of the 80s regarding the developed market economy companies’ radical transformations (US and Western Europe) indicate that a majority of companies tried to surpass difficulties through organisational restructuring and making radical shifts in companies’ strategies. Company recovery considerations in the countries undergoing transition are directed somewhat differently. In the transition conditions, characterised by an underdeveloped capital, companies and management market, what is primarily insisted on are thorough and radical changes

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<sup>3</sup> Research results on the following project: “Company recovery strategies in the Republic of Serbia economy crisis business conditions (2000-2005)”, MNTR

that transcend financial and strategic restructuring only. In these conditions, restructuring encompasses every little pore of a company's dealings, with a view to achieving some structural changes regarding the ways business is operated in and companies' business stability.

In order to resolve successfully an economic crisis, great changes, both globally and within a company, are needed. It is possible to achieve some alternative solutions for a crisis' detangling through defining the acute crisis stage, crisis management and adequate restructuring strategies implementation.

Judging from an opinion poll conducted by the Market Surveys Institute, it is businessmen's recommendation that, apart from economic policy regulation, a thorough process of the market, organisational, technological, financial and proprietary restructuring should be carried out in order to achieve a situation of successful business running. This calls for an organised and planned approach to companies' recovery, directed primarily and directly towards economic entities expressing some "illness" or crisis signs, but also indirectly towards their business and strategic partners. Strategy's results should serve to create a healthy business climate through a process of elaborating and implementing consistent programmes, whereby current business and developmental problems will be surpassed and conditions necessary in order to join the world's market and developmental flows will be created. At the same time, business and strategic partners, as the project results' indirect beneficiaries, will be enabled to develop further their business and strategic cooperation with domestic producers

In order to resolve successfully an economic crisis huge changes are indispensable, both globally (economy restructuring) and within companies (company restructuring). By implementing the mentioned restructuring strategies on micro and macro plans, adequate alternative solutions for crisis resolving can be created.<sup>4</sup>

### *2.1. Economy restructuring*

Economy restructuring is based on changing certain activities' participation patterns (on a national economy level) and changing economic entities' organisational forms. In this sense, restructuring foresees boosting the role and importance of small and medium enterprises which are run privately, when compared to big state-run corporations. Also, services would be seen as more important-service sector would develop, especially in the high technology domain as well as creating and bringing to the fore small and medium companies that deal with service providing.

When an economic system falls into a crisis, solutions are sought in either sanation or liquidation. Sanation can be done through either immediate con-

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<sup>4</sup> N. Cvetković, S. Grgurević, B. Ilić, "Restrukturiranje preduzeća kao faktor prevazilaženja krize", *Ekonomski vidici*, Vol. X, No. 2, DEB, Beograd, April 2005

tacts among the interested parties or through bankruptcy procedure, whereas liquidation can be done through bankruptcy procedure or directly. In this sense, bankruptcy is a link in company's sanation process and that is how it should be understood and interpreted. The logic is, therefore, that bankruptcy procedure should be led in line with a company's sanation process and with one and only goal of the company's survival. Bankruptcy procedure should be carried out following a clear programme that always comes down to studying arguments in order to decide whether a company should be saved or liquidated and under which conditions it can survive. Therefore, bankruptcy is an economic procedure, not a legal process that halts every economic movement. This procedure is called working bankruptcy in our practice, but it is not developed to a level that is necessary in this time and that the situation our economy is in requires.

Legal procedures are economy-wise unjustified and tailored in such a way that the remaining capital of a company that has entered bankruptcy melts away, thus rendering the whole process purposeless as creditors invariably end up without money.

Legal experts could seriously fault the way this issue is being explained here, as they advocate the opinion that proprietary relations in bankruptcy procedure have to be sorted out. This is hardly an easy job to do, especially in disorganised companies, which most of those entering bankruptcy are.

When a majority of companies entering bankruptcy become enabled for further functioning, this process can be considered to be settled. The final message resulting from all these conclusions is that no matter how things progress, they must be efficient. Fixed expenses of the companies entering bankruptcy are too high for the bankruptcy procedures to be conducted for unrealistically long periods of time.

Domestic economy situation reflects on the capital market characterised by a poor development level. Financial market operating is in the current privatisation model's function. There has been an increase in the privatisation stocks trade, which affects favourably Serbian stock business advancement. A negative aspect is that the process starts from small stock holders and flows towards bigger ones. The main reason for this is small stock holders' being ill-informed, as they often do not even know what they sell and at what price.

## *2.2. Domestic companies' restructuring within privatisation process*

The state, that is, the Republic of Serbia Restructuring Agency, is in charge of the domestic companies' restructuring within the privatisation process. The agency was founded in order to equip companies of strategic importance for the country to run their business in a successful manner and to continue and finalise the privatisation process.

As from the mid 2001, when a new company and other legal entities privatisation model started being implemented, companies restructuring programme gains new importance as a possible prerequisite for a successful privatisation process execution.

A basic objective of domestic companies' restructuring is a successful privatisation, or selling of companies and/or their parts. Restructuring programme is a document that represents a plan for solving financial, organisational, social and ecological obstacles for carrying out companies' privatisation process. The programme is deemed successful in the following instances:

- When a company, that is, its independent business branches (as many of them as possible), have become market-wise sustainable business units;
- When known parts of a company, that is, its assets that can be sold only individually, are outside the business wholeness (in order to achieve selling of a company without surplus), and
- When solutions dealing with redundant workforce have been established and accepted.<sup>5</sup>

These are the polled companies' managers' prognoses regarding the projected sales figures:

- 42.86% of them stated that companies would be privatised within 6 months up to one year;
- 28.57% is of the opinion that privatisation takes more than a year;
- 23.81% expects privatisation to happen within three to six months;
- 9.52% said that companies would be privatised within three months at the latest.

Restructuring within privatisation means an active engagement of the following parties: companies being restructured, their creditors and The Privatisation Agency. The Agency has made a preliminary identification of around 40 state-run companies whose economic and organisational performances, as well as a huge number of employees indicate an inescapable need of conducting restructuring within the privatisation process.

Legislation stipulates that restructuring should be done in three phases:

- 1) Pre-privatisation activities that will identify companies eligible for restructuring, selecting consultants and producing a diagnostic report;
- 2) Putting together and adopting a restructuring programme-a privatisation initiative is instigated and a restructuring programme is prepared and adopted within 90 days;
- 3) Restructuring programme implementation and selling procedures- privatisation within which restructuring programme is implemented and capital (assets) is sold through public tenders or open auctions.

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<sup>5</sup> Research results on the following project: "Company recovery strategies in the Republic of Serbia economy crisis business conditions (2000-2005)", MNTR

The success of *restructuring of privatised companies* hinges largely on the management's capability to initiate and implement a programme of projected and planned changes. Therefore, we talk about a restructuring strategy element here that is closely linked with providing financial funds. New modes of financing are expected to get a boost as a result of the privatisation process development and its particular, characteristic institutions. These modes have been functioning with great success in all countries that underwent transition and also in developed Western countries, some of them being private stock capital funds, business-angels etc.

Results of a survey showed that:

- 23.8% companies are currently in the first phase;
- 38.1% of companies are in the second phase;
- 38.1% of companies are in the third phase.

These figures show that restructuring is a time-consuming process and it does not progress at a desired rate, as there are around 62% of companies that are still in the first two phases. It should be noted that a maximum time limit for the first phase is six months, 90 days for the second phase, whilst the third phase is conducted according to the Restructuring programme.<sup>6</sup>

The experience in the restructuring of privatised companies so far indicates that, given the undoubted complexity of the subject and the necessary wholeness of the process, it must be realised in several stages that will result in a series of inter-linked subprojects as follows:

- 1) Preparing information basis along with the current company's overview;
- 2) Preparing companies' restructuring strategies' starting points and foundations;
- 3) Creating companies' restructuring strategies;
- 4) Implementation monitoring.<sup>7</sup>

***Preparing information basis regarding the current situation and company's developmental limitations*** (production, use of the capacities and their current state, human resources and motivation, organisation and management, integration and cooperation, supplies and expenses, advertising and the market, financial position and results, strategic solutions etc.) is to be done based on the analysis of the company's current situation and includes basic data, company's production programme and importance; technology description and use of capacities, human resources and motivation; organisation and management; production description (basic products and services); advertising and the market; innovativeness; quality and standardisation; integration and cooperation;

<sup>6</sup> Privatisation Agency's internal data, Belgrade, 2004

<sup>7</sup> Privatisation Agency's internal data, Belgrade, 2004

expenses and competitiveness; financial position and flows analysis; conclusion along with the assessment on the likelihood and possibilities of a successful restructuring. Authentic data about a company serve to enable drawing conclusions regarding testing the influence proprietary structure, selected privatisation model and sale rates have on the restructuring activities.

***Preparing companies' restructuring strategies' starting points and foundations*** based on the general findings and research results from the first phase, this stage should include the following research areas: general developmental conditions in the recent period; accomplished results and tendencies; assessment on the company's developmental capacities and limitations; expected structural fluctuations in demand and supply on the domestic market. Analysis of the general developmental conditions in the recent period should entail the institutional and developmental environment analysis, as well as the economic policy effects, emphasizing companies' position on the market, and finally, closely related to that, capacities to contribute to the use of comparative advantages and developmental flows tracking, especially in the technology area. The world's developmental and market tendencies, with a special emphasis on the structural, regional and technical-technological changes and current market flows, are extremely relevant for proper functioning and business dealings of a company. Accomplished results and business tendencies are supposed to show the productive and foreign-trade activities so far, as well as all the structural and technical-technological changes.

***Company restructuring strategy*** should entail: starting foundations; expected climate and developmental flows; general market and developmental environment; basic developmental objectives; main developmental directions; premises and realisation of the developmental goals; projected effects on the production results; developmental and market position of a company. Formulation of premises and developmental objectives' realisation is a paramount strategy segment. The objectives can relate to: production basis modernisation; staff adjustments and motivation system promotion; marketing approach and information system development; organisational, status and managerial restructuring; financial consolidation and resource allocation modes. Financial consolidation can be achieved through the creation of a debtor-creditor relation regulation programme, social programme or other measures that are in company restructuring function (additional capitalisation, workforce increase/decrease measures, other measures that enable selling capital or assets). And finally, restructuring effects can result in a number of employees becoming redundant, it can also affect the total amount of duties collected through payment instruments and amount of other duties, the possibility to convert debt into capital, possibility to write a part of debt off based on company's or

creditor's position and a new net cash flow that shows company's future capacity to deal with debts.

***Company restructuring strategy implementation monitoring*** – over the upcoming five-year period company's expert team and consultants in charge of restructuring should enable a successful implementation of the started process and company's getting back to a productive business path.

### 3. The role of state in restructuring in crisis conditions

When talking about restructuring as a crisis resolving factor, experiences of a number of developing countries can be grouped in three chapters and concern government's role in company restructuring. Namely, we deal here with: 1) legal frame for company restructuring, 2) tax system, and 3) knowledge that restructuring requires.<sup>8</sup> This said, the author's main intention was to exhibit some specific experiences which undoubtedly have to be adapted to a particular country's circumstances and conditions. Measures accepted and desirable in one society will be of hardly any use in a country where legal framework is inefficient.

#### 3.1. *Company restructuring legal framework*

Legal frame for resolving company bankruptcy issue should be clear and non-compliance sanctions stiff-including law improvement, court staff training and enhancing administrative system efficiency.

Efficient insolvency resolution regime is a prerequisite for a successful company and bank restructuring. Insolvency regime objectives should be directed towards decreasing legal and financial instability, enhancing efficiency and ensuring a fair and equitable treatment for stock holders in an insolvent company.

A great number of bankruptcy cases that happen after a crisis arises results, aided by inefficient judiciary, in maintaining out of court settlement practice at a constant level. This kind of procedure is necessary when debtor-creditor relations need to be sorted. Agencies that would have powers to terminate mediation and initiate bankruptcy procedure are called for (Korea is an example).

On the other hand, out of court procedures, though very important for many countries in crisis, can extend the deadline and thus increase instability in conditions when it is certainly not in the majority of stock holders' best interest. Out of court restructuring procedure entails:

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<sup>8</sup> G. Caprio, *Episodes of Systemic and Borderline Financial Crises*, World Bank, Washington, 2003

- Company restructuring agreed between domestic and international creditors, which is binding for all creditors and stipulates binding deadlines;
- Reliable mechanisms for resolving differences between creditors, that is, reasonable threshold for meeting deadlines and contractual obligations (for example 75%);
- Coordination committee in charge of performing arbitration in case of creditors' opposing views, whose decisions would be binding for all creditors.<sup>9</sup>

### 3.2. Tax issue

Developing countries' experiences show that there are various obstructions within tax system which can hinder company restructuring and bring the process to a halt. Some forms of the tax obstruction are: a) tax treatment of debts can make creditors unable to seek tax decrease on the debt that is written-off, as written-off debt is considered as debtor's tax income; b) in some countries mergers and acquisitions can bring about tax collection (for example, a buying corporation cannot take over tax losses), and c) transfer of bad debts to a pool, as for example a trust is, can be regarded as selling and that is why it can result in tax selling or tax transfer.

That is why it is desirable for the tax policy to be neutral regarding company restructuring process. For example, in order to facilitate restructuring Thai government introduced temporary and permanent tax measures simultaneously. Temporary measures were motivated by restructuring acceleration and they included: a) deducting written-off debts from creditors' tax income, b) cancelling debtors' written debts' tax income, c) abolishing all debtor-creditor property transfer tax and d) cancelling all taxes regarding cumulated but uncollected interest rates and restructuring tax limitation, which means interest rate decrease by creditors.

Permanent measures entail: a) commission for tax exempt mergers and provision on property non-cash purchases, b) cancelling VAT and special property transfer taxes on special purposes funds.

### 3.3. Skills and capabilities

In a state of crisis, countries that have professionals such as researchers and insolvency experts are able to respond much quicker than those that have no appropriate experts. This refers also to countries with huge investments that have certain risky investments management mechanisms in place, including a secondary debt market, companies' financial restructuring funds, real estate

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<sup>9</sup> G. Caprio, *ibid.*

and securities investment funds. However, in order for these mechanisms to develop and be implemented properly a solid knowledge foundation, including experts, researchers, financial analysts and auditors, is required.

As an example, Asian financial crisis enhanced international standard development in the sense of strengthening public financial institutions, primarily in banking and securities sector. The experiences so far have proven the significance of the private financial sector strengthening through international standards in most important professions, as well as the significance of educational institutions enhancement. It has transpired that that there is a shortage in some very relevant professions such as insolvency experts, lawyers, accountants, researchers, financial analysts and auditors. By creating quality standards in this educational sphere, efficient legislation can give a boost to these professions.<sup>10</sup> In similar cases government also stimulates the consultative knowledge development in the area, which foreign developed countries' consultants' role can be of extreme use in.

#### 4. Conclusion

Serbian real sector is in a very bad condition. The crisis in the last decade resulted in macro-economic instability, market loss and technological advancement isolation. It has already largely slowed down the privatisation process started at the end of the 80s. As a result of this, the economic growth continued in public and state-owned companies, which, in turn, resulted in an inefficient, excessively indebted and loss burdened economy.

Restructuring of public-owned companies is a time-consuming process. In a great majority of cases the main reason for a crisis situation is excessive indebtedness, which poses the question of whether these companies qualify for restructuring or simply for bankruptcy. It has been established through studying crisis development stages that as many as 70.59% of companies are in the chronic phase. The causes are known and it is to be decided between recovery and liquidation.

By following both positive and negative experiences of the countries undergoing transition, it can be concluded that it is not possible for Serbia to achieve a long-term advancement of its economy without conducting a thorough companies and banks restructuring. Unlike other countries undergoing transition, Serbia undertook bank restructuring first, the process of which is in its final stage. However, Serbia's biggest problem is public companies restructuring along with 65 major money-losing companies that are the key to Serbian economic invalidity. Such a process cannot yield positive results as company

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<sup>10</sup> G. Caprio, *Episodes of Systemic and Borderline Financial Crises*, World Bank, Washington, 2003

restructuring is not synchronised with bank restructuring. Restructuring process is also long overdue, which resulted in only few companies having finalised their restructuring. Due to further stalling and lack of strategy and concrete restructuring solutions, companies suffer unimaginable consequences. Apart from this, the current restructuring situation has come as a result of the lack of funds to finance the process in a more aggressive way. One of the key reasons is the fact that privatisation funds received from company selling are almost in their entirety directed towards spending, whilst potential foreign direct investment sources are insufficient, as the influx is meagre due to the Serbian discouraging business environment.

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## BUSINESS MORALS AND CONSCIENCE IN COMMERCIAL CONTRACTS

**Abstract:** *In modern business dealings of legal entities and particularly of those in the economy, contracts represent a prevalent way of expressing agreement of subjects to sign a legal deal. Additionally, signing of an agreement should be accompanied by adherence to appropriate legal and moral codes and compliance with relevant principles. The main topic of this article is the way in which the compliance with business moral norms and the implementation of the principle of conscience and honesty in economic contracts are to be realized.*

**Key words:** *Commercial contracts, business morals, conscience and honesty principles*

### 1. Introduction

Legal relations, as defined by the legal theory, are not created, changed or terminated based on the abstract legal principles, but rather in line with legal facts that can be divided into: 1) events and 2) human actions. The latter, that is, human actions, are exceptionally important and numerous in everyday life, as they originate legal effects the foundation of which the will of people, specific entities, that is, those who participate in such relations, is woven into.

In legal terms, further definition of the human willing action points out that it is an action undertaken with the intention of producing certain legal consequences.

In the beginning, the distinction should be made between human actions as legal facts and human actions as legal objects. In the traditional division of the civil law objects that lists 1) items; 2) personal effects; 3) products of human mind and 4) human actions, human actions are, as it can be seen, categorised under objects. The nature of this work does not call for a detailed elaboration of these differences, but in order to dismiss potential misunderstandings, we are drawing readers' attention to them.

Contracts fall within the category of the most important legal dealings, as they express the will of a legal relation subjects' most comprehensively and directly. At the same time, contract is one of the oldest and commonest legal instruments through which two or more subjects consensually express their will directed towards creating, changing or terminating a legal relation.

Given that there are several types of legal relations (real, obligation, administrative, economic etc.) there is understandably more than one type of legal contracts which came as a result of this institute's genesis over the course of a long legal history.<sup>1</sup>

The social life dynamics and some of its aspects' development, especially in the area of traffic and goods exchange, resulted in the surfacing of new types of contracts as the existing ones could not reflect the novelties brought about by these changes in their entirety

In order to define areas which business morals and conscience and honesty principles apply to, the notion of a *commercial contract* needs to be elaborated.

## 2. Commercial contracts – main characteristics

Theoretically, commercial contracts entail those social-legal dealings concluded by economic entities in the traffic of goods whilst they conduct their registered businesses intended for the goods traffic (production, exchange, distribution) or service providing.

A similar definition is used by the legislator and it reads: "...according to this law (Law on the Obligation Relations, LOR in the further text) commercial contracts are those concluded between companies or other legal entities with commercial purposes, action originators and other individuals who run a commercial business as a registered enterprise; they conclude these contracts in the course of conducting activities that are the subject of their businesses or linked to them". (Article 15 LOR)<sup>2</sup>

The legal definition leads to a conclusion that commercial contracts in our legal system are determined by two criteria, subjective and objective, which is significant given the subject dealt with by this piece of writing.

Namely, according to LOR, commercial contracts are those contracts concluded between commercial entities, and it is not emphasized whether these are legal entities or physical persons. Nevertheless, a majority of commercial contracts are concluded between legal entities in practice, that is, between com-

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<sup>1</sup> Interestingly, Roman lawyers defined some contracts more than two thousand years ago, such as the buy-sell contract (*emptio-venditio*), which contents-wise (regarding its main ingredients-elements) has not been changed to the day and which is being implemented *mutatis-mutandis* in other life spheres outside the civil law, for example in the economy law.

<sup>2</sup> Law on the Obligational Relations, "Official Gazette SFRJ" No. 88/78 (In Serbian)

panies organised in various different ways. The objective criterion is expressed through the fact that these contracts are concluded within a business area that is the contractual parties' business subject. Unless its subject fulfils the objective criterion, a contract cannot be considered a commercial contract

Business morals and conscience and honesty principles can potentially be infringed by both mentioned criteria, an occurrence explained in the text to follow. What should be noted as well is that non-compliance with subjective or objective criterion has led so far and is still leading in practice to legal proceedings dealt with by commercial courts. The analysis of legal decisions brought by these courts<sup>3</sup> shows that the objective criterion has precedence over the subjective one when deciding on determination of the concept of commercial contract.

On the whole, commercial contracts display certain characteristics which justify their being classified into a separate category of contracts.

These contracts are specific because:

- They are concluded amongst commercial entities;
- Their subject comes from those areas which the signatories deal with on a permanent and professional basis;
- The number of these contracts concluded is massive;
- They call for a swift conclusion procedure (which leads to the creation of so called formula contracts- adhesive and type contracts);
- Deadlines are shorter than in the civil law;
- The exchange of goods (*traditio*) is symbolic (exchange of bills of lading, warrants etc.), and it is done through endorsements ;
- The business objects are limited to goods, commercial services and money, so that in broader sense commercial contracts encompass goods exchange contracts and monetary traffic bank dealings, whereas in the narrower sense they include goods exchange contracts only;
- Compared to the civil law contracts, these envisage a stricter form (so called *forma ad solemnitatem*, and not *forma ad probationem*);
- Due to high values of the concluded contracts, liability with regard to compensation claims is stiffer, but this is also due to the fact that commercial dealings are based on trust, which, in turn, promotes the conscience and honesty principles' consistent implementation and a broad compliance with the business moral norms;
- These legal dealings are such that can be charged bilaterally (*negotia bilateralia onerosa*), except when free-of-charge treatment is explicitly stated and agreed upon.

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<sup>3</sup> See the Commercial Court's and Higher Commercial Court's in Belgrade reports for the period 2000-2006

### 3. Types of commercial contracts

The mentioned and other commercial contract's characteristics indicate that these contracts not only constitute a separate category but they also differ amongst themselves, thus creating various types. Therefore, according to the legislator's logic as expounded in LOR, two types of commercial contracts can be differentiated:

- basic contracts,
- auxiliary contracts.

Basic commercial contracts are those concluded amongst commercial entities and other entities whilst conducting activities that fall within their business scope.

However, auxiliary commercial contracts are those concluded amongst commercial entities regarding activities that fall within their business scope, with the main purpose of facilitating the performance of these.<sup>4</sup>

Depending on the type of contract, the law stipulates certain contractual obligations. Thus LOR requires that all contractual parties should display the good entrepreneur conduct upon carrying out their contractual obligations (Item1 Article 18 LOR).

However, with respect to the execution of stipulations from professional domain, that is, duties that constitute the contents (obligations) of a basic contract, an increased care of the specific subject in question is required. They are obliged to operate with the good expert care (Article 2, LOR). Both "types" of care requested upon the execution of the contract have their moral dimension, as every "ordinary" entrepreneur, not to mention a professional, is obliged to comply with the "ordinary" and professional moral norms.

Speaking of the commercial contracts' categorisation, it should be remembered that some dealings are traditionally considered to be commercial, regardless of whether they fit into the commercial contract legal definition. However, these contracts' commercial aspect is accentuated to such a degree that these dealings are regarded as commercial even when one of the contractual parties is not a commercial entity. As a result of this comes some legal authors' attitude according to which there is a differentiation between bilateral commercial dealings (both contractual parties are commercial entities) and unilateral commercial dealings (when only one contractual party is a commercial subject), but at the same time the contract's nature is such that these dea-

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<sup>4</sup> For example, for a transporter, a transport contract is a basic commercial contract, whilst part-time job contract concluded with a garage that repairs the means of transport is an auxiliary commercial contract.

lings are still considered to be commercial.<sup>5</sup> Some general acts<sup>6</sup> also enumerate certain goods traffic dealings (purchasing and selling of goods, exchange of goods, mediation, representation, commission sale of goods, transport, storing etc). This list should be taken as a list of examples, not a prescriptive one.

On the other hand, there are some dealings not encompassed by the commercial law stipulations, though they could fulfil commercial contracts' legal conditions; these are for example part-time job contracts, lease contract and similar. Obviously, commercial contract concept is sometimes broader and on other occasions narrower than its formal, legal definition.

#### 4. The concept of commercial contract in the comparative and international law

It has already been told that the concept of commercial contract is present in all modern legal systems. The commercial dealing concept is given special attention to, as this term constitutes a basic commercial (trade) law concept. Nowadays, regarding the commercial contract concept, there are two dominant systems in the comparative law: objective and subjective.

The first of the mentioned systems (objective) stipulates that there is a certain group of dealings that irrespective of who performs them are considered to be commercial and consequently the commercial, not civil law stipulations, are applied to them. This is a system accepted by French legislation.<sup>7</sup>

The second (subjective) system takes the concept of trader as a starting point when determining the commercial dealing concept. Namely, traders (as subjects) attach commercial character to the dealings which they take part in, irrespective of the dealings' contents.<sup>8</sup>

Modern trading conditions promote increasingly international trade, which has inescapably led to the creation of norms that regulate this type of legal dealings in which participants are of different nationalities. International legal sources are most often displayed in the form of conventions that define

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<sup>5</sup> M. Stražnicki, *Predavanja iz trgovačkog prava*, Zagreb, 1926

<sup>6</sup> See: General conditions for the traffic of goods, "Official Gazette FNRJ" No. 15/54 (In Serbian)

<sup>7</sup> Article 632 of the French commercial code stipulates that commercial dealing is every purchase of movable objects in order to resell them; see French commercial code (Code de Commerce) from 1808, Comparative law institute, Belgrade, 1976. This was the world's first commercial code.

<sup>8</sup> Paragraph 343 of the German commercial code stipulates that commercial dealing is any dealing by a trader which they perform within the commercial scope of activities; see: German commercial code (Handelsgesetzbuch) from 1897 (In Serbian), Comparative law institute, 1966

closely certain kinds of legal international relations. Regarding the international trade the most important convention is the Viennese one.<sup>9</sup>

This convention makes a compromise between the Continental (civil law) and Anglo-Saxon law (common law) in the field of understanding the importance and scope of commercial contracts (translational and obligation significance). The convention's international nature is to be observed upon its implementation (Article 7 of the Convention), along with the adherence to the principles of conscience in the international trade.

### 5. Commercial contracts and business morals

Commercial entities' dealings, especially those performed within the contractual sphere, are conducted in such a way and amongst such circumstances that often cast doubt over their activities and conduct validity. Therefore, various dilemmas concerning ethical aspects of the business environment entities' dealings have been raised. Undoubtedly, business moral issue, and moral issues in general, constitute essential issues of specific societies and countries, each one of these having their own moral codes that regulate commercial and social life entities' conduct

Regarding the business morals, it is clear that it determines the general frame of conduct with a view of ensuring a harmonious functioning of every individual country's commercial system, and after all, functioning of the whole society.

It is a common attitude, translated into a law, that commercial entities are under obligation to operate within the business moral boundaries that, in turn, form rules of conduct in commercial relations and these rules stem from the business world moral principles. These rules have their roots in the commercial society's understanding of what is socially acceptable and what is not, that is what is allowed in a society and what is forbidden. These are unwritten ethical rules on the commercial entities' conduct, which are complemented by the rules encompassed by laws. It often happens that through state activities moral norms are converted into legal regulations, which increases their law-binding level as non-compliance is always followed by enforcing of the sanctions as stipulated in advance

The creation of business morals is a time-consuming process that takes place on a broad, historic plan and entails several generations in a society and different social spheres. It would prove an impossible task to enumerate all potential infringements of business morals. Every enumeration, namely, has a listing character of the *exempli causa* type and every limiting enumeration is excluded. Finally, business morals are a multi-levelled product of a social consciousness

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<sup>9</sup> UN Convention on contracts in the international trade of goods, brought in Vienna in 1980.

that does not fully fit in regulations, regardless of how comprehensive and flexible they might be. For, life is invariably richer than norms and does not “fit” in them in its wholeness. After all, it is not up to laws to regulate life in *extenso*.

Good business practices, as a manifestation of the business morals, are binding for commercial relations’ parties, and, accordingly, also for commercial contracts’ signatories. Whilst contractual parties can relinquish a practice upon common consent, good business practices are binding and of the imperative nature for the commercial-business relation’s parties. Commercial relation’s parties should not (read: must not) negotiate on a potentially immoral course of conduct. Though it sounds like a paradox, the highest binding level in commercial relations lies precisely in the unwritten (ethical) norms which are engraved only in the consciousness of those who implement them.

Business morals are similar but not identical to the conscience and honesty principle. Their differentiation is based on two important facts: first, business morals encompass some general and very broad ways of conduct of commercial entities on the market, and in those situations that are not legally regulated (with the understanding of law as a minimum legal requirement), and second, we can talk about the conscience and honesty principles’ compliance only in those cases that are governed by law, under the assumption that legal entities are already in a certain legal relation and these principles are to ensure the exercise of some subjective powers stemming from those relations. In order to illustrate the business morals infringement instances the following are enlisted: non-compliance with the rules and practices of the profession, giving preferences to some buyers and users of services, abusing and maltreating of buyers and service users, purposeful failure to adhere to the contractual provisions etc.

Infringing business morals provisions is on many occasions harmful for other participants in commercial relations. However, even though the damage often comes as a result of the lack of business morals, it is not a prerequisite for its existence. For, business morals infringements are possible even when no material damage is incurred on other entities

The extent of the importance attached to the compliance with business morals is best illustrated by the fact that its institutional protection mechanisms are in place. There are specialised authorities within commercial professional associations (such as chambers) which run proceedings and decide on the good business practice infringements in concrete commercial relations. These are so called courts of honour, of which there is one within Serbian Chamber of Commerce.

Measures and sanctions to be enforced upon the business morals infringements are determined by these organisations’ highest codes (statutes), as well as by the enforcement authorities’ regulations.

By deciding on measures to be enforced in reply to the business morals infringements, courts of honour within chambers of commerce protect com-

mercial entities' professional morals. Their decisions serve to protect those commercial entities that are fully compliant in the course of their business dealings. It should be noted that in the proceedings generated by the good business practice infringements courts of honour do not decide on the material and legal requests and claims. If a person claims damages as a result of a good business practice breach, then compensation claims are decided upon in lawsuits before regular courts.

## 6. Conscience and honesty principle in commercial contracts

It has already been explained that upon concluding contracts commercial entities are to adhere to certain business moral norms which then form some other principles as well, especially, or most importantly, the conscience and honesty principle. The significance of the principle is illustrated by the fact that it represents one of the essential principles that are bestowed a general legal importance upon when concluding all types of obligation contracts, especially those in the modern commercial law. Article 12 of LOR is an obvious example to this effect (on the national legislation level), and Article 7, Item 1 of the Viennese convention on the international trade of goods (on the international law level).

Without doubt, the current legal solutions have their historic genesis. There are numerous examples in the legal history that prove this. The conscience and honesty principle (*bona fides*) was widely treated even in Roman law which was renowned by its norms' rigidity (*dura lex sed lex* – law is stiff, but it is still law). This principle precisely served as a means to mitigate and overcome the excessive rigidity of the original norms of the obligation law.

In "Digestas" this principle was expressed with: *Non omne quod licet est honestum est* ("Not everything allowed is honest").<sup>10</sup>

Also, another well-known old legal source – General Montenegrin Property Code (GPC) defines brilliantly: "...what is not forbidden can still be dishonest" (Article 999 GPC).<sup>11</sup>

Contemporary legislation, both national and international, entails regulations that also attach importance to the conscience and honesty principle.

In LOR this principle is elevated to the general level of binding principles. The legislator is explicit: "When establishing obligation relations and exercising rights and obligations generated by those relations, parties are obliged to adhere to the conscience and honesty principle" (Article 12 LOR). Therefore, cogency of the conscience and honesty principle in general obligation relations but also in specific commercial relations cannot be questioned through the will of parties.

<sup>10</sup> Paulus, 144, Dig. 50217, according to: O. Stanojević, *Rimsko pravo*, Belgrade, 2001

<sup>11</sup> Montenegrin General Property Code from 1888 (In Serbian)

The legislator states that commercial entities' wills ought to be directed towards compliance with the basic ethical norms of which conscience and honesty principle represents one form. It should be accentuated that legislation represents only a minimum level of morals the massive infringement of which would jeopardise the survival of other public institutions (and one of the commercial contracts' characteristics is that they are signed in large numbers). Hence the logical requirement that conscience and honesty principle, as a basic premise of morality, should be adhered to, which leads to the adherence to commercial contracts' stipulations as well

The conscience and honesty principle's basic purpose is to ensure implementation of law and legal instruments (for example contracts) in line with the moral principles of contemporary society.

Legal regulation of a concrete social relation envisages a standard number of situations that can potentially occur in practice. More precisely, situations could occur in practice when a strict adherence to a commercial contract's stipulations would not be satisfactory, given the moral standards of a society. In case a conflict arises in such situations, neither contractual party can call upon such contractual provisions. Court will decide upon such conflicts by applying the conscience and honesty principle

Court has rather a creative role in such conflicts as it has the responsibility of establishing the contents of the conscience and honesty principle, bearing in mind the circumstances in which the principle is to be applied. Needless to say, the application of the decisions reached by court in such situations is of extremely restricted nature and relates only to the case in question, for, in case the principle is applied in an inadequate way then legal security and integrity could be brought into question. Even a Roman lawyer Quintilian emphasized the issue by raising the question as to the reason of having laws in the first place if their contents are going to be criticised in court on every occasion in an attempt to establish what is just and moral! Moreover, formal laws and legislation were established precisely because not everybody understands justice in the same way.

The conscience and honesty principle's problem arises from the fact that the legislator, notwithstanding calling upon it often, has not established its contents. After all, defining the contents is not feasible as life circumstances are varied and always different, not to mention that different societies' understanding of the issue differ too. From the entire civilisation's aspect, morals are not a unique and identical category.

Establishing the contents of the conscience and honesty principle was a legal theory subject and it is German legal theory that played a crucial role in it. The issue was elaborated in the course of legal practice. That is why the conscience and honesty principle falls within the legal standards category and its contents are determined according to the most common occurrences in life,

that is, in line with how the majority of people consider a conscientious and honest man should behave.

*6.1. Some principles significant for establishing the contents of the conscience and honesty principle in court*

As it has already been said, in case when concrete commercial contracts result in a dispute, court is bestowed upon a significant (creative) role in the process of establishing of whether the conscience and honesty principle has been breached.

What should be noted here is that court *ex officio* ensures in such cases the compliance with the principle and it is not necessary for the litigation parties to ask for it. The significance of the conscience and honesty principle is thus manifested yet again.

Also, when implementing any norm regarding a commercial contract (in its entirety or some of its provisions), the conscience and honesty principle should be borne in mind at all times. By calling upon this principle, court is entitled to annul any legal or contractual provision that contravenes the principle, irrespective of the issue it refers to. Therefore, the conscience and honesty principle takes priority over any legal norm or contractual stipulation. Nevertheless, public interests upon the regulation of a relation prove to be the only exception, when the implementation of the conscience and honesty principle can be purposefully (by law!) discontinued.

In an individual case though, court shall not decide on whether the enforcement of a law or a contract contravenes the conscience and honesty principle in general. It is essential that court decisions should apply directly (and only) to the subject of the dispute in question, which again accentuates the restrictive nature of deciding on not implementing certain legal or contractual provisions.

*6.2. Strict implementation of the conscience and honesty principle examples*

Considering the general character of the conscience and honesty principle, it is hardly possible to enlist all the cases in which its implementation is in place. Still, there are some situations that can be stated as a clear illustration of the implementation of this principle in commercial relations.

There are some cases when the law directly provides the implementation of the conscience and honesty principle. Thus Article 136 of LOR states that contractual parties can in advance renounce calling upon the changed circumstances, unless it contravenes the conscience and honesty principle. Article 264, Item 2 of the same act stipulates that the fulfilment of contractual provisions by enhancing debtor's liability cannot be requested in case it breaches the conscience and honesty principle.

It often happens in the practice that conclusion of a contract is predated by future contractual parties' negotiations. Though this kind of negotiation is not obligatory, it announces the intention of concluding a contract. However, in case a subject (negotiator) had no such intention during the negotiations, they are regarded as non-conscientious and will be held liable for the damage thus incurred to other negotiators (Article 30 Item. 2 LOR).

For example, the conscience and honesty principle stipulates that debtor is obliged to timely notify creditor on not being able to settle their commitments within projected deadlines (Article 268 LOR), so that the creditor could timely protect their interests that can be jeopardised in this way.

Modern ways of conducting business include a huge securities' circulation. As a result of this, situations that require the implementation of the conscience and honesty principle can arise as well. Thus, a securities' issuer shall not exercise therein prescribed provisions to the benefit of a payee, unless they know that the payee is the securities' legal owner.

The conscience and honesty principle infringement can also manifest itself by one party changing their conduct for the duration of a contractual relation and at a time that is significant for the realisation of the contractual relation, without the other party expecting it, that is, whilst the other party trusted their contractual partners would continue with the accepted conduct and practice, which, in turn, resulted in them sustaining damage.<sup>12</sup>

Finally, principle of the abuse of law (Article 13 LOR) also originates from the conscience and honesty principle, as the regulation that states insisting on legal "tricks" is not in line with honesty (*bonae fidei non congruit de apicibus iuris disputare*) dates back from the Roman law.<sup>13</sup>

There are similar examples from the comparative legal practice. Thus French Civil Law Code<sup>14</sup> (Article 1135) states that contracts are not binding only regarding to what is explicitly stated therein, but also regarding to all the consequences attached to the obligation relation according to justness, trade or law customs. German Civil Law Code states the similar (Paragraph 157)<sup>15</sup> by providing that contracts are to be interpreted in line with conscience and honesty and with respect to the trade customs.

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<sup>12</sup> For example, if buyer objects to the goods' quality with delay, and seller then starts considering the objection, it is not possible for the latter to call upon its untimeliness afterwards. Such conduct would contravene the conscience and honesty principle.

<sup>13</sup> D. Stojčević, A. Romac, *Dicta et regulae iuris*, Beograd, p. 30.

<sup>14</sup> French Civil Law Code (In Serbian), according to: B. Blagojević, *Komentar Zakona o obligacionim odnosima*, Knjiga I, Beograd, 1983, p. 59.

<sup>15</sup> Ibidem

## 7. Instead of conclusion

All the changes that have happened or are currently underway regarding legal relations, primarily the speed in operating businesses (internet business), new types of commercial contracts and similar, have not absolved participants in the relations, that is, subjects, from the obligation to comply with legal and moral norms especially, as well as relevant legal regulations. On the contrary, this is an additional reason for the reaffirmation of moral norms, that is, business moral norms and certain principles, such as conscience and honesty principle.

It could be said, and we have endeavoured to explain that in this work, that modern ways of conducting business request legal entities nowadays more than ever to behave in line with the traditional understanding of honesty and justness in legal affairs. This paper draws attention to some important elements regarding the implementation of commercial contracts (as primary instruments of commercial business dealings), precisely from the point of view of the business morality and conscience, which constitute a basic premise of the commercial dealings' integrity.

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## LIABILITY FOR DAMAGES INCURRED BY DEFECTIVE MERCHANDISE IN THE EUROPEAN UNION LEGISLATION

**Abstract:** *The provisions of the Treaty of Rome, together with the provisions of other foundation treaties, constitute the foundation of the Community law on consumer protection, which, together with the Programmes and Action Plans as well as the Court of Justice practice, constitute the structure of the European law on consumer protection against defective merchandise. In spite of a considerable conflict of interests and priorities among various groups of producers and consumers, the EU Directive that has been implemented since 1985, has largely fulfilled its very difficult task of formulating and enforcing a balanced, stable and coherent legal framework which contributes to fair risk distribution.*

**Key words:** *European Union, consumer protection, producers' responsibility, defective goods*

### 1. Introductory remarks

Liability for damages incurred by defective merchandise is a specific type of civil legal liability that has been attached considerable importance to in the recent court practice. Production of goods intended for broad consumption by means of making use of complex and modern technology that has resulted from modern achievements, is inextricably linked with the mass damage risk.

It should be borne in mind that the issue of civil legal liability for damage incurred by defective product is only a part of a broader consumer protection context within the European Union legislation which has its civil legal characteristics and independence. Consumer protection is a constant concern of various European Union bodies. The majority of the EU various bodies' mea-

asures concerning the European law on consumer protection originate from the Treaty of Rome provisions<sup>1</sup>.

A number of sensational cases of health jeopardising that resulted in deaths of a great number of individuals who took harmful medicines drew the public attention in the world's most developed countries to the risk posed by defective products. Special regulations on consumer protection have been brought in some countries. Legislation on the standards to be adhered to upon the production and distribution of merchandise is also in place. In the engineering sphere, for example, a certain level of quality and building material structure are requested, along with other various security measures regarding complex items or items with dangerous features.

With a view to a quicker and more adequate protection of damaged individuals, civil liability rules have undergone considerable changes regarding the compensation for damage incurred by defective goods.

Regulations concerning the selling contract were for a long time applied to the liability for damage incurred by defective goods, especially those regulations with respect to the hidden defects guarantee and other general Civil Law regulations on both contractual and out-of-contract liability. Considering that producers' liability proved to be of a special nature, the dichotomy of the traditional concept of contractual and out-of-contract liability gradually prevailed through the court practice. By means of this the liability regulations *sui generis* were created. The US court justice is exceptionally rich with respect to this. Therefore, rich variety of court practice in the area shows tellingly the direction of the liability development, from the traditionally subjective towards objective.

Damage incurred by defective goods is a relatively new social phenomenon which shortly after its appearance drew lawyers' attention, especially in the industrially developed countries. It was first considered as a separate legal issue in the Anglo-American theory under the name of product liability, and it was at the middle of the 20<sup>th</sup> century that European lawyers increasingly started to deal with it. For this reason lawyers from these highly developed

<sup>1</sup> Treaty on the EEC Foundation (Treaty of Rome) from 1957 mentions the regulation of the consumer protection issue only in several instances (Articles 2, 39, 40, 85, 86, 92). By adopting the European Unique Act from the February 2<sup>nd</sup> 1987 and the Treaty of Amsterdam from October 2<sup>nd</sup> 1997, legal consumer protection as stipulated in the Treaty of Rome was considerably improved. The provisions of the Treaty of Rome, together with the provisions of other foundation treaties, constitute the foundation of the Community law on consumer protection, which, together with the Programmes and Action Plans as well as the Court of Justice practice, constitute the structure of the European law on consumer protection against defective merchandise. For more details see: P. Kelly, *Overview Product Liabilities Law*, London, Edinburgh, Dublin, 1997, pages 5-35; N. Misita, *Osnove prava zaštite potrošača Evropske zajednice*, Pravni centar, Fond za otvoreno društvo BiH, Sarajevo, 1997; R. Vukadinović, *Pravo Evropske unije*, Beograd, 1996. Text available on the Internet: [www.europa.eu.int/pol/cnos/index\\_en.htm](http://www.europa.eu.int/pol/cnos/index_en.htm)

industrial countries were forced to use such legal constructions that were a flat negation of the essential understanding of known legal institutes such as for example warranty *tort* in American legislation.<sup>2</sup> These tendencies indicated towards a need to bring separate set of legal regulations regarding the damage incurred by defective goods, which would encompass all the decisions reached within the rich court practice in the area. That is how *sui generis* regulations were formed. According to the court practice data, the number of compensation claims was constantly on the increase in the US, which resulted in the media showering publicity on the cases of damage from defective goods and lawyers' fees soaring drastically. From 1974 to 1985 the number of court cases went by 758% up in this country, which triggered a legislative reform. In 1978, in the state of New Jersey, Law on product liability was introduced, together with appropriate penal measures which granted producers' requests to a large degree. According to this law, producers and sellers are held liable only in those cases when damaged party can prove that the product in question was not safe for use due to non-compliance with production standards or the absence of necessary warnings and notices. Other countries brought regulations that had the same purpose, but they still differed. Introduction of a law that would govern the product liability issue in a uniform way is being considered.<sup>3</sup>

There was a tendency in Europe for a long time to harmonise regulations concerning liability for damage incurred by defective goods, especially in the EEC countries. This objective to introduce uniform rules in this sphere resulted in the introduction of the EEC Directive on the product liability in 1983 which encompassed rules that had manifested themselves through the European countries' long practice. This directive also affected other countries, non EEC members, in so that a similarity in solving some basic issues regarding the liability showed in regulations brought after 1985. The directive stipulates that producer is held liable for damage incurred by products' failings. In order to exercise right to claim damages, damage party ought to prove that the item in question had a defect, that they sustained damage and finally the cause-effect link between the two. Nowadays, the majority of non EEC member countries make use of the definitions provided by the Directive.

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<sup>2</sup> A. Tunc, *Rapport de synthese general la responsabilité des fabrikants et distributeurs*, Paris, 1975, p. 406.

<sup>3</sup> S. R. Shulman, *Tort Reform Activites in the United States*, Simposium CSDD, Tolloires, 1989, p. 46.

## 2. Conditions affecting the liability for damage incurred by defective merchandise

In case that buyer sustains damage by an item delivered to them by seller, the question that rears its head here is: who are they to address regarding compensation for the damage incurred to their legally protected assets through the purchased items' defects? Legal protection can be achieved through the administrative law – by the market and sanitary inspection rules, goods standards and products' quality, then through the Criminal law regulations- with respect to the acts of crime concerning production and trade, and finally through the Civil law provisions. Civil law means of protection are the following: law suit based on the sold goods' quality guarantee and compensation claim resulting from the damage inflicted by the purchased items' defects. Apart from these, law suits on the grounds of disloyal competition have consumer protection as their final goal.

It has already been said that Civil law protects consumer's following two material rights: the right to use purchased item in accordance with its intended purpose and the right to make such a use with no unjustified risk of personal injury or damage to other entities. Therefore, on the grounds of providing contractual guarantee for the items' physical properties, sellers are held liable for the damage inflicted through diminished using value (prejudice commercial) but also for the damage inflicted by the items themselves (prejudice cause par la chose).<sup>4</sup>

When talking about costlier purchases, buyers are invariably provided with producers' warranty. In the case of personal injury, buyer can file lawsuit against seller. But, as it happens, buyers are often not able to sue sellers (when deadlines for submitting appeals, complaints and objections based on the contractual warranty have expired, or it is difficult to prove that items in question were sold by that one seller precisely, or seller used contractual provisions to make sure they are not to be held liable, or seller in question's insolvency). Therefore, damaged party, the buyer, is left with no other possibilities but to address directly the producer who they have no contractual relation with. On such occasions damaged party has at their disposal the so called *actio aquiliana*, that is, damages claim. Determining all the premises and conditions necessary to initiate such a claim when producer is damage inflictor and consumer a claimant, is the subject of our further study.

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<sup>4</sup> See in more detail: H. Mazeaud, "La responsabilité civile du vendeur-fabricant", *Revue trimestrielle de Droit civil*, 4, 1954, p. 61

### 3. Producers' position

Establishing the cause of damage is limited to the production process control and there is therefore a dilemma as to whether buyer's contractual partner should be liable for paying damages.<sup>5</sup> Producer is, in effect, the liability factor for the damage inflicted by defective goods. There are numerous reasons that speak in favour of the theory. Before all, contemporary sellers are becoming more and more anonymous distributors of someone else's goods; they are just a link in the selling chain at the ends of which there are producer and consumer. Through advertising and other forms of market distributing producer establishes an immediate "social contact" with their goods' consumer, which, in turn, diminishes the weight of the sell-buy contract between consumer and seller. The concept of producer should entail not only industrial producers, but also those in crafts, entrepreneurs and agriculturists. Those who install someone else's spare parts, who mark someone else's products with their stamp or just do repacking, also qualify for the role of producer.

Bottles with refreshing sparkling beverages are often causes of injuries. These often burst in consumers' hands with no apparent reason. There have been numerous cases when items of clothing, due to chemicals used in the course of their manufacturing, triggered different types of dermatitis; cosmetic products have caused hair loss, skin ailments and allergies; tins have been the causes of various poisonings; electric appliances have caused fires; faulty brakes on just bought cars have triggered car accidents, whereas past sell-by date or insufficiently tested medicines have brought about some very tragic consequences.

Allergies constitute a special type of injuries inflicted by products of mass consumption. The allergy or hypersensitivity concept covers the state of an individual who reacts in a characteristic way and manifests unusual symptoms as a result of the use of or just contact with certain substance that, when used by great majority of other people and in the same quantity, does not produce such an effect. Allergy triggering substances appear most often in cosmetics, medications, insecticides, fruit, vegetables, additives, clothes. Hence the expectation that producers should avoid the use of such substances in production. However, the prediction or the mere possibility should not be enough for the producer to be held liable. What needs to be established is that a number of consumers ended up with allergies through the use of the same product. Therefore, the demarcation line between liability and non-liability should be the number, or more precisely, percentage of the allergy-stricken people.

Producer should be held liable for any damage caused by a product defect and inflicted in the course of standard use. That can be damage resulting

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<sup>5</sup> U. Diederichsen, "Schadensersatz wegen Nichterfüllung und Ersatz von Mangelfolgeschaden", *Archiv für die civilistische Praxis*, Heft 27, 1965, p. 2.

from physical injuries (medical treatment expenses, lost income, diminished working capability), the so called material damage. But apart from this, producer should also compensate any non-material damage inflicted. In the case of physical injuries, the so called compensation for sustained pain can be due for payment, and in the case permanent consequences are brought about, such as mutilation or disfigurement, the damaged party should also be entitled to a sum of money as a satisfaction for thus diminished life activities.

Producer of defective items is held liable on grounds of objective responsibility. Reasons for this are numerous; one of them being that objective responsibility is expected to force producers to increase standards for establishing products' marginal safety to their maximum. This should be a standard that will redress balance between products' potential danger and social usefulness. Sometimes, damage inflicted by products is inescapable. It is a price paid for the sake of social progress and it is not fair that this price should be paid only by those unjustly stricken by the damage. Producers are in the most favourable position to pay compensation to damaged parties, through insurance or otherwise, and by raising the products' prices they should distribute the compensation or insurance expense amongst a mass of consumers and in the form of companies' typical expenses. Insurance against product liability is largely at the disposal of the food products' producers' in the US, Canada and developed European countries. Therefore, reasons for the objective responsibility of producers will lead to an enhanced control in the course of production, exercising carefulness in the manufacturing of products and handing the risk increasingly over to the mass of consumers.

As a rule, producers are held liable for damage incurred by defective goods. However, "producer" is a very broad term as it covers both individuals who produce final product, product's basic ingredients or parts, and those whose only task is to put together individual parts of a complex item. Therefore, it encompasses everyone who can in the course of their work make a mistake that could potentially result in damage. Our courts' prevalent practice shows that it is the final or basic producer who is directly liable to the damaged party.<sup>6</sup> It is held logical that damaged party should decide for themselves whether they are going to sue producers of precisely that part of the item that directly caused the damage.

On the top, apart from the real producer, the so called quasi producer is held liable too. This is a party that qualifies as a producer by putting their stamp, name or some other distinctive mark on the product. In accordance to Article 488, Item 3 of LOR, seller of defective goods is liable for damage to buyers, on a par with producer

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<sup>6</sup> Decision by the Supreme court of Croatia 963/63, from June 28<sup>th</sup> 1963, upheld by the Federal court decision 4329/63 from February 26<sup>th</sup> 1964, from the Federal court archives.

Licence issuer is not considered a producer, but can be held liable as quasi producer. Importers are liable for damage inflicted by imported goods.<sup>7</sup>

Serbian legislator envisages in Article 179, Item 1 of LOR that in case producer of defective goods did not know of the defects, they are held liable for so called reflected damage. In case they were aware of the existing defects then there is no dilemma as to whether they are liable for the inflicted damage and consequently obliged to provide due compensation.

Serbian Law on obligation relations stipulates the producer's liability irrespective of actual guilt. By merely releasing the product in question producer created potential risk of damage to others and they should be held liable for the risk accordingly. Defective products can be qualified as hazardous items so that regulations concerning liability without guilt apply to the damage incurred by them.

As for the domestic legislation, we are of the opinion that the concept of producer's objective responsibility should be adopted. At the same time, it is up to the damaged party to prove that the defect in question dates from the period it was under the producer's control. The adoption of the objective responsibility concept is corroborated by numerous reasons, but on this occasion we are going to expand only on the two which we view as crucial. First of all, in the case of presumed liability it is as easy for the producer to prove their non-liability and exercising due care in the course of production as it is impossible for the consumer to prove otherwise. Irrespective of whether the producer is able to distribute the compensation expense amongst a number of people, which would certainly be desirable, they are still undoubtedly in a financially more favourable position to pay the damages than an individual consumer. Moreover, it should not be neglected that producers are often able to predict some defects on their products and undertake measures to prevent them.<sup>8</sup>

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<sup>7</sup> In more detail: Welser, according to: J. Radišić, "Odgovornost za štetu koju uzrokuje stvar s nedostatkom", *Pravni život*, No 1/1989, p. 18.

<sup>8</sup> Related to this, here is an example of unfair and inadequate conduct of a soya producer in our country. At the end of July 2003 some suspicious-looking plants were removed from over 66 hectares of the Vojvodina fields. Destroying of the genetically modified soya was organised at the agriculture society "Kac" in the vilage of Kac. According to the data proffered by its director, soya had been sown there without knowing of its genetically modified nature. The majority of it was planted in the region of Srem. Vojvodina's Minister of agriculture Mr Igor Kurjacki pointed out the forbidden plants were certain to be growing also on other fields than those discovered and destroyed that far. It is interesting to note that the same type of soya had been also used on some of the fields in the previous year. The question raised here regards preventing the usage of genetically modified soya in the course of its production as it results in loss for both producers and consumers, but also for the whole country. Soya products are crucial in the health food chain but also indispensable for healthy posterity. Bearing this in mind, along with the fact that soya yields on our fields have always been rich, the least desirable thing is to end up with the soya surrogate-a mutant.

This all indicates that producers are, in effect, able to predict defects on their products and thus avoid harmful consequences to consumers and their health.

Producers should not be held liable for damage incurred by a defective product in those cases when damaged party knew of the defect or was aware of the risk. In those cases it should be presumed that they acquiesced to the damage. It becomes much more intricate to solve a case when damaged party was under obligation to test the purchased product before using it. The opportunity to test a product should not absolve the producer; what matters after all is the usual manner of consumption, usage and selling. In those cases when producer expects their products to be sold in their original packaging and used with no prior testing whatsoever then the producer's position with respect to the consumer becomes the same as it would have been in those situations when prior testing is not practically feasible. But in those cases when damaged party was under obligation to test the purchased product as the usage instruction provides and when such testing would suffice to uncover the defect timely, then the damage can be considered to be inflicted through the damaged party's guilt, which then, in turn, absolves the producer from any liability.

Domestic legislation adopted a stipulation stating that producer is to be absolved from liability in case they prove that the duty of testing product's faultlessness has been transferred to a third party by law or by contractual provisions.

Producer is liable for any damage incurred by defective products and inflicted in the course of standard usage. This is damage resulted from physical injuries (medical treatment expenses, lost income, diminished working capability). Apart from material damage, producer should compensate for the inflicted non-material damage, that is, in the case of physical injuries and impaired health a compensation for the sustained pain could be stipulated, whereas in the case of mutilation or disfigurement, the damaged party should be compensated for thus diminished life capabilities with an appropriate sum of money.

As for producers, a comparative legal review indicates towards three potential solutions to the issue of the grounds for producers' liability for reflected damage. Firstly, producer's liability can be established in case of the damaged party proving it satisfactorily. Secondly, producer can be liable for reflected damage on the grounds of presumed liability. And thirdly, producer's liability for reflected damage can be established irrespective of the actual guilt.

According to the American court practice, constructing motor vehicles in such a way that passengers and drivers are protected against predictable accidents is considered to be motor vehicle producers' responsibility. Therefore, motor vehicle producers ought to presume that vehicles are likely to participate in an accident at some time and they are under obligation to construct vehicles accordingly. In such cases (for example in the case of a Ford Punto) a

defect on the car is legally relevant as it affected the scope of damage, without being its direct cause.<sup>9</sup>

There is a regulation that renders the position of producers of defective goods much more unfavourable when compared to the position of sellers of defective goods. It is becoming an increasingly accepted and widespread view that it is producers' liability for the damage incurred after the product in question was released for sale, even if the existing defect could not be regarded as a defect at the time, given the then scientific and technological developmental level. The same stance was accepted in the Article 1, Item 2 of the EEC Directive. This should, therefore, presume producers' liability for the so called risk of development. More on this will be said in the continuation of the paper.

#### 4. Consumers' position

Defective items released for sale can result in two types of damage. Buyer can sustain damage merely due to the fact that the purchased items are defective. This is illustrated in the example to follow: if a buyer buys an appliance that upon usage proves to be faulty, in case they timely notify the seller, the seller can be requested to mend the defect and pay the damages. Our legislator envisages the same in Article 44 of LOR. Also, the damage can come as the result of lost benefit sustained by the buyer due to not being able to use the purchased appliance till its repair. In the latter case, the defective purchased item can cause damage to other items in buyer's possession. Therefore, the buyer could sustain physical injuries due to using a faulty appliance or alternatively, by using a defective piece of equipment fire can be triggered, which then can cause damage to other items too. Defective items' sellers are to be held liable for such damage too (Article 488, Item 3 of LOR)

However, in the modern commercial environment sellers' sole liability for damage inflicted by defective goods is no longer a satisfying solution. Modern conditions of the goods traffic are such that on most occasions seller is not at the same producer. Sellers are most usually just producers' "extended arms".<sup>10</sup> This explains why not only defective items' producers but also sellers of defective goods are liable for damage incurred on some other item in buyer's possession (that is, final user's possession).

Therefore, domestic legislation stipulates that both the producer and the seller of defective goods are liable for damage incurred to other items in buyer's possession, so called reflected damage. Damaged party can then decide who of the two they are going to claim damages from, seller, producer or both at the

<sup>9</sup> See in more detail: Welser, according to: J. Radišić, *ibid.*, p. 19.

<sup>10</sup> J. Radišić, *Garancija za trajan kvalitet i ispravno funkcionisanje robe i odgovornost za štetu za stvari s nedostatom*, Beograd, 1972, p. 121.

same time. This said, the damaged party should ensure when claiming damages from both the seller and the producer that the grounds for their respective liability for damage incurred through defect are different.

Modern technology procedures that produce a whole string of items at the same time, along with the fact that the production process itself is getting more and more complicated and consequently increases the risk of mistakes, are bringing the liability for reflected damage issue increasingly to the fore. In the situation when mistakes still occur despite all the efforts invested towards preventing them, what could be done is to ensure damaged parties are paid damages for harmful consequences brought about by possible mistakes. This is especially important when dealing with items intended for mass consumption, such as food, medicines, cosmetic products, automobiles. The same kind of defect can occur in a string of products of the same type, so it can cause damage to a number of people.

In relation to this, we are going to remind you of some well known examples from court practice. Automobiles Ford Pinto manufactured between 1971 and 1976 had their fuel tanks installed in such a place experts hold as extremely sensitive in case of a rear crash. In June 1978 American National Administration for Road Traffic Safety demanded from the "Ford" to carry out repairs and alterations on fuel tanks on 1 500 000 of their cars with a view to enhancing their safety. There is a well-known case from 1978, *Grimshaw v. Ford Motor Co.*, when by jury's decision a thirteen-year-old defendant who had sustained grave burns was awarded 127,8 mil dollars in damages, including 125 mil dollars of the so called *punitive damages*.<sup>11</sup> The damages were reduced to 6 600 000 dollars in the further proceedings. The thalidomide poisoning that took place between 1957 and 1961 is a well-known example of serial damage with catastrophic consequences caused by thalidomide, a substance produced by a famous German pharmaceutical company. Women who had been taking the medicine in pregnancy gave birth to children with serious deformities.<sup>12</sup>

Domestic court practice also records some cases of liability for reflected damage. For example, restaurateurs were held liable for damage sustained by customers through eating spoilt food.<sup>13</sup> Or, if due to rotten food baby pheasants died, the food producer is held liable for the damage.<sup>14</sup>

<sup>11</sup> P. Schroth, "Recent Developments in American Product Liability", Cologne Reinsurance Company: *Tendencies in Product Liability in America*, Cologne, 1981, p. 101 and 105.

<sup>12</sup> Published in the "Politika", Decembre 28<sup>th</sup>, 1970

<sup>13</sup> Decision brought by the Supreme Court of Croatia, 586/71, from Decembre 21<sup>st</sup> 1971 "Pregled sudske prakse u 1972" No. 1, addition to *Naše zakonitosti*, p. 18; Decision brought by the Supreme Court of Croatia. 659/76, from March 16<sup>th</sup> 1977, same review, No. 11, p. 30.

<sup>14</sup> Decision brought by the Supreme Court of Vojvodina, 659/76, from March 17<sup>th</sup> 1977, *Zbornik sudske prakse*, No 27/77, p. 88.

The provision making potentially both the seller and the producer of defective goods liable for reflected damage has resulted in an increased number of cases of insurance against the liability, along with the enhanced interest of the state towards this problem's legal regulation.

Individuals who sustained damage incurred by defective products and who consequently seek compensation, are as a rule referred to as users, damaged parties or simply consumers.

The US court practice allows the best insight into the developments regarding consumers' position and liability. Organised American consumers claimed full damages not only from the seller but also directly from the producer, irrespective of the fact the products in question are provided by a third party. It can be noted that consumers' protection has been accomplished through establishing the liability without guilt, regardless of such liability not being explicitly stipulated by legal regulations and thus representing a significant point to call upon subsequently, upon the efforts to legislate this area of liability.

Definitions on the liability for damage incurred to consumers by defective goods are usually quite similar, as they all accentuate the following: it refers to the defective goods incurred damage that individuals usually sustain in the capacity of physical, private persons, or consumers. So it does not relate to the damage inflicted on the item in question itself, which is regulated by general rules on contractual liability.

## 5. Sellers' position

Obligation law protects two very important material interests of the consumer: the first saying that purchased item ought to be used in line with its intended purpose and the second stating that such use ought to be risk-free, with no risk either of personal injury or inflicting damage on other items. This is best illustrated in the following example of refreshing beverages. Our requirement concerning a refreshing beverage is that it should have refreshing, tasteful and healthy properties. Similarly, we rightfully expect hermetically sealed bottles not to burst in our hands and consequently inflict damage due to either the concentration of carbon dioxide CO<sub>2</sub> being too high or to inadequate packaging. In accordance with the agreed guarantee for the goods' physical properties, the seller is held liable for both the damage inflicted through the diminished usage value (prejudice commercial) and the damage inflicted by the item in question itself (prejudice cause la shoe).<sup>15</sup> In the first case, the seller is held liable on the grounds of the items not having the agreed and expected properties, whereas in the second case they are held liable as a result

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<sup>15</sup> H. Mazeaud, "La responsabilité civil du vandrue-fabricant", *Revue trimestrielle de Droit civil*, 4, 1954, p. 611.

of the items displaying properties they should not. In the latter case personal injuries to the users are possible who are then entitled to claim damages for the sustained damage that was incurred by an item that is blatantly faulty.

According to the general rules concerning the liability for damage the seller is liable for reflected damage (Article 488, Item 2 LOR). This means that seller is liable for damage unless they can prove that the damage was inflicted without their guilt. (Article 154 Item 1 LOR). The seller can be absolved from liability only if they manage to prove that neither were they aware nor was it possible for them to be aware of the defect that inflicted the reflected damage. In order for someone to be held liable for reflected damage, it is necessary that defective items should be released for sale. There are some legislators who define it strictly by saying: "A product is considered to be released for sale the moment entrepreneur confers on any count the power to handle the item or to use it to someone else." Merely sending of items to a consumer also satisfies the qualification (Article 6 of the Austrian federal law). As for the products that are already out on the market, these are regarded as already having been released for sale. Putting items for sale presumes a conscious and willing activity undertaken as prescribed by sell-buy contract, lease contract, gift, transport, storing or other type of contract. If a potential buyer is given an item for testing purposes in the very shop or factory (TV set, automobile), it is also regarded as putting for sale.

Sellers of defective goods, given that their liability is based on the presumed guilt, are not to be held liable for the so called development risk. Sellers were not aware, neither was it possible for them to be aware that further scientific developments would prove that products they were selling were faulty and that through these faults damage to buyers' other property could be inflicted. However, seller and producer shall not be absolved from the reflected damage liability in case relevant authorities issued permits for putting for sale the item through the use of which damage was inflicted subsequently. Permits for selling products are invariably issued under the presumption that the rights of third parties that could potentially sustain damage through their use should remain intact.

Given the rampant mass production (and its essentially commercial nature) a requirement for a special legal treatment of damage inflicted by defective goods has arisen. In relation to this, the question is raised of the liability of a professional supplier or a seller for either personal injuries or other material damage inflicted by defective items, the prerequisite for establishing such liability being that the producer has previously put the defective item for sale.

## 6. Final considerations

The area of the liability for damage incurred by defective products is a legal sphere that is currently in its infancy stage in domestic legislation. The LOR can be considered to represent an important stage in the development of this complex and sensitive discipline, as it introduces and regulates the issue of the (objective) liability of defective items' producers for the first time in our legislation. However, a more comprehensive and precise legal treatment and relevant legislation regarding this sphere are evidently called for, as the existing regulations on civil liability of defective goods' producers, prescribed by Article 179 LOR, are insufficient both quantity and quality-wise.

Both in the EU, and even more so in American legislation system, the product liability legal institute has already formed its structure to a great degree and taken its rightful place. The contemporary community law can hardly be imagined without the product liability institute being developed within a broader context of consumer protection.

The European Union product liability Directive is of extreme importance for domestic legislator as the harmonisation of Serbian law and regulations with the EU legislation is an inescapable step in the alignment of Serbia with the European integration modern processes and constitutes one of the key tasks on Serbia's path towards the integrated Europe of the new millennium. EU member countries' experiences in the field are certain to be of use to domestic legislator in order to select the most appropriate solutions and options that do not diverge from the Directive's spirit but that will be at the same time most adapted to domestic interests.

It is not fair that risk of developments in knowledge and technology should be transferred to damaged parties, by which they would be also burdened by damage inflicted through the so called developmental risk. The term "safe product" should be interpreted in the broadest sense possible, so that producers should be held liable for all the damage inflicted by their products, irrespective of the fact that such damage could by no means be predicted or avoided.

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## FREE ZONES – TOOLS FOR THE EMPLOYMENT GROWTH OF THE ECONOMY OF SERBIA –

**Abstract:** *The role of free zones in the world economy is growing at the beginning of the new millennium. More than 25 percent of overall turnover is made though 5000 free zones throughout the world. It is a positive thing that Serbian government has raised the question of free zones development based on international experiences so far. The new Law on free zones is being considered and it should enlarge the scope and number of conveniences for doing business within the zones and thus make them more competitive compared to other zones in the surroundings. That would be the way for zones in Serbia to reach their goal – attracting direct foreign investments and contributing to the employment growth.*

**Key words:** *Serbia, free zone, foreign direct investments, tariff conveniences, stimulations*

### 1. Introduction

Free zone is an enclosure within a country with special business facilitations in place and used by the government as an economic policy means in order to create areas of quick development. When compared to the rest of a country such zones favour an alternative economic frame. In these times of big changes and transition it is crucial for a country to have means for experimenting with novel economic solutions. Major economic policy changes are often difficult to make. Lots of changes can only be introduced gradually or can be used only to a limited degree. Free zones are the only economic instrument enabling to a limited degree the implementation of fully fledged and radically new policies, without incurring any damage on other parts of the host country.

Direct foreign investments and the development of new technologies have an ever-growing influence on international economy. Free zones have a major role as an instrument for the swift attraction of investments in certain areas.

Facilitations on both state and local levels and tax exemptions will end up as more important than customs free zones concept in those highly developed industrial countries which are members of customs unions, where customs duty rates are low, where limitations in trade dealings are few and where services' share in the economic overall structure has grown considerably. At the same time, due to precisely these instruments, different countries can be expected to start competing over foreign investments. From the competition point of view, free zones can be seen as political tools the effects and benefits of which can be more favourable compared to those produced by other concepts of economic development. For all these reasons, a modern approach to free zones concept should be adopted which would, on the top of traditional ideas about free zones, give modern variations of enclaves of different economic branches. What all these concepts have in common is constant effort to increase the level of facilitations offered to users, with a view to inciting them to invest capital, introduce new technologies and achieve their basic goal of increasing employment rates in the host country.

Developing over centuries, the free zone institute reached its developmental pinnacle in the 1980s. The starting number of 800 free zones soared to 5000. The initial concepts of customs and trade free zones have undergone major changes today and taken on various forms (industrial, production, preferential, special, scientific, technological, tourist, media, internet-zones etc). The modern concept of free zones as specific developmental projects enabled countries and national economies to create a most favourable form of free zones, that is, the form that suits their characteristic features and comparative advantages with respect to political system, location, business and political environment and natural resources.

The essence of free zones is encompassed by their basic and simple characteristic: by offering special facilitations to business activities these zones attract direct foreign investments that, in turn, enable the growth of employment rates on the host country's economic and geographical territory.

## 2. The free zone concept

The term "free zone" entails a great number of different models of the specific foreign trade instrument that is exempt from various economic duties in the country where it operates.

Even though there are numerous definitions of the term "free zone" they all have some common elements that describe a free zone as an especially enclosed and marked part of a country's territory where trade and other activities are performed under guaranteed preferential treatments and facilitati-

ons.<sup>1</sup> Depending on different concepts that vary from country to country and national legislations that regulate dealings within free zones, different operations are conducted within the zones: production of goods, processing of goods, amendments to goods, packaging, sorting, classifying, warehousing, as well as foreign trade related tasks, different kinds of services, banking activities, insurance and reinsurance etc.

Basic trade facilitations introduced by countries in free zones are the following: exemption from import customs duties, taxes and other formalities, as well as relieving economic trade limitations; tax relieves (such as VAT, excise types of duty- excise, income tax and corporate sales tax, real estate taxes); exemption from regulations regarding minimum remuneration, social expenses, working conditions and any other limitations stemming from economic policy. The following are enabled within the zones: allocation of state assistance, cheap soil and lease; cheaper services (such as insurance, electricity, water); use of infrastructure; efficient handling of freight and its storing.

The European Community (EC) law defines free zones and free warehouses as “parts of the EC customs territory or areas within this territory where (with respect to import duties and importation measures imposed by trade policy) goods coming from the EC member countries are not considered to be on the EC customs territory unless already released in free traffic (definitely cleared) or underwent another customs procedure, or used and spent under some other non-customs conditions. By the very fact that goods coming from the EC are stored in free zones of free warehouses they are considered to fulfil the conditions stipulated by EC law that regulates specific areas concerning the implementation of measures usually undertaken upon export”.<sup>2</sup> No matter how free zones are defined or what forms and types they might come in (depending on national legislation) they all have the following in common: simplified procedures of importing/exporting of goods, free transit and storing; simplified procedure of licensing users; simplified customs procedure; exemption from customs duties and taxes; fiscal incentives (exemption from VAT, from corporate sales tax, property tax, excises, local taxes), financial incentives (free flow of capital, free repatriation of capital, profit and dividends; preferential treatment of interest rates); infrastructure facilitations (low prices, cheap services); free transport paths from and to the zones; labour legislation free from the state control.

<sup>1</sup> Law on free zones, “Official Gazette SRJ” No. 81/94, 28/96 (In Serbian)

<sup>2</sup> Council Regulation (EEC), No. 2913/92, article 166OF, October 12<sup>th</sup>, 1992

### 3. Free zone mission and reasons for their founding

Free zones' mission is to attract investments that will be in the service of regional development; to enable opening of new posts; to concentrate services and needs in one place through logical centres; to make savings in the course of trade possible (exemption from customs duties, taxes, fees, stimulative economic measures) and direct international trade through controlled channels. Free zones are supposed to enable *the most favourable trade conditions possible* which will then lead to attracting investors and making profit with a view to fulfil interests of zone users, economy and state.

Main reason for the creation of free zones is to make scope for accelerated economic development and open new working places, for the realisation of which a liberal law on free zones is crucial. The law is supposed to enable competitive trade conditions in zones, as well as unfaltering and organised support from the state by means of adhering to and harmonising other legal regulations that cover free zones dealings.

There are various different objectives set upon the formation of free zones. In essence, these objectives have to do with increasing employment rates, direct foreign investments, foreign trade exchange and public revenue, but they are also directed towards industrial development, researches, service sector enhancement, education and logistics, industrial dispersion, then increased usage of domestic materials in production, enhancing technological level of production and staff training. One of free zones' goals is also to exercise an indirect effect on broader surroundings through the cooperation between companies from the zones and other domestic companies from the background. This affects so called know-how, that is, general knowledge on making use of high technologies, then it also contributes to the involvement of domestic companies from the surroundings into the processes taking place within the zones, whether by means of providing services, selling raw material, capital goods, processing of goods or by means of producing various half-finished products. This affects domestic companies to the effect of expanding their capacities and hiring new workforce.

Another goal expected to be achieved through free zones is direct involvement in the world's market through multinational companies operating within the zones, along with the development of logistic and transport centres that provide quick access and link with other parts of the world.

#### 4. Types of zones

There are different terms referring to free zones which can be encountered in practice: export zones, free port zones, free trade zones, customs zones. These names are not only different terms for essentially the same thing but they rather indicate various different concepts of free zones depending on their purpose and types of facilitations they offer in trade. Various types have developed over the last decade. They can hardly be classified into neat groups that can be given all-encompassing names, but here we are offering the following division that have resulted from weeding out or merging together of some less important identifying features:

- Free zones,
- Free trade zones,
- Foreign trade zones,
- Trade zones,
- Free business zones,
- Logistic trade centres, free ports,
- Customs zones,
- Duty-free zones,
- Industrial free zones,
- Industrial export zones,
- Free production zones,
- Export processing zones,
- Free export zones,
- Mexican industrial zones,
- Export zones with preferential treatment,
- Free economic zones,
- Special economic zones,
- Joint investment zones,
- Joint entrepreneurial zones,
- Production zones,
- Scientific and technological parks,
- Industrial parks,
- Off-shore centres,
- Tourist, medical and education zones,
- Internet-city free zones,
- Development incubators.

The free zone concept has seen a great expansion over the last twenty years. The actual number of zones has soared to an unimaginable extent, so that currently there are around 5000 different business models worldwide which

run business under preferential conditions. The zones have taken on various forms, of which the most popular ones are Asian export processing zones<sup>3</sup>, EU free trade zones, US foreign trade zones, special economic zones in the Republic of China, bonded warehouses in ports, free ports and special processing zones particularly popular and developed in Mexico (maquiladoras).

In their further evolution, the zones are taking on various other forms, such as high tech and science zones, finance zones; logistics centres, tourist resorts zones, internet city zones as for example in Dubai, as well as zones in which a broad palette of activities are conducted.

In some cases new forms of zones allow only for the development of specialised activities (single zones), such as single-industry zones, jewellery zone in Thailand, or leather zone in Turkey; then specialised single-commodity zones, for example coffee zone in Zimbabwe; single-factory zones, such as export-oriented companies in India or single-company zones in Dominican Republic. Mauritius has been developing the free zone concept on islands whilst Hong Kong and Singapore have been increasing their strategic trade roles by offering special customs regimes for all export-oriented productions and transshipment in ports. Private initiative in the development of free zones is increasingly coming to the fore, as these have outstripped state-run zones in their attempts to offer better conditions with which to attract quality investments.

More than 5000 existing free and economic processing zones worldwide are situated in different locations in half of all the countries in the world – 90% of the world's population and 70% of the territory are encompassed by developed free zones, and 25% of the international trade exchange is conducted through these zones. The total number of people who work in these zones has amounted to 50 million.<sup>4</sup>

## 5. Preferentials and benefits in free zones

In order to achieve goals set upon the formation of free zones countries offer to zones' users various preferential conditions for conducting their businesses. These entail a broad spectrum of facilitations from all business areas and can result in the users cutting their business expenses and increasing their profit, which, in turn, trigger quicker and bigger cash flow.

These facilitations offered by free zones worldwide have not been elaborated on as such or neatly systematised. There are some sources on this matter

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<sup>3</sup> P. G. Warr, *Export Processing Zones, The Economics of Enclave Manufacturing*, The World Bank Washington, D.C., 1992

<sup>4</sup> F. Trampus, *Challenges, Threats and New Opportunities for the World's Free Zones*, Third World Free Zone Convention, Brussels, June 2003

which are not comprehensive enough but still offer a decent general insight into the full breadth of all the applied solutions.

Judging from the researches done on some representative free zones<sup>5</sup>, some facilitations usually offered in free zones can be generalised. These are exemptions from the following: customs duties supposed to be paid on various goods, machinery and equipment imported to a free zone, VAT on precursors; corporate income tax; income tax (wages); dividends, interest rates, royalties or services; capital goods taxes and taxes paid on income resulting from investments. Facilitations regarding the exemption from paying special capital taxes are also included here. Further, precursors that do not originate from the EU countries are allowed to be imported to a free zone, processed and then exported to the EU market. Upon such export of finished products to the EU countries, import duty is to be paid but only on those components of the products which are not of the EU origin. Also, there is a possibility for full exemption from import duties upon a special approval and so called IFTZ permit issued by the EU Commission.<sup>6</sup>

The free zone idea is very common and widespread today so that users and investors are now being offered facilitations that were completely unimaginable some twenty years ago. It does not suffice anymore just to profess that in certain zones business can be conducted duty free; developed infrastructure is now called for too, along with a whole set of business facilitations accompanied by a cheap and efficient administration capable of providing a wide range of services.

When forming a competitive free zone the following conditions need to be met: political and legal stability which can guarantee protection of investments; bringing a special free zone law- *lex specialis* that provides protection against nationalisation and expropriation processes, together with the profit repatriation; liberal regime of foreign currency dealings and availability of foreign currency to be at free disposal; simplified procedure for founding and running companies within the zones. Set of customs facilitations should encompass free import/export of goods and services to/from the zones, duty free regime within the zones' boundaries, simplified and expeditious customs procedures. Further, in order to achieve efficient functioning of a free zone developed infrastructure is called for in the form of airports, ports, international roads and railways, logistic centres that provide efficient organisation of loading/unloading of all types of means of transport and leased warehouses. The availability of telecommunications is also significant, such as telephone, Internet, mobile phones, satellite connection, as well as infrastructure such as electricity, water, heating, steam, gas, sewage system etc. Efficient garbage disposal service is also counted

<sup>5</sup> T. Kusago, Z. Tzannatos, *Export Processing Zones: A Review in Need of Update*, Social Protection Group, Human Development Network, The World Bank, Washington D.C., January 1998

<sup>6</sup> Stipulation by the EU Commission No. 1487/97

on. Also, zones' efficient functioning is not possible without quality services provided by forwarding agencies, transport organisers, banking and postal services, as well as restaurateurs" and other business services. As there is no time limit for keeping goods within a zone, subsidies for investments are offered, including issuing grants for soil, building sites and equipment, then subsidies for arranged researches and developmental programmes, and finally subsidies for staff training and management development.<sup>7</sup>

Benefits and preferentials offered by free zones can be also classified as financial, fiscal and indirect. Financial benefits and preferentials are those directly provided by state, such as incentive credits or exemptions based on investments. Fiscal preferentials encompass all tax relieves for direct foreign investments,<sup>8</sup> then import customs duties and capital gain taxes. Indirect preferentials entail offering sites and infrastructure at prices more favourable than market ones; then enabling privileged market positions; special preferentials concerning state contracts, as well as offering a monopoly to a company by means of banning others to explore the same branch in the zone.

The principle on which the free zone concept lies is a very simple one: facilitations with regard to fiscal policy, when combined with additional stimulations both on state and local levels create attractive conditions for investments, accelerated development areas and higher employment rates.

## 6. Free zone effects

By means of different mechanisms resulting from their functioning and their users' activities free zones can stimulate background/domestic trade. Mutual interaction between the zones and this background trade is reflected through providing services and trade and processing activities (for example inward processing of half-finished products). There are various ways in which either purchasing of local precursors and half-products can be stimulated or different subsidies can be provided to local companies when these supply and provide different services for companies operating within the zone. As companies operating within a zone are seen as ex-territorial then domestic companies are also offered customs refunding for the goods taken into the zone. A problem usually encountered in this business of activating background trade is that domestic prices of services, products and precursors are invariably higher than those on foreign markets. Therefore, there is a problem in covering the price gap, which is often dealt with through state incentives. The competitive-

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<sup>7</sup> R. C. Haywood, *Free Zone in the Modern World*, CFATF Meeting, Aruba, October 18<sup>th</sup>, 2000

<sup>8</sup> UNCTAD, *Foreign direct investment: inward and outward flows and stocks*, Geneve, 2003; <http://www.unctad.com>

ness of domestic products can be seen in lower transport costs that generally speaking can have a significant influence on final pricing.

A good side of the high demand for services and products originating in the zones is that it can often lead to restructuring of economic activities in the surroundings and enhancing domestic companies' competitiveness. Many multinational companies that operate in free zones work on gradually enabling domestic suppliers to produce half-products and provide services of required quality and standard. A good example for this practice are Chinese special free zones and big TNCs. By means of this direct foreign investments spill over the free zones' limits and have an additional positive effect on local economies. On the other hand, higher employment rates activate broad demand and consumption in the region in question, thus enabling the development of all types of services and trade activities.

Free zones also contribute to the process of transferring technologies to developing countries. Direct contact with international knowledge promotes the paramount development component-human factor. What is crucial is to enhance human resources through various know-how projects, that is, through direct contact with technical, marketing, management and other advanced achievements. Admittedly, not all business activities bring along high technologies (textile industry), but nevertheless, close contact with foreign companies serves to raise general business culture awareness and creates links with the world's market.

Financial incentives to small and middle companies in their fledgling stages can also be important; admittedly, these can be offered outside free zones too but with considerably lesser level of state control. Provision of funds, especially under preferential conditions, makes a powerful tool for enhancing business activities. Credits offered under preferential interest rates are great incentive for export-oriented programmes. Off-shore banking is particularly easy to conduct in free zones as banking conditions are especially liberal within these. Foreign currency dealings are quite simplified and allows for more liberal transactions regarding the host country.

One question cannot be avoided here: what is the right balance with incentives and how is it possible to measure positive effects and efficiency resulting from granting various incentives? Namely, it becomes simple if we accept that state has got nothing to lose anyway as there was nothing whatsoever on its green empty meadows, let alone foreign investors. When, for example, Dubai renounced customs and tax duties in the area of sand dunes along the Gulf bay, its country was certainly done no harm to, as there was nothing there anyway and the state had no income whatsoever. Nowadays, one of the most successful free zones, the Jabal Ali zone, extends there over a territory of 100 km<sup>2</sup> and boasts more than 1000 foreign companies and the highest development rates in the region.

There are four recommendations given by the UN Centre for trans-national corporations which offer the simplest principles with regard to striking the balance and achieving the right measure when providing incentives and measuring effects on the host country. Firstly, maintenance and development costs in free zones should be covered by user-companies through paying rent for sites, business premises and their maintaining, in which case mentioned incentives can by no means result in losses. Secondly, the incentives should not outstrip the projected foreign currency influx and other benefits. The incentive measure should be established based on goals to attract certain industries and in order to master this rather difficult task experiences of other locations worldwide should be made use of. Thirdly, the incentives should be distributed in such a way that they enable the development of all types of activities; apart from processing activities, marketing and business services need to be enhanced too. And finally, the incentives have got to be clear, understandable, reliable and unchanging.

Speaking of the accomplishment of goals set upon the formation of free zones, it is paramount that concepts of monitoring and support to all projects within a zone should be properly established on the state level. It is only through a country's systematic and organised cooperation and incessant care that positive results can be achieved. An exceptional organisational example that led to favourable results is the formation of a special Sub-secretariat for free zones in Turkey which deals with general free zone development through a broad spectrum of activities. A similar approach exists in the US too where a federal body for monitoring free zones has been formed, so called NAFTAZ (National Association of Foreign Trade Zones), the activities of which affect the zones' business autonomy by no means.

## 7. Free zone operating in the EU

The free zone system has been preserved in the EU member countries despite the fact that there are alternative options (temporary export and storing of goods, customs warehouses, refunding, processing under customs control).<sup>9</sup> The concept is expected to develop further in order to enable cheaper business dealings. Zones within the EU enable high concentration of modern technologies and direct investments in various areas. In industrially high developed EU countries the volume of funds allocated as regional development incentives is considerable; some of these being tax relieves and direct state assistance. There are different potential avenues of development for EU free zones, such as technological parks, then modern zone concept in the form of incubators

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<sup>9</sup> M. Lux, *Free Zones in the European Community*, International Conference of Free Zones and Export Processing Zones, Flagstaff, Arizona, USA, 1998

for the development of middle and small enterprises, as well as logistic centres with all-encompassing services concerning transport of goods. A modern way of the clearance of goods is being introduced into zones (great volumes of duty free goods and goods originating in the EU) along with a new business practice (making use of checking documentation and invoices instead of physical search of goods). Many existing free zones are expected to start using the new concept based on customs declarations and checking invoices.

The expansion of the EU has already changed the overall picture of the number and nature of free zones within its territory.<sup>10</sup> Many of the new member states, especially Hungary, Czech Republic and Poland, have exceptionally developed processing free zones. Therefore, the European zones' character will be undergoing changes, more in the processing direction than trade. For example, relying on the Western European experiences Hungarian local authorities and companies initiated in the early 90s industrial parks development programmes with a view to making use of spent industrial premises and opening new posts. There are 160 industrial parks in the country today, employing almost 100 thousand people and exporting 80% of industrial products. The biggest seven parks (all are situated in the western part of Hungary) take part in 80% of the overall production and account for 60% of the employed in the country.

In accordance to EU legislation, free zones are customs union's territory. However, they are treated to a degree independently from the union for the following reasons: firstly, so that import duties could be collected and economic measures undertaken on non-EU goods; secondly, that non-EU goods could qualify for incentive export measures (for example, refunding export transport costs) on grounds of their free zone position.

The EU fiscal law stipulates that goods within a free zone are to be exempted from VAT. Also, the provision of services relating to the goods within a free zone is subject to VAT exemption. For as long as goods are within a free zone excise duties are not charged. Non-EU goods are not considered to have entered customs territory upon their entering a free zone. Customs import/export declarations are to be dealt with upon goods leaving a free zone. There are also other goods-related facilitations within EU free zones with regard to taxes, excise duties, sales tax, local taxes, all of which vary from one zone to another. EU free zones are mainly intended for services within the goods trade domain and facilitations in customs formalities.

Main advantages of EU free zones concern goods being exempted from customs formalities upon entering a free zone, upon their storage, transport and handling, as well as upon their export to non-EU countries. One disadvantage is that there are no duties exemptions for the equipment or goods used and spent within a zone. There are exceptions though, such as special permit

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<sup>10</sup> Up till May 1<sup>st</sup> 2004, before the last EU expansion, there were 31 free zones within the then 10 members. *EC Official Journal EU*, OJ C 50/2002

issued to the free zone of Madeira which has been granted import of some precursors to be used on the EU territory.

At free zones meeting held in London on December 4<sup>th</sup> 2003 Ms Meerut Hanonnen stated in her expose entitled “EU obligations” that EU free zones mainly had the same role as customs warehouses. Customs warehousing is a procedure by which imported goods are kept under customs control at a certain location, without paying any duties or taxes. Unlike in some other countries, EU free zones are considered to be a part of customs and tax territory. Therefore, EU regulations concerning tax harmonisations and coordination, as well as state assistance, are complied with in these areas too.

Once imported goods are stored in free zones, import customs duties, VAT and excise duties can be suspended until the goods are released in free traffic or alternatively, until customs and tax debt is forcibly collected due to customs and tax regulations infringements. The same procedure applies to customs warehouses.

Trade policy measures (for example import permits) can be suspended. Such measures are not relevant and applicable upon exiting or entering the EC. Export-bound goods placed within free zones potentially have already benefited from refunding customs expenses, VAT and other duties exemptions, as well as from the export refunding preceding the export itself. The same applies to customs warehouses.

Within a free zone, imported goods can: be released in free traffic (under the regulations concerning final use); undergo usual handling procedures; be placed under internal regime of customs controls or temporary importation regime, but it can also be left unattended or destroyed. The exactly same activities can be conducted in a customs warehouse.

According to the latest amendment of the Customs EU law from December 2000, there are two types of free zones. There are special rules applying to “the controlling type I of free zones”. The rules state that goods brought directly into a free zone are to be exempted from customs duties. Physical entrance of goods into a free zone places into under the free zone regime. Upon their re-export the goods have to be declared to the customs. However, this requirement is subject to some exceptions in those cases when goods have not been unloaded or have merely been forwarded. On the other hand, “the controlling type II of free zones” adheres to the customs warehousing formalities. The only difference when compared to customs warehouses refers to the importation of goods directly entering a free zone, not being unloaded or merely forwarded. In such cases the requirement that the goods arriving to or leaving the customs can be relieved.

## 8. Free zones in Serbia

Free zones in Serbia were mainly founded at the beginning of the 90s and up till middle 2006 there were 14 of them, whereas today there are only 3 left (Pirot, Zrenjanin and Subotica).<sup>11</sup> These are infrastructure-wise well equipped areas located on geographically attractive locations, that is, important roadways, in which a special business regime was established under the Free zone law from 1994 and amended Free zone law from 2006.

Modest results achieved so far in the course of business dealings within Serbian free zones are immediately linked with the imposed economic sanctions, war in surrounding areas and altogether unfavourable political climate that caused foreign investors' disinterestedness both within the zones and out of them. The fact that till recently there were no basic conditions for proper functioning of the free zone concept in Serbia is no excuse for not evaluating effects, advantages and faults of the entire existing domestic concept of zones. Though modest, Serbian free zones' results have been encouraging so far, as well as adoption of a new Free zone law and changed attitude of the state towards the whole free zone concept.

Given the tendency of decreasing customs rates, it becomes clear that basic advantages and incentives for investments within a zone lie in the tax relieve area. Not less important are favourable conditions for building premises in free zones. Prerequisites for the creation of attractive business premises are clearly defined, uniform building conditions, obtaining building and usage permits, stimulants for the building ground and minimum administration etc. In order for such a business concept to prove successful in the Republic of Serbia an active state role and engagement of its institutions are necessary, both with regard to a quality legal frame and free zone promotion in the sense of a developing institution.

### 8.1. History

First free zones (in today's sense of the word) on the Balkan Peninsula were registered in Rijeka and Zadar. Rijeka was proclaimed a free port in 1719 and the city and port of Zadar in 1923, when it was given a status characteristic only for Hong Kong and Gibraltar. An attempt to create a Yugoslav customs zone in Sušak (suburbs of Rijeka) ensued, followed by the foundation of the Free Yugoslav Zone in Thessalonica in 1929 and then other free Yugoslav zones formed under the provisions of the Law on amendments of

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<sup>11</sup> Working material from the round table "Free zones in Serbia", held on December 2<sup>nd</sup> 2002 in Novi Sad.

the Customs Law from 1963<sup>12</sup>, all up until a special Law on customs zones was brought in 1985<sup>13</sup>, then replaced by Free zones law in 1994,<sup>14</sup> and finally the adoption of Free zones law in 2006.<sup>15</sup>

Yugoslav free zone in Thessalonica is particularly important in the light of a clearly articulated need for a free traffic of goods concept and its subsequent successful realisation. It had a special ex-territorial status in the sense that one country formed its own free zone on the territory of another country by means of a time-limited concession. The zone was operational as from 1923 though a formal resolution on its constitution was brought by Geneva protocol in 1929. The concession was granted for a period of 50 years. The zone extended over 94000 m<sup>2</sup> of the port of Thessalonica. This meant that goods entering Yugoslav free customs zone in Thessalonica could not be subject to any customs controls, either on Greek border crossing points or during their transit through Greece. The zone was abolished in 1974.

The need for uniform legal regulation to enable the development of the free zone concept, as expressed through various studies<sup>16</sup> and economists' consultations, was finalised through adoption of the mentioned Law on amendments of the Customs law from 1963 and Guidelines for implementation of the stipulations of the Customs law on free customs zones<sup>17</sup> by means of which methods for foundation and functioning of customs free zones were established. Under this Law, Free customs zone Kopar was formed (1.1.1964), followed by Rijeka (15.7.1964), Belgrade (9.7.1966), Split (1967) and later Zadar, Pula, Bar, Ploče and Novi Sad (1969). These zones offered a range of facilitations, such as: exemption from customs duties, flexibility with loading, unloading and storing arrangements, packaging, re-packaging and processing.

But despite all the effort invested and all the facilitations offered within the zones they did not yield the expected results. The main limiting factor that brought this outcome about is considered to be a stipulation concerning the zones' status only in certain areas that did not guarantee entrance of capital (infrastructure-wise underdeveloped ports and ports with low traffic volumes). Also, the incompatibility of other legal solutions regulating business dealings within the zones with the legislation regarding free zones themselves

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<sup>12</sup> Customs law, "Official Gazette SFRJ" No. 13/63 (In Serbian)

<sup>13</sup> Law on customs zones 1985, "Official Gazette SFRJ" No. 58/85 (In Serbian)

<sup>14</sup> Law on free zones, "Official Gazette SRJ" 81/94 (In Serbian)

<sup>15</sup> Law on free zones, "Official Gazette of the Republic of Serbia" No. 62/2006 (In Serbian)

<sup>16</sup> See, for example, study: "Economic needs, justification and possibilities for the increase of traffic in sea ports and harbours by means of introducing the concept of free warehouses, zones or ports, that is, harbours" Secretariat of the Federal Executive Council for traffic and communications, Belgrade, July 23<sup>rd</sup>, 1961

<sup>17</sup> *Guidebook on the implementation of the stipulations of the Customs law on free customs zones*, "Official Gazette SFRJ" No. 45/63 (In Serbian)

was evident. State support to the institute of free zones was inadequate and insufficient; unnecessary and unwieldy volume of administration, along with bureaucratic approach to the whole concept, were also present hindrances.

Law on customs zones from 1985 was our first independent law on free zones and it was a huge stride towards further development of the free zone institute. Industrial production of goods was allowed, as well as exportation and processing services, various procedures concerning non-cleared goods within a zone, banking and other financial activities, insurance and re-insurance dealings. A broader range of locations in which zones could be formed was allowed—besides ports, now airports and main road and railway directions were also included. This meant a huge boost for the creation of zones so that out of 27 permits for the foundation of zones 12 of them actually started working. As early as in 1988 first results were recorded in the form of enhanced export from the zone areas which reached 5mil US dollars. In 1989 21 zones were granted work permits (7 in Croatia, 5 in Serbia, 4 in Slovenia, 2 in BiH and Macedonia each and 1 in Montenegro). Further evolution of the legislation came as Law on free and customs zones from 1990 which paid significant and separate attention to customs and free zones respectively. The most important stipulation within it was the right for special legal entities to form free zones, which gave them independence in bringing business decisions. There is a clear differentiation between free and customs zones' respective functions, which proved to be a further legislative breakthrough.

Law on free zones which proved to be a huge progress compared to earlier ones was brought as early as in 1994 in line with the definition of customs zones by the Customs law from 1992.<sup>18</sup> This was the first time that it was defined as *lex specialis*, and various stipulations concerning different segments of conducting business within the zones were added to it. Zone users' biggest objections concerned the area that had not been defined by the Law (these areas were left to be decided upon on the republic level), such as: taxes, labour and labour relations and ways to handle ground/sites. Free zones in Serbia have not been able to fulfil expectations of the social community as from 1994 up till today, all due to the known political events and unfavourable conditions for direct foreign investments. However, the Law brought in 2006 created conditions to overcome this situation.<sup>19</sup>

### 8.2. Free zone Pirot – example

Free zone Pirot is located at Serbian gate towards the Middle East, runs along the international E-80 motorway, so called corridor 10, and extends over 17ha of infrastructure-wise fully equipped ground with a possibility for exten-

<sup>18</sup> Customs law, Official Gazette SRJ 45/92 (In Serbian)

<sup>19</sup> Law on free zones, "Official Gazette of the Republic of Serbia" No. 62/06 (In Serbian)

sion to 50ha. Free zone Pirot became operational in April 1998 since when it has been recording constant growth of business volume, which has made it a leading free zone based on export effects achieved within its boundaries.

**Table 1:** *Number of permanent employees in the company Free zone Pirot, together with their education levels (2003)*

EDUCATION	NUMBER OF STAFF
University	4
College	3
High school	16
Primary school	1
TOTAL:	24

Source: Data from the Free zone Pirot

**Table 2:** *Number of employees in the Free zone Pirot within all existing branches (2003)*

STAFF-TYPE	NUMBER OF STAFF
Free zone Pirot-permanent – employees	24
Free zone Pirot users – permanent employees	147
Occasionally hired employees	20
TOTAL:	191

Source: Data from the Free zone Pirot

**Table 3:** *Free zone Pirot capacities (2003)*

	PREMISES within the zone		AREA (m2)
1.	OPEN SPACE		103,180.5
2.	CLOSED SPACE	Business	350
		Production	2,597
		Warehouses	14,516
		Total::	17,463
	TOTAL:		120,643.5

Source: Data from the Free zone Pirot

When the free zone Pirot started working business conditions were very unfavourable and difficult, so that at the time the main priority was its infrastructure, building and equipping it to the level when it was capable of providing best possible services to its users. The following activities were being carried out within the zone: offloading, storage of raw material and goods, providing forwarding services for its users, along with ensuring customs supervision measures within the zone. In the mid 2000 one of its users, “Tigar” holding, started production within the zone. According to the free zone data

the overall value of import of various type of goods conducted through the zone in 2003 was 43 460 109 Euro, out of which 43 349 483 euros worth of the imported goods were produced within the zone too. Again according to the free zone data the overall value of export of various type of goods conducted through the zone in 2003 was 68 269 973 Euro, out of which 66 415 772 euros worth of the exported goods were produced within the zone. Therefore, export conducted through the zone outstripped import by 48%.

The free zone development has been followed by a constant rise of all business parameters. Total turnover reached 110 mil euros till the end of 2005, whilst the number of free zone users and value of conducted goods and services traffic show growing tendencies, accompanied by an increase in the total business volume.

**Table 4:** *Overall turnover in the free zone of Pirot (2000-2005)*

Final products	2000		2001	
	Quantity/pieces	value/EUR	Quantity/ pieces	value/EUR
Total:	740,560	13,074.929	3,062.734	38,167.329

2002		2003		2004		2005	
value/EUR	vrednost/EUR	Quantity/ pcs	value/ EUR	Quantity/ pcs	value/ EUR	Quantity/ pcs	value/ EUR
3,361.192	25,549.966	6,665.716	39,707. 855	6,821. 967	52,345. 115	7,673.000	68,991. 350

Source: Data from the Free zone Pirot

**Table 5:** *Turnover in the free zone Pirot (2000-2003)*

	Procedure		2000	2001	2002	2003
1	IMPORT	Produced in the FZ	9 361 455	27 039 994	23 660 816	33 043 747
		Regular import	4 974 409	14 598 079	15 048 872	10 305 736
2	EXPORT	Produced in the FZ	13 074 929	25 812 665	25 549 966	39 707 855
		Regular export	20 783 053	12 354 664	30 178 640	26 673 142
TOTAL:			48 193 836	79 805 402	94 438 294	109 730 480

Source: Data from the Free zone Pirot

Free zone Pirot is absolutely ready for foreign investments. There is a building capacity within the zone at a location covering 30 000 m<sup>2</sup>. Customs and the Free zone working hours are 24hrs a day and permanent services operating within the zone are the following: management, security, logistic centre, forwarding agency, transport, and customs. Besides the activities and services stipulated by the Law on free zones, users are offered numerous other services in the field of production, warehousing, flow of goods through its logistic centre, services regarding the preparation of customs documents for the zone

users (processing and warehousing), forwarding services, offloading of goods, container terminal, international transport agency, storage of goods (both in open space and in warehouses).

There are various facilitations and benefits offered by the Free zone Pirot<sup>20</sup> that achieves this through the combination of three types of stimulating measures: facilitations made possible by the Law on free zones; stimulating measures enabled by local authorities from the municipality of Pirot and stimulating measures for the use of services provided by the company that manages the free zone of Pirot.

The law on free zones provides the following facilitations:

- both the import and export of goods and services to/from the zone are free;
- imported raw material intended for the production of goods that are to be exported subsequently is not subject to customs duties and other import duties;
- imported equipment, machinery and other construction material are exempt from customs and other duties;
- the zone users are free to handle profit made through conducting business within the zone at their own will;
- the zone users' rights, as established by the Law on free zones cannot be diminished by any other regulation;
- importing all types of goods to the zone is exempt from customs duties; goods coming from the zone can be sold on the domestic market upon paying customs and other duties; in case goods entering Serbian customs territory were produced within the zone or manipulated/processed using a domestic component then customs duties are to be paid only for foreign components in the goods;
- import/export to/from the zone is completely free, that is, contingents are not applied, nor are export/import permits or any other limitations of the foreign trade; goods imported from the zone to the domestic market are subject to the regular import regime, but in case the goods domestic contents' value is minimum 50% of the total value then such goods will be treated as domestic
- goods from the zone can be temporarily brought on to the rest of the domestic territory or, alternatively goods can be brought into the zone from the rest of the domestic territory in order to be processed (including: processing, adding, changing, installing something new, alterations, quality controls, marketing presentations etc), which altogether offers great possibilities for linking with the domestic economy;
- free transfer of profits made from business dealings within the zone;
- expropriation is not allowed within the zone boundaries;
- the zone users can rent, buy or build themselves any processing, warehousing and other business premises.

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<sup>20</sup> For more details see the Free zone Pirot web site: [www.freezpi.co.yu](http://www.freezpi.co.yu)

As for the stimulating measures offered by Pirot local authorities, these days the municipality has no great capacities for its own investments, so its development-oriented role boils down to ensuring necessary local conditions such as decent ground for premises, garbage disposal, infrastructure and other local conditions. By ensuring necessary conditions for the zone to become operational in the first place the municipality of Pirot resolved some of its major economic-structural and infrastructural problems. This was achieved by means of creating an atmosphere of utter readiness for providing the best and in international terms competitive business conditions.

When carrying out construction works within the zone users are fully exempted from: any expenses for the municipal building site cleaning; taxes and expenses due to be paid to municipal authorities (garbage disposal taxes, building permit, building approval, construction permit, tax on the certificate for building rights); paying anything to get connected to the local infrastructure net, water supply and sewage. Users are exempted from paying anything for being granted permission to connect to the communal net, for being issued approval to connect to the communal net and finally for the connection itself (except for some basic material expenses), all with communal companies "Water supply and sewage" and "Heating system". As for the public urbanisation company, users are again exempted from any expenses stemming from issuing documentation with a view to solving current issues, but are also free from expenses for urbanisation and technical conditions, issuing urbanisation approval for building and installing temporary and auxiliary premises. When using premises within the zone users are exempted from paying any local communal taxes or fees for using local building sites, along with communal services expenses.

Stimulating measures for making use of the services provided by the company that runs the Free zone Pirot relate to the all-encompassing processing services, then services concerning warehousing and flow of goods through the free zone's logistic centre. These services entail:

- monitoring and enabling the zone users' unhindered business dealings (processing and warehousing);
- forwarding services in the foreign trade activities;
- organisation of domestic and international transport;
- trans-loading of goods;
- container terminal;
- warehousing of goods (both in warehouses and in open space);
- the so called "On Stop Shop" working system, which means that all the administrative procedure start and finish within the zone, whether they concern business activities carried out upon the transport of goods or issuing certain permits and approvals that are in customs jurisdiction;
- making use of infrastructure-wise thoroughly equipped site, electricity (10/0, 4 KW power 400 KWA), water supply and sewage;

- developed telecommunication and information systems that enable the conduct of e-business- 150 independent phone lines
- making use of the railways-industrial track;
- opportunity to build at a location covering 30.000 m<sup>2</sup>;
- so called Regulation building plan created;
- construction permit issued under a simplified procedure.

At this moment, Free zone Pirot is the closest in Serbia to the concept that unifies export-processing zone and industrial park with secondary free trade elements. It can serve to prove that it is possible to organise successful business of export-import oriented processing companies within a zone.

### *8.3. Serbian zones' business effects and their influence on export, employment and investments*

Serbian free zones based their existence on service providing and operated basically as free trade zones. The only exception is Free zone Pirot where “Tigar” company, in cooperation with foreign partners, placed their factory for the production of tyre mixtures whereby the zone started operating as an export processing zone too. This enabled testing of the system that entailed processing within zones in Serbia and the result showed that using free zones in the function of export-bound production is very beneficial.

Nevertheless, conducting business through free zones in Serbia has not yielded the expected results as the total foreign trade exchange through free zones in Serbia in 2001 was merely 150 mil US dollars, the only significant export was conducted via Free zone Pirot, reaching around 60 mil dollars. The next biggest export result is minor-amounting to only 5 mil dollars. This shows that zones were not intended to be used for export purposes in the first place and that, with the exception of the Free zone Pirot, their role was of trade character and intended for domestic market. Therefore, the need and ambition to create an export-bound area of accelerated development, with a great number of new posts, has not been fulfilled.

**Table 6:** *Serbian free zones' basic indicators of business results*

		Foreign trade business		
		2003 in thousands of euros		
No	Free zone	Import	Export	Total
1.	Belgrade 1993	132 966	2 272	135 238
2.	Novi Sad 1987	45 669	5 028	50 697
3.	Pirot 1996	43 460	68 270	111 730
4.	Šabac 1993		450	
5.	Lapovo 1995			
6.	Prahovo 1994		30	
7.	Kovin 1992			
8.	Subotica 1996		1 535	
9.	Senta 1993			
10.	Sombor 1996	73		73
TOTAL:		222 168	77 585	297 738

Source: Report done by Serbian Ministry of Finance for the year 2003

It is quite clear that basic projected goals have not been met within the zones-first of all, direct foreign investments influx and employment rates growth. Judging from the previous business report submitted by Serbian free zones to the Ministry of Finance, the free zones' influence on export, employment rates and direct foreign investments can be said to have been completely unsatisfactory, but what also can be stated is that under the current circumstances nothing else could have been expected either, given that free zones' development is conditioned by a country's international position and its institutions' relation to the free zone concept. Over the recent ten years both these conditions have been unsatisfactory. The country was under the international community sanctions whilst at the same time the Republic of Serbia government did not recognise zones' instruments' value. Quite a few reasons contributed to the failure: international sanctions, huge political and legal uncertainty and instability, incomplete and inconsistent legislation, lack of funds for infrastructure and construction works, absence of the state incentive policy, invalidating Law on free zones by some other legal regulations and acts, unnecessary administrative apparatus and bureaucracy, war-inflicted destruction in the country and all over the region.<sup>21</sup>

The encouraging news is that the very companies in charge of running the zones have been running their businesses with a positive and ever-growing trend since. As opposed to many, in essence right, opinions about the free zones in Serbia not accomplishing their mission, we hold the view that these data are

<sup>21</sup> M. Živković, "Jugoslovenske slobodne zone danas, mogućnosti i ograničenja", *Direktor*, 11/1999, pp. 37-40

still heartening as Serbian free zones after all managed to survive even in those times when they had no opportunity to operate and develop. In those hard times when a number of big companies stopped working and went bankrupt, free zones proved their vitality. Formed as foreign trade instruments, the zones resumed their work amidst absolutely unlikely conditions for that sort of business. The argument often cited by the free zone concept opponents who claim that free zones have turned into “customs storehouses that are in the function of avoiding customs duties and taxes”, is actually indicating to a great flexibility of the concept that is yet to prove its value in the open economy.

In general, free zones have been achieving positive results. If managed properly, they can attract foreign investments, generate revenue and contribute to opening new posts. Unqualified workforce benefits largely from training delivered on the spot, at their working places. On the other hand, qualified, educated employees who deal with monitoring and management establish new contacts, master new organisation, management and marketing skills and methods, along with adopting entrepreneurial spirit.

Lots of examples of successful free zones can be identified. What should never be forgotten is that different types of free zones prove successful in different environments. Just like with made-to-measure suits, amongst a wide range of different zone models every country has to tailor a free zone model that suits its particular needs. Serbia finds the eastern European transitional model akin to its needs and requirements, therefore it is important to get familiarised with these countries' zones' experiences with regard to harmonisation of the overall economic relations with the EU. This, combined with the world's most successful zones' experiences can lead to a right balance and a free zone related law ideal for Serbian needs.

## 9. Concluding considerations

One main conclusion that comes as the result of research and above elaborated analyses, is that states introduce in their respective national economies free zones as instruments for attracting direct foreign investments and employment rates boost, all in line with their relative developmental needs, in-built parameters and their relation with global and European surroundings. By means of this, economic and regional development is considerably accelerated and state is involved in international economic flows.

The free zone practice has shown so far that in general, free zones founded in any geographic or economic area *enable quick attracting of foreign investments and boosting of employment rates*, which is corroborated by a majority of world's free zones' experiences. Either directly or indirectly, there are around 42 mil people employed nowadays in free zones, out of whom 30 mil in

China, 2 mil in Mexico, 700 000 in the Middle East, 300 000 in America and 250 000 in transitional countries.

The developments so far have shown that *support for the free zone concept and idea* has been on constant increase worldwide. A great number of countries and multinational companies have been recognising their interests in founding and enabling functioning of various types of free zones. There has been a steep increase in the number of free zones of different profiles over the last twenty years: from 800 the number has risen to 3500. There has been a drop in direct foreign investments over the last two years, except in states with highly developed free zone nets where the number of zones is rising unceasingly (China, Hungary, Poland, and Turkey). Chinese free zones provide an illustrative example for this as they have attracted five hundred thousand direct investment programmes and accumulated around 500bn dollars in total. There are 200 foreign companies operating in Chinese different profile free zones (special trade zones, free trade zones, export zones, processing zones) and around 20mil new working posts have been opened.

Economic parameters confirm that the key to the newly-formed zones' success is properly chosen location with a developed infrastructure and world-oriented communications; then well-trained and cheap workforce; friendly political and business surroundings; state economic support; a broad spectrum of business services; number and variety of business facilitations in place and efficient administration.

In national economies' development free zones are one likely and *alternative instrument of the economic and developmental policy* which has shown a great level of efficiency. The concept has proven extremely successful in some countries, whilst not yielding expected economic effects in some other. As for the free zone concept and practice there is not a universal solution or pattern applicable in every area or environment and guaranteeing success. China has shown the greatest progress in the use and development of free zones, both as economic enclaves and development generators. However, the Chinese free zone model is difficult or even impossible to adhere to in many other countries. Results from Puerto Rico, Taiwan, South Korea, Mexico, Ireland and other countries have proven the significance of various different approaches to the free zone concept. Each of these models are very specific and unique to the effect that every one of them suits one country's needs and national economies' respective policies depending on their current and long-term developmental needs. India calls for a programme different than Dubai's, just as for example Poland has completely different economic needs compared to Germany or France.

Free zones are not merely instruments for making use of tax benefits and customs concessions, they also encompass *economic developmental mechanisms and procedures*. As institutions and organisations, free zones entail processes that attract and keep investors under the established and controlled con-

ditions favourable for their development. They are an example and pattern of reasoning and conduct offering to investors the scope for quick development, opportunity to install new technologies and economic programmes, as well as making bigger profits

*Free zones are a dynamic economic and developmental instrument*, and very flexible as such. If properly directed and managed, all the changes in world's trends concerning free zone development or the international community relation with the zones can be successfully absorbed. By installing a new information system, collecting statistical data and other information necessary for the zone evaluation programme, the programmes' efficiency is boosted and zones' development in line with state in question and users' needs is made possible

The research conducted within this paper has shown that in order to achieve a long-term success *goals must be clearly defined, as well as Serbian free zones' developmental directions*. The creation of a high-quality business and processing environment by means of conducting a stimulating business policy through various facilitations and state stimuli to the countries within a zone, opportunities for attracting foreign investors would certainly be increased. The successful zones' model shows that even *without engaging any state resources, that is capital, state can develop its national economy and specific economic projects* such as free zones, by renouncing income that is not even in its possession at the moment.

Tax system within a zone should be one of the major and basic stimuli allowing zero rate profit tax for corporations over first couple of years. Once this period is over, the tax should not amount to more than 50% of the regular tax rate, whilst investment tax credits should be made possible through re-investments. VAT should be abolished within zone boundaries, as everywhere else in the world.

*Customs facilitations* make a considerable part of the stimulation system. As for customs procedures, high efficiency level customs services within a zone should be made possible and developed in line with global standards. Clearance procedure should not last for longer than two hours and it should be made possible seven days a week, 24 hours a day. Zero customs rates for both precursors and any other processing equipment are to be taken for granted. Customs duties are to be collected only in those cases when raw materials are used for domestic consumption.

The system of state offered *benefits and facilitations* should be combined with facilitations given by local self-governing bodies and being a usual practice in industrial parks. In the future free zone practice and its developmental concept, the classic trade zone concept and customs free zone concept should be directed towards modern types of free zones, such as industrial and technical parks with development incubators at disposal which enable the development of small and middle companies if provided necessary financial and

fiscal incentives along with the state service and infrastructure assistance. The openness to middle and small investors as well as to bigger companies, is also crucial. The zones used by and cooperating only with big multinational companies and large investors will not meet the EU approval and support.

Undoubtedly, the *EU relation and attitude towards the free zone concept* have a large role in planning zones, their operation and affirming their role and concept. It is possible to build an efficient free zone concept in Serbia by combining domestic experiences with global practice and transitional experiences of those countries that have already joined the EU. Proper orientation and quick development of free zones can be reached through negotiations that will enable some special facilitations to free zones within the EU. Zone aspects and programmes would be more efficient if the EU accepted the variety of economic conditions springing from the free zone concept expansion.

Research and practice prove that *state attitude and its institutions' attitude towards free zones are crucial for their development and success*. Only those free zones enjoying full state support can achieve success. This is confirmed by the examples of free zones in the US, Turkey, Egypt, Dubai. Each of these countries has within their respective state administrations separate agencies or directorates in charge of free zone business control and development.

Further institutional support to the free zone concept should be enabled in Serbia by means of forming a separate body, for example an agency for free zone development within the government, the managing board of which would comprise representatives from relevant ministries, Customs administration representative, as well as representatives of free zone groups and experts on the subject. Apart from Serbian free zones promotion, the Agency's task would be to control and assist everyone operating within a zone. In majority of countries where free zones operate successfully top political leaders are also engaged, alongside experts and consultants, with a view to ensuring the zones' quicker economic development and overall progress of the concept.

Parallel to the free zone concept development, what needs to be done is to initiate the formation of a joint body consisting of representatives from southeast European EU candidate countries that have free zones operating on their territories, all in order to ensure a joint approach and negotiations with the EU concerning harmonisation of regulations. Boosting the development of free zones in a region will contribute to quicker regional integration and overcoming some inherited political, ideological, national, religious and other divisions whereby the Euro-integration of those countries would be sped up. A good example is the cross-border cooperation between US and Mexican free zones (zones McAllen and Reynos) as well as the initiative of the Free zone of Pirot and Free zone of Dragoman (Bulgaria) to establish so called Good neighbours programme between Serbia and Bulgaria with a view to establishing cross-border cooperation.

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## MARKETING APPROACH IN HEALTH CARE

**Abstract:** *Health care institutions are answering the challenges brought by modern environment by the application of marketing orientation in their dealings. Since the possibilities for such application are limited, it has to be very efficient. The efficiency of its application in health care depends on theoretical-methodological foundation on which it was built. This paper expounds on the subject approach to the study of marketing in health care.*

**Key words:** *marketing, subject approach, health care, service client*

### 1. Justification and limitations of the implementation of marketing approach in business

Marketing used to be attached in the past exclusively with business dealings of commercial producers, so the impression was created that it was reserved only for those branches that had physically tangible goods of varied levels of finalisation as their final results. Nowadays, marketing is being made use of also by non-commercial enterprises, especially a vast number of non-profitable organisations that have service provision as their primary activity.

Problems encountered by non-profitable organisations that had no quick and adequate response to the market demands in the 70s, have brought about the decline in the number of users of their services. Many non-profitable organisations from developed countries have lost their stable market positions through not reacting timely to the lack of necessary financial support. For example, in the mid 1960s-mid 1980s period 170 out of 3000 private colleges were closed down only in the US, as these were not able to attract either sufficient funds or students. One fifth out of several thousands of hospitals in the US were closed down in the 1980s through the negative effect from redundant capacities.<sup>1</sup>

Over the last decade of the 20th century all the demands on the health care market were directed towards the quality health care services and other accompanying products, developed and placed using cutting-edge technology,

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<sup>1</sup> Ph. Kotler: *Upravljanje marketingom I*, Informator, Zagreb, 1998, p. 30.

then towards improved working conditions and a different climate that would result in cutting waiting queues whilst increasing the level of provided services. Due to the lack of human and financial resources needed in order to create a modern business process, inadequate premises, and out-of-date equipment and accompanying capacities, many health care institutions were not able to respond efficiently to thus articulated market requirements.<sup>2</sup> This resulted in the decline in the number of service users.<sup>3</sup> This indicates towards the absence of the marketing business orientation the focal point of which are service users' needs and the primary goal of which is the users' satisfaction with the provided services. There is one general hurdle hindering the efficient transformation of health care to the marketing approach, and that is the specific nature of the market of health care services on which parties who are in the supply-demand relation are by no means economically equal. This is the key reason as to why health care institutions have been implementing the marketing business orientation with difficulties, especially given that the state affects and directs health care dealings through the economic policy measures.<sup>4</sup> The aforementioned reasons though should not serve to health care institutions as an excuse for clients' dissatisfaction. Even though the limitations of the marketing orientation implementation in health care are obvious, they still do not make the possibilities for its implementation non-existent. When compared to the public health care sector, private sector is in a much more favourable position when it comes to the implementation of the marketing approach, but is in a more disadvantageous position when the state's attitude to the two sectors is considered.

## 2. Opportunities for the marketing orientation in Serbian health care

A difficult and time-consuming process of transforming the existing into the marketing business orientation lies ahead of Serbian health care institutions. Health care protection of Serbian citizens is achieved through the health

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<sup>2</sup> Less than 1% of all health care institutions in the US were implementing the marketing business orientation in mid 1990s.

<sup>3</sup> Health care service client is every individual or an organization that appear on the demand side of the health care market dichotomy. If a health care service client is an individual, then they can be a patient, sick or healthy, every individual who exercise their rights stemming from the Health Care Law and Health Insurance Law and every individual who endeavors to regulate the mentioned rights in someone else's stead or on behalf of their organisations. Health care service clients are not only medical service clients but they also make use of services provided by non-medical staff with a view to exercising rights to health care and other rights prescribed by law.

<sup>4</sup> The influence that state exercises on health care institutions differs in various countries, which has been brought about by different ways in which economies are established, countries' economic policies, their respective health care policies and health insurance provisions.

care institutions' operating. This protection, as performed by the health care service, entails enforcing health care measures and activities that, in line with the health care doctrine and the use of appropriate health technologies, are used with a view to sustaining and improving citizens' health.<sup>5</sup> Health care service in Serbia comprises health care institutions and other forms of health care (private practice) which are founded in order to ensure and enforce health care, but it also includes health care workers and associates who perform their duties in line with the Health care law provisions.

Changes made in favour of private sector in the proprietary health care status, along with the strengthening of competition on the health care market, serve to accelerate the shifting in the health care institutions' attitude towards conducting business and their role and position on the market. According to the Health Care Law of the Republic of Serbia (Article 46) a health care institution can be founded in the form of a municipal health centre, pharmacy, hospital (general and specialist), health centre, public health centre, clinic, institute, clinical-hospital centre, clinical centre. Private practice is carried out through individual offices of physicians and stomatologists (general and specialist), polyclinics, laboratories (for medical and clinical biochemistry, microbiology and patohistology), pharmacies, infirmaries (for health care and rehabilitation), and dental technique laboratories. Every citizen of the Republic of Serbia, as well as any other individual with temporary or permanent residence in Serbia, is entitled to the health care prescribed by law and they are at the same time under obligation to protect and improve their and other citizens' health, together with the living and working environment conditions.<sup>6</sup>

Market-oriented health institutions endeavour to provide quality health services by means of providing it in its entirety. Thus formulated goal should be primary upon establishing the marketing orientation in the operating of Serbian health institutions.

### 3. Medical service as the focus of the subject approach to the marketing studies

The development of the subject approach, the earliest in marketing studies, enabled studying of the marketing of some particular types of products and services. Marketing of producer and consumer goods, producer and consumer services, as well as business services marketing, are studied separately.<sup>7</sup>

<sup>5</sup> Article 5 of the Law On Health Care, "Official Gazette of RS" No. 107/2005, (In Serbian)

<sup>6</sup> Article 3 of the Health Care Law, *ibid.* (In Serbian)

<sup>7</sup> About characteristics of producer and consumer services and goods see: B. Maričić, *Ponašanje potrošača*, Ekonomski fakultet, Beograd, 2005; S. Vasiljev, *Industrijski marketing*, Ekonomski fakultet, Subotica, 2004; Ph. Kotler, K. L. Keller, *Marketing Management*, Upper Saddle River, Prentice Hall, New Jersey, 2005, pages 173-239; 402-432.

The rise in service participation on the whole market, along with the service-based competitive advantage in the changed and unpredictable business conditions, on the one hand, and rising contribution of the service-providing sector, employment rates increase and creation of the gross domestic product of the world's most developed countries on the other, proved reasons sufficient for marketing theorists to embark on the service marketing studying<sup>8</sup>, with marketing practitioners studying its application.

The application of marketing in a service sector is as characteristic as the nature of services within which marketing develops and gets implemented, along with the conditions in which services are provided and sought. This applies to medical services too. With this in mind, it becomes clear that it is necessary that medical services marketing should be studied, as medical services are as characteristic as the medical sphere itself and the conditions in which medical services are created, provided, sought and used.<sup>9</sup>

Health care is an organised and a comprehensive social function with one basic goal to achieve the highest possible level of maintaining citizens and families' health. It entails enforcing measures for maintaining and improving citizens' health, fighting, preventing and timely discovery of illnesses, injuries and other health impairments, as well as timely and efficient treatments and rehabilitation.<sup>10</sup>

Health care service is one participant in ensuring the implementation of health care.<sup>11</sup> By providing information required by individuals or the society necessary in order to act in a responsible way and exercise their right to health care, the health care service looks after citizens' health in the country.

Health care and looking after citizens' health are achieved through providing medical services.<sup>12</sup> They constitute the essence of studying and implementing marketing in health care, as seen from the viewpoint of the subject approach.

<sup>8</sup> Theodore Lewitt talked about marketing in the service providing sector as early as in the 60s, and continued dealing with the same issue in the following decade that was also marked by the impact of Philip Kotler and his books "Marketing management I" and "Marketing management II", *ibid.*

<sup>9</sup> Publications by domestic authors regarding medical service marketing are few. Readers can familiarise themselves on the issue from publications that deal with health care management and pharmaceutical management and marketing. B. Mihajlović, N. Kostić, *Menadžment u zdravstvu*, Čigoja štampa, Beograd, 2005; P. Mićović, *Menadžment zdravstvenog sistema*, ECPD, Beograd, 2000

<sup>10</sup> Article 2, Law on Health Care, *ibid.* (In Serbian)

<sup>11</sup> According to Article 4 of the Law on Health Care of the Republic of Serbia, apart from medical institutions there are other entities participating in ensuring and implementing health protection, and these are citizens, family, employers, educational and other institutions, humanitarian, religious, sports and other organizations, associations, health insurance organizations, municipalities, towns and the Republic itself.

<sup>12</sup> More on the development of medical institutions here and abroad see: B. Mihajlović, N. Kostić, *ibid.*, pp. 12-23.

In order to embark on formulating a palette of offered services, defining of quality and design of both individual medical services and medical services in their entirety, marketing managers ought to know the nature of medical services, characteristics of the medical service clients' needs and motives they have when claiming their rights to these services.<sup>13</sup>

#### 4. Marketing challenges in health care

##### 4.1. *The nature of medical services*

Looking from the viewpoint of standard features differentiating services from products, services can be said to be intangible, inseparable from source, difficult to standardise, their servicing and providing guarantee for them is very difficult to achieve, as well as putting objections and complaints with regard to them, replacing and storing them. The listed identifying features of services determine a specific approach to the service management, which also applies to medical services. Apart from this, marketing managers ought to know the medical service nature, primarily from the medical and marketing-economic viewpoint. Studying the nature of medical services calls for a multidisciplinary approach takes into consideration psychology, sociology, philosophy, economics, law, politics and demography.

Providing and making use of medical services usually require that both parties should be present- both health care staff and medical service client. The presence of both parties is crucial when health care staff is in essence medical staff (doctors) and clients are in the capacity of patients, whilst the requirement is absolutely indispensable in the case of urgent medical interventions. Making use of medical services can rarely be postponed, except in those cases when specific times for providing of a service have already been scheduled; sometimes it is urgent and is getting increasingly unpredictable. The decline in predictability with which certain medical services are used by individuals and the whole society comes as the result of a new modern living style in which requirements for medical services have become less transparent, but when they do (suddenly) arise, then a rapid delivery is called for. This is the reason why health institutions find it difficult to harmonise demand and supply.<sup>14</sup>

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<sup>13</sup> The package that is on offer reflects the variety of medical services and products.

<sup>14</sup> Services or products demand oscillates daily, seasonally or periodically. Medical service demand is affected by seasonal influences (virus infections in the winter time, allergies in the spring), but also by a number of factors from an individual's environment, which increase the unpredictability of demand and disproportion between the planned supply and the projected demand.

Providing of medical services is characterised by a distinct disproportion between the time spent in waiting for a service to be provided and the time that its delivery takes up. This is especially prominent in those cases when service supply entails various individual services.<sup>15</sup> When there is a whole set of services to be delivered then individual services from the set require different waiting and delivery times respectively, which, in turn, leads to a misbalance amongst individual times within the total time needed for the set of services to be provided. The synchronisation of individual waiting and delivery times is a task for marketing managers operating in the sphere of logistics.<sup>16</sup>

The nature of medical services is such that the quality of service delivery and quality of the service itself<sup>17</sup> constitute a foundation for the formulation of clients' opinion on the services and institutions providing them.<sup>18</sup> After retaining the same opinion on a service and the institution providing it over a longer period of time, the client starts appreciating the service, which then makes a basis for the creation of an image in their mind on an institution and the services it provides. Clients' positive opinion on an institution and the services it provides is a good indicator of an efficient exchange within which client appreciates highly the institution and its services. Long waiting queues made up by medical service clients and excessive resource engagement in inadequate conditions present in Serbian public health institutions serve to create an inefficient exchange within which citizens think not too highly of either the services or the institutions providing them.

Marketing managers can contribute to clients' improved opinion of services through the following:

- Creating sets of medical services which could respond to some clients' specific needs and requirements;

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<sup>15</sup> As an example, it suffices to mention a surgery that offers several services at once, different with respect to either the delivery time or waiting time for the following service to be carried out but cannot be executed before the previous service is performed. Also, a recommended series of several individual therapies that take up different time intervals can have different delivery times per therapy. Each therapy can require the patient to check in and out with the administrative and auxiliary medical staff before and after a therapy, whilst consecutive therapies do not allow big time lag in between.

<sup>16</sup> V. Milanović-Golubović, *Logistika*, Megatrend univerzitet primenjenih nauka, Beograd, 2005, pages 36-38.

<sup>17</sup> The quality of service is considered in marketing terms to be more difficult to measure than the quality of product.

<sup>18</sup> According to a survey on the satisfaction of medical service clients published in "Dnevnik online", Novi Sad, June 21<sup>st</sup>, 2004, and D. Kocijan-Hercigonja, J. Despot Lučanin, *Komunikacijske vještine u radu zdravstvenih djelatnika*, priručnik, Ministarstvo zdravstva i socijalne skrbi Republike Hrvatske, Zagreb, 2004

- Coordination of individual activities in the process of delivery of medical services from their source to clients (logistics);<sup>19</sup>
- Creation of a characteristic kind of relation of health care staff with medical services clients.<sup>20</sup>

The mentioned areas can easily be made separate spheres for studying by both marketing theorists and practitioners with a view to further developing medical service strategies, medical service related logistics strategies and medical service client communication strategies.

#### 4.2. Characteristic features of medical services clients' requirements, motivation and conduct

People have different requirements. Different strivings lie at the bottom of different requirements. However, all the strivings to satisfy the requirement for medical services are made up by one and the same – wishing to be healthy.

Requirements for medical services are very characteristic as they contribute directly or indirectly to every human being's health protection, maintenance or improvement. Satisfaction of the requirements is largely influenced by the level of satisfaction of both inherent and acquired requirements as well as by the level of implementation of the Maslow hierarchical scale of requirements.<sup>21</sup> Related to this, medical service requirements can be said to be derived, which does not contradict the fact that they are treated as primary in the slightest

<sup>19</sup> Service logistics aim at shortening the service delivery time and service reception time, increasing the delivery capacity and the service capacity, enhancing the quality and security of the service delivery. V. Milanović-Golubović, *Logistika*, *ibid.*, page 36.

<sup>20</sup> Experiences of medical institutions' managers' from the south-east of Serbia indicate that the communication between medical staff and patients is very poor. The opinion is that the main reason for this, apart from poor working conditions and inadequate system of financial incitements, is medical staff's insufficient education in the areas of marketing and management, which only intensifies their unfavourable understanding of the relations between medical staff and patients. These findings resulted from the exchange of experiences at the educational seminar "Communication with patients and users of medical services", I part, Medical centre, "Zaječar" and Faculty of Management in Zaječar, Megatrend University in Belgrade, April 15th, 2006

<sup>21</sup> Maslow's hierarchical scale of needs is based on physiological needs, further developed by needs for safety, social needs and needs for respect and finished by needs for self-confirmation. According to Maslow, clients satisfy their physiological needs first, whilst self-confirmation comes last, once all the other sub levels in the scale of needs have been accomplished. V. Milanović-Golubović, *Marketing menadžment*, Megatrend univerzitet primenjenih nauka, Beograd, 2004, pp. 135-136. This condition primarily reflects a psychologically disturbed individual, and indicates one's physical dysfunction too.

Health care marketing managers ought to be aware of all the factors that influence the manifestation of medical service requirements.<sup>22</sup> These are psychological, sociological, philosophical and economic factors which manifest themselves in various different ways depending on the level of development of economic and social systems<sup>23</sup> and health care systems' organisations. Psychological factors that influence medical service requirements are opinions, prejudices, viewpoints and individuals' characters. It is important to be aware of the following sociological factors that have impact on the medical service requirements and their manifestations: the influence of culture, education, social status, origin, marital and family status, individual's social role and living style. Attitude towards religion, religious affiliation, attitude to philosophy and other philosophical factors can be important for the manifestation of individuals' and groups' requirements concerning the delivery of medical services. Possibilities for the fulfilment of requirements for medical services are also influenced by some economic factors, amongst which living standard and buying capacity, working status and job are most dominant.

Experiences of working with patients in Serbian health care institutions<sup>24</sup> have shown that sociological and economic factors do not guarantee that clients will rank in their mind the requirement for medical services as primary. Psychological and philosophical factors are effectively stronger allies to the internal motives that incite clients to satisfy their requirements.<sup>25</sup> A new role of the marketing in health care should be developed accordingly, and it regards the education of clients to the effect of enhancing their care for health and raising their awareness about the necessity to rank the requirement for medical services as primary, especially those requirements that have preventative and instructive-educational character.

The first association with the majority of clients with respect to medical services is either pain or fear. This is clearly justified as pain is with the majority of clients a signal for visiting a medical institution, after which they tend

<sup>22</sup> This does not relate to the factors that determine operations on the health care service market.

<sup>23</sup> On environmental factors affecting client's conduct, including international surroundings factors- important in the globalization of medical services, see: V. Milanović-Golubović, *Međunarodni marketing i globalni biznis*, Megatrend univerzitet primenjenih nauka, Beograd, 2005

<sup>24</sup> V. Milanović-Golubović, "Marketing menadžement sa upravljanjem kvalitetom u zdravstvu", educational seminar "Health care management" organised by the Faculty of management in Zaječar, held on February 24<sup>th</sup> 2006

<sup>25</sup> Though urban, more educated and well-to-do people are expected to be more health care oriented, it is not a rule in our practice. The concept of the need to protect one's health depends primarily on one's character and upbringing. In theory, medical service requirements are primary. But in practice their fulfillment is often marginalized due to some individual, aforementioned factors the manifestation of which results in these requirements being delayed in clients' minds.

to put the visit off due to the fear or feeling apprehensive regarding diagnosis. Psychological and physical pain should not be primary incentives for fulfilling requirements for medical services. The role of pain as an incentive should be brought to minimum with regard to requirements for preventative medical services. By promoting medical services of the preventative and instructive-educational nature the pain will be sidelined as a primary motive for the fulfilment of requirements for medical services, along with the fear being an intense emotion experienced upon their delivery. Such marketing role cannot be marginalised by any economic measures; neither can it be diminished depending on whether an institution is state-owned or private.

Marketing holds emotions to be equal motivation to reason, often even more important than reason, with respect to the inciting of clients to have their requirements fulfilled.<sup>26</sup> Though they rule reason, certain emotions can cause the expression of some irrational motives regarding the fulfilment of requirements for medical services. For example, if a person is effectively hungry then hunger is a rational motive for buying food and it becomes an irrational motive when a person is not hungry but craves food. However, actual hunger can cause fear with someone who is constantly hungry despite taking regular and substantial food intakes. In this case fear will act as an emotional motive that incites reason to seek medical help. Fear acting as an emotional motive can bring about either moderate manifestation, complete absence or excessive manifestation of requirements for medical services (hypochondria). In the first case, there is a balance between requirement and wish, in the second case there is an actual requirement but wish is lacking, whereas in the third case there usually is not a realistic requirement, but there is a strong wish to satisfy needs for medical services. Requirement for medical service will be fulfilled when there is a complete harmony between requirements and wishes; paying capability is required too with some services. It is the role of marketing to bring clients' requirements and wishes in line and to stimulate the fulfilment of requirements and satisfying of wishes by offering a variety of requested and sought after services appropriate for clients, given their paying capability (insurance or paying privately). So in this scenario marketing performs economic and social function as it offers to clients an opportunity to assert their rights as social beings, these being the right to choice and the right to satisfaction.

There are few medical service clients who do not feel anxiety, apprehension, uneasiness, distrust or unrest. These emotional conditions result from uncertainty, potential physical and (or) psychological pain, shame. That is why medical experts as medical service deliverers should have marketing skills necessary in order to recognise client's type of conduct. Firstly, these are skills to create a client's psychological profile, as well as profile of individuals from

<sup>26</sup> In more detail: V. Milanović-Golubović, *Marketing menadžment*, Megatrend univerzitet primenjenih nauka, Beograd, 2004

their surroundings who exercise significant influence,<sup>27</sup> and secondly, to create the profile of a type of conduct exercised by a client before, in the course of and after using medical services. By means of this they are in the position to speed up the process of clients' taking decision about making use of a medical service, depending on the type of "purchase",<sup>28</sup> with a view to converting the services of providing treatments and rehabilitation into preventative type of services in the course of the following cycle of using the services.

Speeding up of the process of making decision with respect to medical services use does not happen with the clients who try as hard as possible to avoid the fulfilment of medical requirements. Due to fear over finding out the truth about one's medical condition, many clients would rather not satisfy their medical requirements at all, thereby limiting the curing opportunities in the situations of timely diagnosis. On the top of that, ill-informed or under-educated clients, especially from rural parts do not respond to proposed therapies or recommendations<sup>29</sup>, which postpones all the activities that otherwise would have been undertaken to stimulate the client to go as quickly as possible through certain stages in the process of making decisions on the further use of medical services in the institution in question. For all the mentioned facts, Kotler's model of decision making in the process of "purchase" cannot be automatically applied to medical services. The model comprises the following stages: recognition of the problem, collecting information, assessing alternatives, deciding on the purchase itself and after purchase conduct. Apart from the mentioned reasons that explain avoiding of both the problem recognition and information collection phases, medical service clients are limited when it comes to the assessment of alternatives too.<sup>30</sup>

Transformation of the service of providing treatment and rehabilitation into preventative services in the following cycle of using the services is possible when marketing managers, having prior knowledge on the factors that shape clients' conduct before, during and after the use of a medical service, can influence clients in the sense of inciting them to use the services again, especially preventative services. For example, regular check ups that some clients undertake are a good indicator of their satisfaction after making use of a previous service- service of treatment.

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<sup>27</sup> Members of the closest family usually

<sup>28</sup> When choosing and making use of medical services clients can exercise both simple and complex type of conduct, which is influenced by the type of service, type and urgency of the requirement, as well as the level of risk carried by a wrong choice. Ph. Kotler, K. L. Keller, *ibid.*, pp. 191-210.

<sup>29</sup> Under-educated and ill-informed medical service clients do not understand diagnoses made in Latin Therefore, they do not feel advance fear that could bring about a particular pattern of conduct and ultimately shape their approach altogether.

<sup>30</sup> The urgency of needs, lack of financial resources, insufficient supply or monopoly over certain services

The role of the marketing theory and science is to create developmental strategies with regard to relations with clients, all based on their psychological profiles and type of conduct they display before, during and after the use of a service. It is only in the long run the implementation of these relation strategies can result in clients' loyalty to the institution and the service

The experiences of Serbian medical institutions and personal experiences of medical staff<sup>31</sup> confirm the low level of our citizens' health education and awareness; also, what often lacks is medical staff's educational, advisory and informative role in their dealings with clients at their working place. This is why Serbian medical institutions ought to create and implement particular developmental strategies concerning the relations with medical service clients which should be modelled according to their psychological profile and the type of conduct, with a view to enhancing clients' trust and providing further information and education with respect to ranking medical service requirements as primary.

#### *4.3. Distinctive nature of the demand for medical service*

Creating a medical service offer is based on the advance medical service demand identification. Medical service demand identification requires that marketing managers should carry out a research and an analysis regarding more and less required medical services and their correlation.

Required medical services are those that clients voice demand for and make "purchase", that is, use them.

Less required or unsought medical services are those that clients do not voice demand for but they are nevertheless supplied by medical institutions. It is a role of marketing to inquire as to why clients do not demand certain services that are on offer. Upon identifying reasons for the lack of demand for certain services, measures are undertaken tailored to overcome the reasons for the lack of demand.

Medical service clients are entitled not to seek a service despite being informed and aware of its existence. The reason for this can be obligatory payments for the service, whilst at the same not being in the position to make use of the service or not trusting the value of the service or the institution providing it. If it is the case of clients' not being informed on the existence of a service and therefore not voicing any demand for it, then they ought to be duly informed through integrated marketing communication systems and in line with legal regulations on the medical profession advertising. If clients oppose or distrust

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<sup>31</sup> Medical centre "Zaječar" (Dr Nebojša Paunković, endocrinologist, Dr Jane Paunković, endocrinologist), Cardiovascular Institute "Dedinje" (Dr Goran Vučurević, cardiovascular surgeon), Gynecological-Obstetric clinic "National front" ("Narodni front") (Dr Anđa Knežević, Gynecologist-Obstetrician Dr Nikola Sanković, Gynecologist-Obstetrician), Institute of Oncology in Belgrade (Dr Neven Jokić, surgeon)

an institution or a service, it is a role of marketing to enhance clients' trust by creating a campaign that top experts in the field covered by the service will participate in.

Another factor that adds a negative aspect to the medical service demand is the presence of emotions. Related to this, medical institutions cannot be said to be popular, and are often avoided or abused.

As for those services that are not popular and are constantly avoided, means and tools that will serve to create a positive approach towards them ought to be created. For example, in case of a negative attitude towards a service stemming from the presence of pain upon using it, what should be done is to reduce the pain level upon making use of a service, especially when clients are children. In case it is due to fear that a service is avoided, doctors', psychologists' and other medical staff's role comes to the fore. Medical services are sometimes shunned through the feeling of shame, as for example in the gynaecological sphere, in which case it could be that adequately furnished space and appropriate equipment would help patients to feel more relaxed and pleasant and not to express the so called negative demand. It is a task of both medicine and marketing. But to identify unpopular services and establish causes for such a situation and attitude towards these is a role of marketing exclusively.

The abuse of medical services most usually happens with clients who are either hypochondriacs or excessively concerned and worried about their health. These people make use of medical services even when it is not needed. This leads to the conclusion about the significance of the educational role of medical institutions, equally to those people who are not in favour of or blatantly avoid medical services and to those who abuse them. By fulfilling their educational role medical institutions help the realistic manifestation of the demand for services, this being the demand that reflects clients' real needs.

When we talk about providing education for medical service clients with a view to raising their health care awareness and enhancing their understanding of the necessity to rank medical requirements, at least two target groups can be identified. The first group comprises clients who strongly oppose treating medical requirements as primary due to a strong negative influence of both psychological and philosophical factors. The marketing educational programme for this group must be based on psychological influences that could shatter their preconceived ideas, opinions, stance on the role of religion or faith when satisfying one's needs for medical requirements. These programmes usually prove to be difficult to realise as such groups can include at the same time educated, well-informed and medicine-wise extremely knowledgeable clients on the one hand, and under-educated and ill-informed clients who are under an overpowering religious, philosophical and other influences on the other hand. The second group encompasses clients who are under stronger influence of social and economic factors. It is easier to tailor a marketing

programme for such groups as in these cases the main reason for not treating medical requirements as primary is either an inadequate level of personal education or jeopardised social and economic status. Therefore, informative and advisory role of medical staff gains more significance.

By fulfilling their educational, advisory and informative role with a view to enhancing health awareness and underlining the realisation about the necessity to rank medical services as primary, especially preventative and services of instructive and educational character, staff is building a characteristic rapport with medical service clients. This rapport can be a more effective advertising means than others put forward by the marketing theory and practice. Based on an Internet survey regarding the operations of both domestic and international medical institutions and organisations, some new medical services have been identified that could result in Serbian medical institutions' repositioning on the medical service market. These are the following services: compulsory periodic medical check-ups for all categories in the society, educational services in the health care domain which can be realised through lectures in schools and companies, health care tourism services, services regarding the development of organic food, as well as services aiming to promote the quality of health and life in general.

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Book review

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## ONE HUNDRED YEARS OF COPPER PRODUCTION IN BOR

*An essay on the book "One hundred years of mining in Bor (1903-2003)"*

*By Božin Jovanović PhD and Miodrag Đurđević,*

*Mining and smelting basin "Bor", Megatrend University, Belgrade, 2006*

The development of Bor basin is a major achievement in Serbia's economic development. Even at the beginning of the 20<sup>th</sup> century it was a known fact in Serbia that the whole country was under a great pressure from an extremely dense agrarian overpopulation, the assessment that was accepted by both Kingdom of Yugoslavia's and Socialist Yugoslavia's analysts of economic development. This phenomenon could not be mitigated otherwise but by initiating the industrialisation process. It was hardly likely that mistakes would be made in the early stages of industrialisation, considering the given natural sources' structure and almost no industry to start with. Given the colour metallurgy factor, the development of mining was a reasonable choice in the economic developmental policy.

As in some other industrial branches, some of the first companies were founded by foreign enterprises. Thus, French owners of the company found the enterprise very profitable in the first stages of the development of the Bor basin, as they were making hefty profits. Apart from the financial profitability, it turned out after the Second World War that the Bor basin was bringing an even bigger economic benefit. Even if the basin had been a money-losing enterprise, it would still have been enabling the development of the basic colour metallurgy products. But if we consider all its other economic benefits such as creating new jobs, increasing the number of qualified workers, building infrastructure, improving people's education and health, the Bor basin's contribution to Serbian industrialisation process cannot be overrated

The Bor basin, along with others, is finding itself nowadays steeped in crisis. It is hard to predict what will happen to it. This situation makes it therefore very important that the one-hundred-year long copper production in Bor should be recorded so that it is known: Serbia could do it when it wanted! And now it is silently watching the annihilation of its industry. The authors Božin Jovanović PhD and Miodrag Đurđević undertook an extremely difficult and responsible task. Having taken part in the Bor basin history themselves, it was now on the two of them to unravel that same history in an objective and impartial way, leaving it to the future generations to pass their judgement. They could hardly find anything in historiography sources. The bulk of the information comes from the well kept, neat and ordered reports from the basin itself. This makes them contributors to the historiography of Serbian industrialisation and economic development. The thorough approach they assumed when tackling this task delineated both the book's structure and the manner of expression. Though written in an understandable and clear language, it still does not make compromises in order to appeal to broad audience. All crucial statements in the book are upheld by evidence in a very comprehensive way. Those who are not in favour of graphs and charts will be able to realise that the authors speak only based on facts and evidence.

The book is substantial and multi-tiered. It is not necessary that it should be read in a proper order and in its entirety but there will certainly be parts to which readers will be returning. The book's structure is not a matter of routine either. The first four parts offer a chronological overview of the copper production in Bor in the period between the French ownership and the end of the first restoration period after the Second World War. In the following ten chapters the contemporary development, categorised by key areas and projects in the basin, is shown and analysed.

The first part tells of the operation of Bor mines under French ownership, up till the end of the First World War. The second part refers to the in-between wars period (contributed by Smiljana Đurović PhD). The third part reveals the Nazi Germany's intentions to get as much copper from Bor as possible, in order to support its war industry. The fourth part explains the arguments based on which the copper production in the socialist Yugoslavia was rightly given the treatment of one of the more important developmental directions. It is fascinating to learn from this and other chapters about a people, who, whilst living in a war-crippled country on the average national income of around 200 dollars per capita, managed within only 2-3 decades to revive their basic hard and refining industry, create industrial workforce, urban centres, general education and health protection. The Bor basin is a fine example of the process as it made the abovementioned achievements possible for a huge part of Serbia.

In ten chapters of the fifth part the production diversification process in the Bor basin is described. The process ran both horizontally and vertically.

Horizontally, the industry was expanding to other branches (chemistry, artificial fertilisers, agricultural equipment, non-metals etc). Vertically, copper-based production was making inroads into the refining stages.

Serbian and Yugoslavian developmental policy meant that refining branches of the coloured metallurgy and, linked to it, electro industry as well, were being scattered all around the country. This accounts for the fact that the Bor basin started its so called fifth developmental stage later than it would have been the case in standard market conditions. A hundred-year period is a rewarding and challenging topic but also a risky incentive for writing, analysis and assessment. But it is undoubtedly valuable and important for getting an insight and describing the life of a mine, the town of Bor, the Bor region inhabitants and the Timok region history. But it is much more than that. Looking at the period through a time gap that demands an objective approach, the authors describe and view analytically Bor's numerous economic and social developmental stages in an impartial way, they hold witness to the Bor mine's invaluable treasure and describe life of the people in the region, thus keeping it away from oblivion. Through its hundred-year-long existence the Bor basin always had a prominent role in the economic but also the overall development of the region and Serbia. In each phase of its rich blossoming it bestowed a characteristic stamp on the spirit of the time. There is an abundance of evidence, documented and substantiated by figures and data, which bear testimony to the never-fading values and achievements of the mining and metallurgic giant of Serbia throughout its rich but long and strenuous economic and social development. By assuming such an approach, the authors have contributed greatly to the historiography in the area of industrialisation and Serbia's 20<sup>th</sup> century economic development.

This ambitious book of a large scope and varied contents, with an opulence of historiography data and facts, was enriched by some valuable remarks created by experience and common wisdom that the authors have in no short supply. The book was written in a smooth and comprehensible style, at the same time meeting the taste of the most demanding readers but also being understandable to everyone. The book is also endowed with an inspired humour sprinkled with some wistfulness and mild nostalgia. Even more so than a monograph, the book surpasses a historiography piece of writing about the hundred-year-long industrialisation and economic development of the Bor region. It can be added to the invaluable and forever lasting literary achievements' milieu, as it is an indeed impressive chronicle of the tempestuous times in the past but also a testimony to the creative efforts and human's incessant renaissance endeavours.

It would have been every publisher's privilege to release such a book but in this case it was Megatrend University that published the book with a view to raising young generations' awareness but also to incite them into action among

gust all the ever-present challenges imposed by the requirements for a better life and faster development. The book is based on experience and enthusiasm of the past generations who are leaving to the posterity some valuable works and a signpost to success whilst constantly striving for a better life and continuous development.

The authors showed by this book that even in the hard times, poverty and hardships it is possible to create and develop a new, more quality life and people's collective enthusiasm thanks to the persistence, diligence and wisdom of our hard-working people. Božin Jovanović and Miodrag Djurdjević were very ambitious and set about a difficult task of rounding off the Bor basin story, modelling it in a literary whole and a work of permanent value. This is a task they completely succeeded in, exhibiting full awareness about the responsibility for written words, assessments and conclusions made.

When talking about the future, the authors claim that Mining-smelting basin "Bor" will by no means be ever again what it used to be. This is a cruel truth that resulted from the times and circumstances which we live in. However, the most competent judge –time, will certainly show if the basin can continue mission of the old bearer of the development of Bor and Majdanpek and the Timok region, the mission of one of the most important economic development pillar's in the whole of Serbia.. That is what the today's economic entities, creators, but also this region's inhabitants should be striving for. The Bore mines' precious resources, created and multiplied throughout the 20<sup>th</sup> century, should be saved and should serve to a better life of the present generations and people of the region.

The authors are eternal enthusiasts and their message, in a true vein of irrepressible optimists, reads: "Bor will shine again with its rich turnover and its financial results". Undoubtedly, the history of the Bor basin, the Timok region and Serbia will be built in this century by means adapted to a new time and different circumstances. The history will be built by the generations who a rich legacy and experience have been left to. They are fortunate in that they do not have to and need not start from the scratch. They should only lean their wisdom, knowledge and energy against the diligence, bravery and former Bor basin builders' legacy. By means of their own experience, works and impact left, the authors are convincing us here that it is feasible to achieve unimaginable results in hard times, even in our transitional times, all through the sheer hard work, responsibility, bravery and enthusiasm of people.

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## THE IMPORTANCE OF BUSINESS CULTURE

*An essay on the book "Intercultural challenges of globalisation"**by Professor Mića Jovanović Božinov, PhD**and Assistant Professor Ana Langović-Milićević, PhD,**Megatrend University, Belgrade, 2006*

Globally taken, contemporary business conditions demand that, apart from effective strategies and business offers, businessmen should (as well as politicians and scientists) also know as much as possible about the culture and customs of the other negotiating party. Back in 2002, bearing in mind this intercultural aspect of globalisation and its importance in the contemporary economy, the authors, Prof. Mića Jovanović Božinov PhD and Assistant Prof. Ana Langović-Milićević PhD, wrote a book entitled "Intercultural management" that was published by Megatrend University of Applied Sciences. The book was primarily a handbook, that is, it was intended for the first and fourth year students who studied management, but having passed the test of time, it turned out to be a very useful guidebook for a considerably broader reading audience in the management field. The first part of the book concerned intercultural management, and business culture within individual regions was also considered in it. The second part of the book dealt with the basic theoretical principles of management and potential solutions to modern companies' problems. At the beginning of 2006, a publication dealing with a similar issue was released, but it was at the same time considerably enriched with new ideas, amended and updated. The authors were the same and the publication was entitled "Intercultural challenges of globalisation". It deals with the subject of intercultural management, that is, individual countries' business culture patterns.

Yet, Prof. Mića Jovanović Božinov PhD and Assistant Prof. Ana Langović-Milićević PhD, had cooperated successfully even before that, which resulted in two more books "Strategic management" (2001) and "Project management" (2001).

Speaking of the authors, it should be noted that Prof. Mića Jovanović Božinov PhD, has been Megatrend University rector since 1991 and London based

International Expert Consortium chairman. Also, for a number of years he was on the Euro-Asia Management Studies Association (EAMSA) executive committee, based in London and Tokyo. He has produced a great number of scientific and academic writings published in domestic and foreign magazines on management, economy and organisation issues. Professor Jovanović gave lectures at many worldwide universities, among which at the British Bradford and Portsmouth Universities, then Hosei University and The University of Tokyo (Japan), as well as at the National University of South Korea. He works currently as a professor at the Faculty of Management in Grenoble (Grenoble Ecole de Management) in France. He has also appeared as author or co-author of 11 books published both here and in Great Britain.

Assistant Professor Ana Langović-Milićević PhD works currently as Vice Dean at the Faculty of Art and Design, Megatrend University. She graduated from the Faculty of Organisational Sciences, where she also got her MA degree. She completed her PhD studies at the Faculty of Business Studies, Megatrend University. She worked at the Faculty of Organisational Sciences at the beginning of her career where she, showing a great talent for scientific and research work, took part in a strategic project "Company transformation management", financed by the Republic of Serbia Ministry of Science and Technology. She is working currently with other colleagues on a Megatrend University strategic project financed by the Republic of Serbia Ministry of Science and the Protection of Environment and called "Strategic options regarding the economy of the Republic of Serbia becoming a part of the world's economic flows – influence of the electronically-run business on the domestic market restructuring". Assistant Prof. Ana Langović-Milićević has also published a number of scientific and academic writings and appeared as co-author on several books.

Structure-wise, "Intercultural challenges of globalisation" could be conditionally split in two units. The first part, that is, its beginning, concerns defining and explaining some of the basic terms used and mentioned in the book: culture, material culture, cultural dimension and intercultural management. The second part of the book deals with individual countries' or regions' business culture. Twenty-two countries have been covered by this overview in total and presented as follows: Germany, Austria, Switzerland, France, Italy, Portugal, Spain, The United Kingdom, Ireland, Netherlands, Finland, Denmark, Russia, Japan, China, Singapore, Malaysia, India, Arabian Middle East, United States, Mexico and Israel.

What also should be stated is that this monograph abounds in colour photos (47 in total), which contributes largely to the visual, but also the overall quality of the book. As expected, photos are ordered by subject with one main purpose to illustrate and make it easier to readers to envisage a country or region in question.

It is also important to mention that all practical matters that could be of use to a businessman (manager) having a meeting abroad concerning every analysed country have been explained respectively, starting with business meeting dress codes, then seating arrangements at negotiating tables, conduct for the duration of a meeting, but also a preferable way of conduct at business lunches or when visiting a business partner's house. Unlike the first part, which is primarily theoretical and to a degree serves as an introduction into the subject dealt with by the book, the second part dwells more on practical aspects and offers abundance of good advice concerning successful negotiation practice. Thus, readers will find out a great number of new and utterly interesting facts, such as the fact that for example in Russia a business partner is likely to invite you to their home but what you ought not to be doing at any time upon such an occasion is exhibit excessive admiration for any of the individual items seen there, as otherwise, the host will feel obliged to give away the object of admiration as a present. Or, another example: in case you take part in negotiations in Japan, it is desirable that people who are in charge of running the negotiations on your side are of the same rank as your Japanese partners', as any other practice will be regarded as an insult. On the other hand, it is not superfluous that one should get familiarised themselves with the fact that the Chinese are in the habit of consulting horoscope during business negotiations, that is, they assess whether their business partner's star sign is a good match with their own, and then direct the business negotiation flow accordingly.

Another integral aspect of the book is its intention to instruct readers on religion, customs and culture of a people or a region. Numerous examples displayed in the book speak volumes about the importance of this aspect of the book. Namely, it happens (and not rarely!) that even big international companies make major blunders when entering a foreign market, precisely due to the lack of knowledge on the local language or culture of the country where they endeavour to offer their products or services. There are several examples in the book concerning this issue. When Parker Pen launched his biros on Mexican market, slogan that was supposed to inform customers on the pens was: "These will not leak in your pocket and embarrass you". However, the company used Spanish word *embracer* as the translation for *embarrass* (or bring someone to an unpleasant situation), which in the end resulted in the slogan meaning: "These will not leak in your pocket and leave you pregnant". There is another example from Italy, where Schweppes Tonic Water was translated in the advertising campaign as "Schweppes Toilet Water". These and such like examples should serve to all businessmen as a good lesson on how misinterpretation, inadequate communication or lack of understanding of other nations and their cultures can seriously damage their business dealings.

Readers will notice that this book gives preference, in the sense of more space and attention, to certain countries over others when explaining their

respective business culture patterns. Besides, the countries with “preferential treatment” are France, Japan and the United States, which is by no means a random selection. There are fully justified reasons for such authors’ decision, and these are explained in the book. As for France, it is marked by some unique characteristics when it comes to its educational system and the way it operates in France could to a large degree indicate to us towards a preferable model of the domestic educational system restructuring with a view of rendering it more efficient than the earlier ones. On the other hand, Japan, a country that is the epitome of the success and resourcefulness of the Asian region (the part of which is its cooperation with a new world’s economic wonder-China), is seen as an indispensable business partner to a growing number of countries. And finally, the United States, a country that has been holding monopoly over the whole world’s economy for years, which makes it quite clear as to why it was given a proportionately bigger space in the book when explaining the globalisation and business culture phenomena.

When explaining the French economy phenomenon, authors of “Intercultural challenges of globalisation” endeavoured to consider all main factors that resulted in the creation of a strong France but also to give an overview of the French economy’s crucial advantages. France has had great economic results for years and is one of the European Union’s founding fathers. Primarily owing to, amongst other things, a solid education system for the young, it has managed to stand out in the region and enable its economy an unhindered development. Prof. Mića Jovanović Božinov and Assistant Prof. Ana Langović-Milićević point out that a French top manager’s life and career path is very strenuous and demands even during school years a maximum dedication to the final goal which is the completion of university education (*grandes écoles*). In order to reach the university level of education in the first place, future students have to complete first good Grammar Schools or Lyceums, after which they can apply for entering universities. Graduation exams at Lyceums are a prerequisite for taking university entrance exams. Needless to say, there are differences amongst lyceums’ graduates, depending on whether they want to graduate from sciences or economic and business studies. Sciences’ graduates have the best entrance success rate, on the grounds that they opted for the most difficult option, that is, the one that carries the highest number of points. There are two types of universities in France: -first, of technical character, and second, which is commercial. A majority of the schools are technical and these are more renowned, whereas commercial ones are fewer, though with an increasing popularity attached to them recently. Regardless of the lyceum graduation exams being a prerequisite for entering any university, those lyceum graduates with the best results who want to enrol at the university are under obligation to take the national entrance exam that is referred to as open competition. It takes one sometimes up to two years to prepare for

the entrance, the period of time that lingers in candidates' minds forever, or, as put by the authors: "the hardest life experience; it requires ultimate effort, maximum concentration on the studies, sleepless nights, and has as its final objective almost feverishly craved victory, one of the grandest in one's life". With this method of young experts' formation in place, it becomes quite clear how France manages to overcome economic difficulties and continually find new ways of advancement in this world of globalisation.

Japanese culture, religion, business culture and economy are given the most space in the book, and it has got to be noted that this is a somewhat pioneering attempt in our country to get to know Japanese culture and economic practice. It is a common handbook practice to refer to Japan and its ways of getting to its current position in the world's economy as "economic wonder". However, in this book readers will be able to find out about Japan's another dimension (the cultural dimension) which has played a grand role in the Japanese economy creation. Confucianism, (which is "more of a life philosophy than religion, as it teaches on the terrestrial life", and which defines both relations amongst family members and general public relations) and Shintoism ("which teaches that Japanese emperor is a reflection of Japanese state") have been modelling Japanese frame of mind over the centuries. However, it was not before the end of the 19<sup>th</sup>, beginning of the 20<sup>th</sup> century that capitalism made a great entrance into Japan, primarily thanks to Shibusawa Eichi. He introduced the Confucianism's moral principles into capitalism and enabled that businessmen were viewed as moral beings without being exposed to caste prejudices. In its development through history Japan undoubtedly underwent an extremely difficult period when its economy was in shambles after the Second World War. However, precisely owing to the Japanese culture that values greatly diligence, discipline and respect amongst people, Japan managed to overcome this situation and to restore its position in the company of the world's economically developed countries as early as in the 70s. The authors are posing some crucial questions here, both to themselves and readers: a) to what extent will Japanese culture have to adapt to the Western system of values in the conditions of globalisation; b) will Japanese economy resist Western countries' pressures with regard to limiting its further expansion? In reply to these questions Prof. Mića Jovanović Božinov and Assistant Prof. Ana Langović-Miličević state the following values of the Western civilisation that Japan would have to integrate into its business culture in order to adapt to the current global climate: "intercultural tolerance, sex equality and equitable employment opportunities, working life democratisation, that is, working hours decrease". Regardless of certain difficulties that Japan will undoubtedly be facing in the process, the authors are convinced that these adaptations will be carried out in a satisfactory manner. Namely, given that Japan and its culture have managed to adapt to the numerous environmental changes so far

and still maintained its top position, it is only natural to expect Japan to adapt successfully to the latest global challenges.

As for the United States, it is a known fact that scientists and experts from the country have significantly contributed to the management theory development, helping in the process the States' economy to develop into one of the worlds largest. In this view, it is of no surprise that a considerable space in "Intercultural challenges of globalisation" is allocated to the States. For example, if we just cast our minds back to Frederick Taylor, the first scientific management theory creator and the founder of the first business school in America (in Pennsylvania). To what extent America was advanced regarding management issue in comparison to the rest of the world shows a fact accentuated by the authors that: "almost 60% of young Americans were studying business and management at America's famous universities even back during the period 1950-1960". The authors are also using the segment in the book on the States to point to the American management superiority that lasted till the 70s when there was a shift in the world's top economic powers. It is interesting to consider all the means Americans have been employing in the meantime in order to catch up with and overtake the world's new global leader- Japan. In connection with this, for example, American economy introduced and has maintained since one of the most prominent legacies of the Japanese economy-the quality control practice, which the Japanese have always been unparalleled at.

There are undoubtedly some typically American business culture characteristics that have proven extremely beneficial- the quality of being proactive and systematic. The authors are asking: Why are these features so important? It is not difficult to answer the question through reading the text, as the answer forces itself upon us: great desire to succeed, to achieve victory, to advance and improve, as well as striving towards establishing a kind of order, all of which present an excellent foundation for any kind of activity or management. And these are all features that the States have long managed to implement and perfect to maximum.

One of the book's major messages could certainly be intended for the domestic economic entities. If Japan, a country with a long-standing, overpowering tradition that has been reinforced over centuries, managed to adapt its business policy and culture to capitalism, or if Americans, the global leaders in almost all life spheres, could still learn willingly from the Japanese and take over some of their cultural values, then such like examples have to serve us as a great lesson. Namely, it is only through learning from others' experiences, whilst at the same time retaining our own cultural values and heritage, that we can mend some of ours faults and consequently join, as the authors put it, the intercultural game.

The conclusion is that "Intercultural challenges of globalisation" entails several different levels of findings, which, in turn, both individually and as a

whole, enable us to get a full insight into the business culture and economy of some countries at the beginning of the 21<sup>st</sup> century. Though we have already stepped into the new century, where undoubtedly grand global innovations and changes will be facing us, what this book seeks to underline is precisely the need to accept all these changes and understand that culture, economy and history go together- arm in arm. It has been proven repeatedly that keeping one's own cultural heritage and identity, alongside with staying open to the world and other people's experiences, enables better social and economic development.

The authors of this innovative and interesting book have also drawn our attention to the position of intercultural management as one amongst several potential factors of the competitive advantage. Related to that, managers who wish to stand out with their negotiation readiness and skills, together with their knowledge of other cultures, will certainly find abundance of useful information and advice in this book.

On the top of everything already mentioned, the authors of "Intercultural challenges of globalisation" deserve to be praised for their endeavours to present intercultural management in a succinct, smooth and compelling way, and not only to students, who this book is primarily intended for, but also to a broader reading audience. Apart from an indisputable educational value that is reflected in presenting and analysing a new management area, the book has got yet another important dimension. Namely, it can serve as a useful guidebook to all businessmen, even diplomats, at all occasions of familiarising themselves with culture and economy of individual countries and regions across the world.

To sum it up, the following characteristics of "Intercultural challenges of globalisation" can be outlined as crucial: the book is written in a comprehensible way, it is interesting, didactic, with the contents that have a wide-ranging applicability in the business practice. These are all attributes that serve to recommend the book to a broad reading audience, who will without doubt be able to find in it a wide diapason of yet unknown facts about the business culture in general.

And finally, here is an interesting quotation from the book that explains in an appealing way the concept of culture, why it is so important and why it should be studied. Baron Samuel Von Puffendorf came up with this and he says: "Culture makes it possible for every single individual to achieve a true human existence through competition, activities and discovery of other people, but also through personal efforts and every person's individual deliberations and reasoning, and more than anything through the divine interpretation."



Book review

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## MARKETING IN ARTS – WE CREATE KNOWLEDGE AND (OR) KNOWLEDGE CREATES US

*An essay on the book “Marketing in arts” by Professor Dragan Nikodijević PhD,  
Megatrend University, Belgrade, 2006*

Since in 1993 the Institute for Theatre, Film, Radio and Television of Faculty of Drama published a collection of works “Marketing in arts” that was written for the purpose of a scientific seminar “Marketing in arts, arts in marketing”, no other book by a domestic author and in Serbian has been published under the title of “Marketing in arts”. To tell the truth, a book by Dragana Čulić “Creative radio advertising” (Pont, Belgrade, 1997) should not be neglected, but it concerns a considerably narrower area of marketing in arts, or, more to the point, arts in marketing. This fact reveals the subject of the book to be a rather unexplored area of the Serbian artistic production. There are two main reasons for this: first- lack of the theoretical approach to the subject, as theory is indispensable in order to understand and explain practical policy; second- up till the end of the 20<sup>th</sup> century Serbian practical cultural policy would not allow the development of market relations in the cultural sphere, with the result of marketing not being practically implemented in the cultural and artistic practice in this period of the artistic development.

From the Second World War onwards domestic political and ideological reasons have made the state the only patron and financier, but at the end of the 1980s hard times began regarding financing of the cultural and artistic development from the state budget. The state did not dispense with its responsibility for culture altogether, but now art was forced to turn to other sources of financing than state subsidies. One of the potential means of financing that usually comes to mind first is to sell cultural and artistic products, secondary products and services that have their buyers and users. By doing this, cultural and artistic organisations and institutions make internal income on the cultural and arts market. However, it is still rather underdeveloped in Serbia, purcha-

sing capacity is poor and domestic mentality and employees' business conduct are still such that people expect considerable state help and do not rely on their own capacities to sell artistic products to a degree that is necessary in order to achieve additional financing sources. However, independent income made on the market is not the only form of the culture-market relation. Moreover, since the economic crises in the 80s, which started affecting Great Britain and other Western European countries first, followed by the then Eastern European, nowadays transitional countries, this means of income has been yielding less and less. Since that point, when we say *market* then we primarily think of external income made from public and private funds founded in order to employ various ways to establish partnership between culture and market and to realise the external source of financing pluralism principle.

One source of financing, when talking about the combined financing model, is undoubtedly the government or local and regional authorities that can finance certain institutions of national, local or regional importance out of budget, but can also finance some important projects only, in which case national, local and regional institutions, as well as non-institutional projects, are equally entitled to request financing. Another source of financing is corporate support or project support. This form of financing is achieved through so called "giving with nothing in return" (benefactors, philanthropists, charity, patrons, and endowments) and "giving with something in return" (sponsorship). In all these cases, culture is financed by companies, corporations, institutions, individuals or parties of citizens, with foundations' role getting increasingly bigger. They all finance culture and art either because of personal affinities or because they want their companies to get some positive publicity, or, alternatively, some of them are of the opinion that investing in culture can result in gaining material or other form of benefit. Therefore, as hard times for culture financing from the public budget have started, new financing possibilities are opening, but in order to make use of these, new skills, knowledge and aptness at art products selling are needed, but what is needed more than anything is awareness that arts can and have to be a commercial product with its customers and market value. So far, this awareness and knowledge are based on two fragile theoretical pillars only, these being precisely the two books on marketing in arts. During the 13 years in between publishing of the two books, Serbian cultural and artistic production practice was changing, and marketing in arts was implemented to the extent which the employees' skills, knowledge and aptness made possible

Art means, more than anything, people, artists, artistic associates, works of art creators and mediators. It is a bottomless human resource that was not used and developed to its full potential during the totalitarian state regime and therefore was not able to manage all the cultural and artistic creative avenues, including all the opportunities for marketing in art, in an effective and effici-

ent way. That is what makes Dr. Dragan Nikodijević's book so precious, as it has precisely that goal – to educate, to teach and incite artists, managers and producers to implement theoretical knowledge on marketing in practice. The underdeveloped state of Serbian cultural and artistic market makes the book all the more necessary, as it dismisses any theoretical doubts and fears concerning selling of works of art that leads inevitably to the commercialism and homogenisation of art, that is, to the simplification of its aesthetic values, all in order to satisfy cultural and artistic needs of a vast number of potential buyers.

As the author himself says, "in its essence, marketing activities can be brought down to the fulfilment of two tasks: boosting purchases (marketing and advertising) and efficient sale (placement). What is important to know is how to manage marketing so that at the same time art can keep its immanent aesthetic values, irrespective of becoming goods intended for the market." The author of the book answers this dilemma in a quite satisfactory way too. "The essence and a characteristic feature of the marketing in art, which differentiates it from commercial marketing, are in the fact that it sets not only one but more goals that are not always of the same priority. However, sale must always be one of the goals. Sometimes, it is a basic goal. Sometimes, however, it is through marketing that evaluation of those social functions, offered only by art and impossible to find a market equivalent for, is enhanced and achieved. Acknowledging sale as one of the goals does not necessarily have to mean an absolute art commercialisation and relinquishing other artistic goals and functions. What needs to be achieved is to strike balance in the market conduct that will not jeopardise the artistic expression's very essence and character and make them subordinate to commercial goals."

Prof. Nikodijević organised his book in three parts, the first of which includes analysis of marketing communications, such as persuasion, manipulation, propaganda and rhetoric, then business identity and image marketing function, spending and life styles in the consumer society, and finally, the mythic power of a brand: label, reputation, and blockbuster. This part of the book highlights and explains the differentiation between identity and image that as the author says could be defined in the language of philosophy as: "internal and external beings of the same organisation". These terms are often used as synonyms, which they are not in essence, though it is only identity and image together that form organisation's unique character. Image is a picture – a general impression that one person gets of another person or institution, whereas, on the other side, identity is what delineates philosophy, history, culture, strategy, management style, respect and conduct. By further reading, readers will be able to understand the relation between identity and image better, which is the book's essential value. The same refers to brand and label, another two terms in the ever increasing use, whose essence is not sufficiently understood either. The truth is that in order to explain these terms the author

uses here examples from the economic and industrial practice, but it would not be possible to do anything else as these concepts as such have just started to develop in our surroundings, which results in very few positive examples to be used for a more detailed analysis of these phenomena.

After this general, introductory part, the second part of the book deals with marketing in art in a more direct way, through analysing the aesthetic and economic categories symbiosis, analysing the needs of creation and “spending” in art, the relation between art and market, art and money, followed by advertising as a form of the presentation of goods and services and finally art selling. Sale is analysed in this part through the factors that affect it, but more than anything through the market segmentation, so that in that sense sale is considered here in scenic and interpretative arts, then in painting, writing and publishing. At the same time, this part of the book is the most elaborate one; on more than 250 pages the author deals with a detailed analysis of all these important theoretical issues whose understanding is crucial for the practical implementation of marketing in art. However, Serbian cultural institutions have no clearly defined criteria as to which audience their programmes are intended for. This is corroborated by the results of a survey that included interviews with museum directors, managers of theatres, cultural centres and manifestations in Belgrade and throughout Serbia (the interviews were conducted within a long-running action project “Serbian cultural policy – methodology of the comparative analysis of the Eastern European countries’ cultural policies” which was realised between 2002 and 2005 as a part of Belgrade University of Arts’ post graduate studies “Management and cultural policy”, the project’s originator and manager and this text’s author being the same person). Answers to the question: “Who is your target audience?” ranged in a broad spectrum, from very indefinite ones such as: “from children to old-age pensioners, from primary school attendees to PhDs” (National Theatre in Belgrade), through very precise ones: “educated young people aged between 19 and 25” (theatre Atelier 212 in Belgrade), to the most common ones that reveal cultural and artistic institutions as not having either defined target audience or established ways to define it. And where there is not a clearly defined target audience, there is not a clearly profiled repertoire policy either. This explains why there is no clearly defined artistic and business policy either. The absence of all these elements brings about no good results either. This makes it crucial that all who deal with creation, placement and selling of art should master some basic skills and knowledge in marketing management.

And finally, the third part of the book deals with considerations about the marketing perspectives through analysing multimedia marketing which has revealed itself as a new path towards consumers. The book finishes with a conclusion based on the motto: “Advertisement is alive-long live advertisement”. But, instead of recommending marketing in a non-critical and idealistic way

as the solution to all artistic developmental problems – as the enthusiastic tone of the motto might suggest – in this part Dr. Nikodijević warns strongly that “marketing perspective, its essence and its contents, largely hinges on those circumstances that have brought it into being and marked its developmental flows so far”. This can be understood as follows: in the circumstances when state has no sufficient budget funds to finance cultural and artistic production in its entirety, though it was the case till the end of the 80s, it is the role of marketing to ensure necessary resources, and it will have its perspective as such until a new monopolist appears on the cultural market and limits with its exclusive rights of financing all other sources and financing opportunities. This appears as a convincing enough argument for all of us to start acquiring all the necessary marketing skills and knowledge with a view of using this period of liberal social development also for the purposes of liberal development of art. This could last until marketing starts imposing one goal solely – sale. Namely, marketing should bear in mind all the artistic products’ aesthetic values and set to itself more goals accordingly, primarily maintenance, enhancement and development of art.

This is where we reach the author’s key sentence: “What is indisputable is that art is one of the future’s vital resources”, and as to why, readers will discover for themselves by reading the book. What we find important to underline at the end of this short abstract of a comprehensive piece of writing, is that the book seems to be intended primarily for those who are, or will be, directed towards marketing in art in their work areas, and then for those who will simply have to have certain knowledge, skills and aptness at using marketing in further art development, leading it to the future, making its future happen, with the prime aim of rendering it the future’s vital resource, that is, so that the whole society could have a future. Therefore, it is absolutely paramount that we create knowledge so that it could in return create us. And that is the book’s main value, as it creates a new massif of knowledge about marketing in art, whilst at the same time summarising and adapting the existing knowledge in other marketing areas. Only when the knowledge is practically implemented though, will it be possible to create new opportunities for the development of art, that is, for the future of all of us as individuals and the entire society.



Book review

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## DEMYSTIFICATION OF GLOBAL ECONOMY TERMS

*An essay on the book "Economic diplomacy" by Professor Vladimir Prvulović, PhD,  
Megatrend University, Belgrade, 2006*

When the first issue of "Economic diplomacy" by Prof. Vladimir Prvulović PhD came out in 2001, a new domestic scientific literature chapter could already be spotted coming to life. The second issue of the handbook appeared under the same title as a new independent publishing enterprise (with more than 30% of added text) under the auspices of the Megatrend University of Applied Sciences in Belgrade in 2002. No sooner had the pioneering steps been made in this research field and a discipline named economic diplomacy started its scientific existence than in 2006 the domestic expert and scientific public was delighted by a new, third, amended version of "Economic diplomacy" (again with more than one third of new text accompanied with examples).

Though written mainly for the teaching purposes in the course of both basic and postgraduate programmes at the Megatrend University, Faculty of Geo-economics, the book "Economic diplomacy" not only fulfilled but also by far surpassed all limits of the formal, handbook expression, structure and style adapted to students. Namely, the author's opting for the most modern pedagogical and didactic methods, teamed with numerous examples given in the form of case studies, together with a list of questions to be considered at the end of each chapter, made both the book "Economic diplomacy" and the academic subject of the same name itself one of the Geo-economics students' favourites. On the other hand, the book's scientific and social affirmation is being reinforced daily both through scientific works (mainly MA and PhD theses) written under a direct influence of this scientific discipline in which other authors find their scientific and intellectual haven, and through outstanding presence of the subject in scientific and popular magazines, texts and respectable media houses' programmes intended for broader audience.

For all the mentioned reasons, a closer familiarisation with "Economic diplomacy" comes to us as a pleasant and utterly interesting obligation.

At the beginning of “Economic diplomacy”, Prof. Vladimir Prvulović explains the very term *economic diplomacy* and brings its most important conceptual meanings and basic interpretations closer to us. By tracking the economic diplomacy’s genesis as a discipline, followed by outlining its major functions and objectives, Prof. Prvulović answers the first, initial question that imposes itself the moment we take up the book: “What is economic diplomacy?” However, a realisation that it concerns “a fine tuned and specific union of diplomacy in its classic sense, economic and management sciences, foreign partners’ negotiation methods and techniques, public relations and gathering of economic information that are of interest for the economy of one’s country or company with a view to emerging on the world market” gets its full meaning only once the following important issue dealt with by Prof. Prvulović is resolved: “Why should we study economic diplomacy?” In the continuation, the nature and extent of the role of diplomacy in a country’s economic development is best explained by two vocal, carefully selected and presented real-life examples of the economic and political recovery and stabilisation of two European countries-Greece and Ireland.

A well renowned British sociologist Anthony Giddens said that “unless one has mastered the globalisation debate, or grasped its meaning, one cannot perform a social scientist’s duties in a remotely professional manner”. Bearing this fact in mind, it becomes quite clear as to why, amongst others subjects, globalisation (mondialisation) presents itself as yet another major issue in “Economic diplomacy”.

In a chapter dedicated to this subject the author elucidates the origins of globalisation, along with the most important international financial institutions’ role in it. Various types and expressions of globalisation, described through ample examples (case studies) contribute to a better (or, can we say more truthful?) understanding of globalisation processes: mondialisation in the nutrition area, in sports, education, communications, media, economy, consumption and culture. Being one of the most controversial contemporary phenomena, it is essential that globalisation process should be described and studied through both its positive and negative aspects and consequences.

Demystification of this contemporary phenomenon around which, admittedly, numerous contradictions and misconceptions have been woven, presents a particular value of the scientific research done on this subject within “Economic diplomacy”. Considering that “anti-globalism is a global movement” as well, the conclusions concerning the mondialisation processes’ perspectives in the third millennium are unambiguous, contends Prof. Prvulović: “The mondialisation process will be surely overtaking, if not through agreement and consensus, then forcibly, through the force of economic necessity and power of mega capital which transcends borders.”

The chapter dedicated to the international economic communication and its importance when performing duties within economic diplomacy competence, brings first a brief historic resume on the initial forms of international, and especially international economic communication. Given that communication is an essential human characteristic and need, Prof. Prvulović renders this more than a century long gap between the mentioned ancient communication forms and international communication at the beginning of the third millennium almost unnoticeable. For essence is the same, what is different are technical tools and resources that are used, that is, the speed and cost of long-distance communication. This brings us to the most important contemporary form of the international economic communication- electronic communication and the Internet. It does not suffice to say that international communication opportunities via Internet are of outstanding importance for economic diplomats-claims Prof. Prvulović. "When far away from one's country or one's own company and under obligation to be promptly and well informed, communication via Internet is a solution for an economic diplomat by which a majority of difficulties in this area, almost insurmountable in the past, is resolved. Aided by the satellite net and a small lap-top computer, an economic diplomat is able to be both in constant touch with their company's, department's or country's data base, and direct communication with management if necessary, even whilst physically situated in farthest and technically less developed countries."

This well known thesis that equates the value of information in the contemporary economic relations with the value of invested capital is further elaborated by Prof. Prvulović in a chapter on economic espionage. Therefore, searching for (or, we dare say grabbing) valuable and especially confidential economic information (such as business secrets et c.) and the incessant competition in improving technological and technical systems that enable economic information collection, is of no surprise. On the contrary, a successful economic diplomat should be capable and always ready to perform this delicate and oft dangerous job, a permanent "information war", both in its defensive and offensive phases. The book's author states uncompromisingly that economic warfare undoubtedly means a certain correlation of power amongst the world's market game competitors.

In a chapter dedicated to economic warfare Prof. Prvulović ensures us that contemporary international economic relations war is not waged only through skilful use of data, that is, by influence strategies creation and knowledge manipulation. Whether we talk about disloyal competition, theft of economic patents, protected logos and industrial secrets, economic or other international sanctions, corruption or financial inducements to business negotiators, blackmailing, "money laundering" and other illegal economic and financial transactions, we can be quite sure that what we have got in front of us (and,

in reality, all around us as well) are some of the most important forms of economic warfare. Expertly selected and explained through an accessible, smooth, easily understandable style, numerous practical examples speak volumes about the initial statement on the presence of economic warfare in the modern international economic relations of the present time and, as it seems almost guaranteed, of the foreseeable future as well.

What else is there, necessary for a future economic diplomat to know in “a period of a new economy coming into existence, that is, liberal economy and its tenets – private property and free competition on the world’s market”? Considering that conclusion of favourable (or at least as favourable as possible) business deals and their successful implementation are a company’s or country’s economic activities’ essential part, then it becomes clear that productive carrying out of these duties is impossible without business negotiation. Apart from “the initial trust amongst negotiators based on the seriousness of their intentions” along with “the favourable business climate and fair negotiation tone” the success of business negotiation also depends on the authorised negotiators’ qualifications, competence and skills, together with their aptness at the negotiation techniques use. Nevertheless, as the world is not and cannot be perfect, the compliance with signed contractual obligations is not (sadly) the Bible either. Therefore, another occurrence that is often to be encountered by economic diplomats is the issue of business disputes and litigations, which brings to the fore knowledge on the major international legal institutions’ operational procedures. It is unacceptable that an economic diplomat should be caught by surprise or off-guard in such a situation.

The eighth chapter of “Economic diplomacy” is dedicated to public relations (PR), which is a very prominent element in a successful presentation of a company or a country in their operating environment. Regarding the duties falling within the economic diplomacy remit, PR “has got a management function, but also a function with respect to a company’s (firm’s, organisation’s) planned, two-way business communication with surroundings, that is, a function of the institution’s particular image and its business philosophy”, says Prof. Prvulović.

Finally, when all the listed characteristics attached to an economic diplomat, together with all the skills and knowledge they are supposed to master and use effortlessly are viewed, a wrong impression can be created that we deal here a modern Superman, facing impossible missions. Still, Prof. Prvulović is an optimist and he holds the opinion that such capable and skilful staff can be recruited by a careful selection amongst graduates from universities and their further training and perfection through different specialised courses and practical diplomatic experience. Therefore, as we move towards the birth of a modern economic diplomacy of the future, “Economic diplomacy” is a source

of knowledge from this field of paramount significance especially to all those young people who will perform this delicate, serious but also fulfilling job.

The stated example concerning French president Jacques Chirac who reminds his ambassadors, however well experienced in their job they are, by saying: "The ambassadors of France, you are also the ambassadors of French economy", confirms that the moral of "Economic diplomacy" does not carry significance only for novices in the job. "Economic diplomacy's" author finishes his study on the same note, assuring us once again that the future of diplomacy lies precisely in economic diplomacy. This means that it has been long time since diplomacy stopped presenting a stereotype image of sophisticated diplomats wearing dinner jackets and exchanging courteous smiles at cocktail parties and receptions. It is becoming more and more a business where one has to "roll up one's sleeves" and invest considerable effort to reach and maintain one's position on the world's market, in order to improve a position of a company or country one represents. Speaking of countries similar to ours, which cannot pride themselves on enviable international economic and political presentation results, our economic representatives should consequently be all the more aware and receptive of such like advice.

Repeating his statement from the beginning of the book concerning the modern world future, which can be hardly hoped for without economic diplomacy, Prof. Prvulović, as it happens with every piece of superb narrative, closes his scientific idea's conceptual cycle. And whilst the imaginary wholeness of the scientific and theoretical exposition rounds and closes itself through this cyclical flow, new challenges are already starting facing us. It is, however, only through a complete and efficient implementation of economic diplomacy knowledge in practice that these challenges can find their solution, which, in turn, will be witnessed and spoken about by a better and more prosperous future.

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