The Orient's Inneism

"The birth (and rebirth) of capitalism in the Orient
resembles a child gifted by the gods to experience all the crises of growing up,
together with meeting his school chores and the obligations
of being the unique heir of the paternalist tradition."

The experience of post-communist countries in approximating the pro-capitalist path has, essentially, the consistency of an experiment. Simply by referring to the developments structured on a theory contained in the Washington Consensus, witnessing the condition of the transformations is easy.

There is no doubt that the imprint of this theory, founded on excessively idealized assumptions which are fundamentalist in regard to the societal system, did not configure a reality in accordance with the historical layout of capitalist society – as it has naturally evolved in the past three centuries. To the point, the experiment insinuated itself in the void between the expectations generated by the abstract vision – with ingredients of functional Utopia belonging to the Washingtonian pattern of transition – and the reality formed by the long-term existence of the competition for resources, statuses and institutions.

It is known that the temptation for the extremes of attitude, specific to societal experiments, does not change anything per se, except maybe the mathematical sign of the convictions of public discourse. The proof of this is the behavior which gives away the conditioned reflex of changing the dependency on one geographical direction with the other geographical direction. Change is formal, plain and simply, because what is considered to be the strong suggestion of the post-communist transition theory – the independence to act, behave, feel and decide – does not appear.

The theory of post-communist transition has been contaminated, frankly speaking, by what was supposed to be the theory of post-capitalist transition: the dialectic and historical materialism, through its propagandistic phalanx known as scientific socialism, the miraculous force to change the world. The post-communist experiment has in fact, still, another utopian determination, on top of the utopian determination of communism. This experiment is, due to the double determination, the very illusion of the radical and absolute change itself.

History's arguments tell that both in the interrupted phase of capitalism (by way of revolution or geopolitical arrangement) as well as in the one restarted by the post-communist transition, the specific performance of normal, uninterrupted evolution has not been attained – an evolution centered on the concept of capital, as it has happened in the Occident.

The more than a century's delay of the capitalist transformation in the Orient (both the European as well as the Asian one), interrupted by the few decades of the experiment of communist occupation, has implemented a mechanism meant to shorten the path towards wealth. But this mechanism, which is specific to the effervescence of the periphery, has short-circuited the moral element of the social context, as it has liquefied the norms-generating structures.

To be direct, this is the natural effect of inventing the agents of change out of nothing, both with regard to the alignments of freedom, as well as with regard to the management of property.

Ironically, the explanation gathers meaning if we compare the birth (which has always been a rebirth) of capitalism in the Orient with that of a child gifted by the gods with experiencing all the diseased of childhood, together with meeting his school obligations, as well as those of being the single living heir of the paternalist tradition. Here lies the core of the ineluctability of the experimental characteristic of the transition, which can be found – implacably – in the means and goals implied as well as in the societal finality.

Apparently paradoxical, this statement expresses the double essence of the – somewhat integrative of intercultural sensibilities – order, centered on the final cause in the Occident and on the absolute essence in the Orient. Resorting to the collectivist reflexes of the Oriental meme while running a scenario built on the Occidental individualism meme has led inevitably to a Malthusian pre-capitalism instead of a functional capitalism. The observable result is, thus, part of the category of societal constructions which pre-configure capitalism through reformed social agents which stimulate its development by redistributing common property for no equivalent value, toward clan-like structures.

It is obvious that from an exclusively Occidental point of view, the situating and the situation of the Orient are precarious. But what is also evident is the Orient's answer to the Occident's claimed winning choice: causal simplification unites material wealth with spiritual poverty. The explicit accusation is about the excess of externalization in the name of an efficient materialism which annihilates man and about the centripetal accumulation of wealth which draws its proportions from the poverty centrifuged into a periphery which covers increasingly more human space.

Expectedly, the societal Orient tries to remain equally distant from determinations and targets, persisting in a perpetual experiment because it does not opt definitively for one ideological vision or the other. The Orient murmurs continuously, as if coming out of a trance, that the choice belongs to the human nature and not to the ideologies.

What is unsettling is the fact that the measure of all things is to be found between the absolute essence of the Orient – in which fulfillment is, paradoxically, possible through renunciation, and the final cause – fixed by the Occident in wealth, where fulfillment is exclusive and, paradoxically, against nature.

Marin Dinu

Contents

Macroeconomic Impact on CEE Corporate Profitability:
Analysis at the Level of Companies Listed on the Bucharest Stock Exchange
Cristina Maria Triandafil, Petre Brezeanu, Leonardo Badea 5

Financial Development and Economic Growth: A Panel Data Approach
Nuno Carlos Leitão 15

Analysis of the Value Creation in Higher Institutions: A Relational Perspective
Raquel Sánchez-Fernández, M. Ángeles Iniesta-Bonillo, Walesska Schlesinger-Díaz,
Pilar Rivera-Torres 25

Effects of the Formula for Common Consolidated Corporate Tax Base Apportionment
Gheorghe Matei, Daniela Pîrvu 37

European Economics, Update. Another Ten Theses on the Economic Integration
Liviu C. Andrei 49

Importance of Partnership and Cooperation for Territorial Development
Anna Vaňová, Kamila Borseková, Miroslav Foret 73

To Differentiate or Not to Differentiate: A Question when Some Consumers Are Loyal
Yan Meng 83

Convergence of ABC and ABM Principles – Guarantee of a Performant Management
Sorinel Căpuşneanu, Dana-Maria Martinescu 93

Note: The authors are responsable for the content of their articles and for obtaining necessary permissions.

Text revision:
Gabriela Ochianã
Computerized drawing up:
Nicoleta Bobocea
Cover:
Alexandru Ion
Subscriptions distribution:
Mircea Dinu
Tel./Fax: 021/210.73.10; 021/210.63.07
021/210.63.08

Data base indexation:
Research Papers in Economics (RePEc)
http://www.ideas.repec.org
http://econpapers.repec.org
Directory of Open Access Journals (DOAJ)
http: //www.doaj.org
EBSCO Publishing
http://www.ebscohost.com
International Consortium for the Advancement of Academic Publication (ICAAP)
http://www.icaap.org
CNCSIS B+

www.economieteoreticasiaplicata.ro; www.ectap.ro

Reception of texts: economia.ta@edeconomica.com

ISSN 1841-8678 (Print)
ISSN 1844-0029 (Online)

Theoretical and Applied Economics
Volume XVII (2010), No. 10(551), pp. 5-14

Macroeconomic Impact on CEE Corporate Profitability: Analysis at the Level of Companies Listed on the Bucharest Stock Exchange

Cristina Maria TRIANDAFIL
Bucharest Academy of Economic Studies
cristina_triandafil@yahoo.com
Petre BREZEANU
Bucharest Academy of Economic Studies
brezeanupetre@yahoo.com
Leonardo BADEA
"Valahia" University of Târgovi te
leobadea@yahoo.com

Abstract. *This paper aims at identifying a potential impact of the macroeconomic environment on the profitability of the companies listed on the Bucharest Stock Exchange. This research derives from the most recent literature on the macroeconomic determination of the capital structure of companies located into emerging countries. Indeed, as for these corporations, there has been agreed on the risk transfer between sovereign and corporate spreads, but every emerging country incurs a particular approach and generalization tends to decay. Therefore, the research focuses on highlighting out the macro-determination of the corporate profitability; there will be developed a complex perspective, following up the mixture between idiosyncratic and systemic approach.*

Keywords: default risk, macroeconomic impact, profitability, idiosyncratic.

JEL Code: E44.
REL Code: 11B.

1. Introduction

Global economy triggered corporate sector internalization. Companies became more and more integrated into a borderless world, designing and implementing strategies in order to reduce costs through economy of scale and outsourcing.

Meanwhile, corporations are more and more exposed to disequilibriums originating from the international environment. Macroeconomic volatility impacts them more consistently, especially from the perspective of their creditworthiness and profitability.

Economic cycle is closely related to corporate profitability. During boom periods, profitability potential increases while recession brings it down. An economic downturn triggers the probability to not be able to generate enough cash-flow in order to cover the financial obligations.

During the last decade, analysts agreed on the fact that corporate default does not imply only an idiosyncratic side, but also a systemic one, resulting from the correlation of the company with the macroeconomic environment.

This paper aims at highlighting out the impact of the macroeconomic environment on the profitability of the companies listed on the Bucharest Stock Exchange, broken down by sector. There have been selected three variables closely linked to the macroeconomic volatility – current account deficit, economic growth, exchange rate fluctuation – that have been integrated into an OLS regression grouping also indicators reflecting the financial soundness of the company. The conclusions regarding the potential impact of the macro side on the profitability tend to differ according to the corporate sector, some being more impacted than the others.

This research is divided as follows**:** section two includes a literature review and section three is dedicated to the case-study and to the conclusions.

Section 2

Recently there has been developed a consistent literature on the macro determination of the corporate default (see Mc Neil, Frey, Embrachts, 2005). Links between micro and macro-variables closely related to corporate default have been pointed out. Alves (2005) and Shahnazarian and Asberg-Sommer (2007) found cointegration relationships between the macro and Moody s KMV expected default frequency (EDF) variables. Short-term interests, GDP and inflation are closely linked to EDF. Similar approaches have been developed by Aspachs, Goodhart, Tsomocos and Zicchino (2006) as well as by Pesaran, Schuermann and Weiner (2006). These perspectives subscribe to an impact

derived from the macro-environment to the corporate segment, while Pesaran, Schuermann and Weiner (2006) revealed that this relationship can be modeled also under the form of an impact deriving from the corporate to the macro side. They found out that corporate default probability as well as equity values impact GDP variables.

Castren et al. (2007) included domestic output, inflation, nominal interest rate and real exchange rate as endogenous variables into a VAR model, while aggregated default frequency and foreign macro variables were incorporated as exogenous variables. They concluded that default frequency and macro indicators have a similar trend.

This paper follows up the rationale of Jacobson et al. (2005), who conceived macro variables as corporate default regressors using the logit methodology. What it differentiates this approach is precisely the fact that there will be developed an OLS regression at the level of the corporate profitability which is conceived as the key element of the corporate financial soundness. There have been selected three variables closely linked to the macroeconomic volatility – current account deficit, economic growth, exchange rate fluctuation – that have been integrated into an OLS regression grouping also indicators reflecting the financial soundness of the company.

The research aims at revealing to what extent profitability is triggered by variables at the firm level and by variables related to the macro-environment. The conclusions regarding the potential impact of the macro-side on the profitability tend to differ according to the corporate sector, some being more impacted than the others.

Section 3

In order to reveal the macroeconomic impact on corporate profitability, there has been performed a regression integrating profitability reflected into the net margin as endogenous variable and a series of financial ratios related to liquidity, size and solvency as exogenous variables. Regressors included also macroeconomic variables – current account deficit, exchange rate volatility and real economic growth.

Database integrated financial information related to the companies listed on the Bucharest Stock Exchange, broken down by sector. The industries analysis focused on were represented by materials, finished goods producers, fertilizer producers, energy and pharmaceuticals. The period financial information was related to was represented by the interval 1997-2007.

In a first stage, regression included only firms related variables, linked to the idiosyncratic side of the corporate profitability.

We estimated the following equation:

$P_t = \quad + \quad \times X_{it} + \quad_t$

Where:

P_t = Profitability indicator

X_{it} = Idiosyncratic indicators (firm-level related)

$_t$ = Error term.

Secondly, regression was enlarged by the macro-related indicators. The key element originates from the way statistic output evolved from one regression to another, especially from the perspective of the macro-indicators impact.

We estimated the below equation:

$P_t = \quad + \quad \times X_{it} + \quad \times Y_{it} + \quad_t$

Where:

P_t = Profitability indicator

X_{it} = Idiosyncratic indicators (firm-level related)

Y_{it} = Macro-related indicators

$_t$ = Error term.

Table 1

Statistic output of the regression integrating both firm related and macro-variables

Industry		Indicators	Coefficient	T-statistic and associated standard error	p-value	R-squared	Adjusted R-squared
finished goods producers	liquidity and asset management indicators	current assets turnover	-3.553	0.8402 (0.06)	0,008	0.767097	0.638069
		current liquidity	3.553	0.4071 (0.04)	0,005		
	solvency and indebtedness indicators	Debt to EBITDA	-0,06	0,571 (0,0109)	0,007		
		Debt to Total Assets	0,077	0,35 (0,02)	0,006		
		Debt service ratio	0,33	0,236 (0,008)	0,007		
		FFO to Debt	3,61	0,6064 (0,006)	0,008		
	size indicator	Logsales	1,48	0,108 (0,013)	0,009		
chemicals	liquidity and asset management indicators	Current assets turnover	26,48	21,3 (1,24)	0,002		
		Current liquidity	-90,6478	465,718 (-0,1947)	0,008		
	solvency and indebtedness indicators	Debt to EBITDA	-0.322825	0.303902 (-1.062)	0.032		
		Debt to Total Assets	-120.2946	81.75815 (-1.473)	0.018		
		Debt service ratio	-61.18261	70.03182 (0.873640)	0.0413		
		FFO to Debt	-3.209713	3.676670 (-872995)	0.0416		
	size indicators	Logsales	2904.822	1330.631 (2.183042)	0.044		
	macro Related variables	Current account deficit	0.006150	0.001344 (0.4575902)	0.0446		
		Exchange rate volatility	0.879767	2.344224 (0.375291)	0.7435 (0.0073)		
		Real economic growth	0.760596	1.024974 (-0.7420)	0.0354	0.806623	0.71297

Industry		Indicators	Coefficient	T-statistic and associated standard error	p-value	R-squared	Adjusted R-squared
energetics	liquidity and asset management indicators	Current assets turnover	-1.490746	1.881753 (-0.7922)	0.0464	0.77458	0.72345
		Current liquidity	0.016158	0.038759 (0.004168)	0.004168		
	solvency and indebtedness indicators	Debt to EBITDA	-0.000307	0.000275 (-1.1153)	0.03154		
		Debt to Total Assets	-0.214905	0.124874 (-1.7202)	0.01459		
		Debt service ratio	0.234120	1.321903 (0.177108)	0.0243		
		FFO to Debt	0.009080	1.162735 (0.007809)	0.0297		
	size indicator	Logsales	0.000391	0.616623 (0.000633)	0.05645		
	macro Related variables	Current account deficit	1.643851	0.501164 (-3.280)	0.00817	0.87231	0.7956
		Exchange rate volatility	0.876774	0.258170 (-3.3961)	(-3.3961) 0.00768		
		Real economic growth	0.039107	0.010669 (-3.6653)	0.00670		
fertilizers	liquidity and asset management indicators	Current assets turnover	7.430916	13.03398 (0.570119)	0.04701	0.64701	0.59432
		Current liquidity	-23.51600	22.35679 (-1.051850)	0.04839		
	solvency and indebtedness indicators	Debt to EBITDA	0.000898	1.126925 (0.000797)	0.04621		
		Debt to Total Assets	-0.423763	0.539513 (-0.785456)	0.04761		
		Debt service ratio	0.017591	0.812734 (0.021644)	0.05655		
		LTD to equity	0.002415	0.121980 (0.019801)	0.0227		

Industry		Indicators	Coefficient	T-statistic and associated standard error	p-value	R-squared	Adjusted R-squared
	size indicator	Logsales	-24.22621	39.28289 (-0.616712)	0.0482		
	macro related variables	Current account deficit	-0.022339	0.016869 (-1.324308)	0.04117	0.7123	0.7067
		Exchange rate volatility	Unsignificant statistic output				
		Real economic growth	1.521871	1.171911 (1.298623)	0.04178		
materials	liquidity and asset management indicators	Current assets turnover	0.016579	6.763591 (0.002451)	0.04981	0.564	0.5323
		Current liquidity	-4.510994	25.87582 (-0.174332)	0.03659		
	solvency and indebtedness indicators	Debt to EBITDA	-0.000501	0.002364 (-0.211985)	0.0374		
		Debt to Total Assets	-0.141689	0.350452 (-0.404304)	0.0 366		
		Debt service ratio	-0.088327	0.189450 (-0.466228)	0.03535		
		FFO to Debt	0.018331	1.582057 (0.011587)	0.01523		
	size indicator	Logsales	4.66	3.03 (0.153682)	0.0317		
	macro related variables	Current account deficit	-0.007373	0.006641 (-1.110239	0.02991	0.77454	0.67454
		Exchange rate volatility	0.559198	0.926404 (0.603622)	0.05628		
		Real economic growth	0.241970	0.599233 (0.403800)	0.03656		
pharmaceuticals	liquidity and asset management indicators	Current assets turnover	25.04699	8.384082 (2.987446	0.0205	0.7205	0.7037
		Current liquidity	-0.012241	0.009220 (-1.327647)	0.04110		

Industry		Indicators	Coefficient	T-statistic and associated standard error	p-value	R-squared	Adjusted R-squared
	solvency and indebtedness indicators	Debt to EBITDA	0.048321	1.822146 (0.026519)	0.03195		
		Debt to Total Assets	-1.365747	0.500134 (-2.730764)	0.0235		
		Debt service ratio	0.059265	0.339126 (0.174757)	0.019		
		FFO to Debt	-0.006187	0.003731 (-1.658276)	0.0455		
	size indicator	Logsales	Unsignificant statistic output				
	macro Related variables	Current account deficit	-0.318399	0.068292 (-4.662325)	0.01345	0.7743	0.7534
		Real economic growth	0.000416	0.529137 (0.000786)	0.529137	0.0256	
		Exchange rate volatility	-0.59198	0.754404 (0.603622)	0.03628		

Statistic output points out that profitability is impacted to a high extent by solvency, liquidity and size indicators. Material and chemical industry profitability is correlated negatively with liquidity while the other industries seem to be positively correlated. This conclusion is quite interesting. A good liquidity indicator impacts in a positive way profitability. Profit creates good opportunities in order to bring liquidity into the company, but it does not necessarily imply liquidities in the realistic sense which is in line with the case of material and chemical industries.

Size is correlated positively with profitability while solvency and indebtedness indicators are correlated in most of the cases negatively.

Enlarging the regressions by the macro-variables creates a clear opportunity for the R-squared and adjusted R-squared to increase. In all the cases, R-squared and Adjusted R-squared increase at least by 10%. The most significant change is recorded in the case of the pharmaceutical industry (R-squared increases from 0.55 to 0.78).

Profitability is highly impacted by the macroeconomic indicators at the level of 4 out of the 5 industries. The only industry which is not impacted by macro environment is represented by the finished goods industry. Its profitability is impacted only at the firm level. Current account deficit impacts negatively profitability at the level of the material, fertilizers producers and pharmaceutical industries while chemical and energetics industries are impacted positively. This impact is explained by the correlation of the industry with the final consumption. Energetics and chemicals are strongly linked to the usual consumption supported by a high current account deficit while the other industries are not linked to the same extent. Materials do not imply goods related to usual consumption which has been recently reflected into a growing current account deficit. Real economic growth impacts in a positive manner the profitability at the level of all the industries, confirming the assumption that a prosperous macro-environment creates incentives to corporate profitability. Exchange rate volatility has a negative impact on the evolution of the corporate profitability only in the case of the pharmaceutical industry. This finding is in line with the assumption that pharmaceuticals concentrate its activity mainly on imports which implies a high sensitivity to exchange rate fluctuations.

Overall, macro-related variables determine to a high extent corporate profitability. In order to provide an accurate assessment of the corporate profitability, it is necessary for the analysts to consider also the macro-environment the company activates in. The conclusions of this paper must be interpreted within the context of the limitations imposed by the database dimension. Future research will keen on integrating into the research other macro-related indicators.

References

Cohen, D., „Incorporating default risk into Hamada's Equation for application to capital structure", MPRA Press, 2007, http://mpra.ub.uni-muenchen.de
Dangl, T., Zechner, J., „Credit risk and Dynamic Capital Structure Choice", Vienna Univesity Press, 2006, www.creditrisk.com
Davydenko, S., „When do firms default? A study on the default boundary", London Business School Press, 2005, www.creditrisk.com
Dwyer, D., „Examples of overfitting encountered when building private firm default prediction models", New York: Moody's KMV, 2005, www.moody's.com/whitepapers
Dwyer, D., „Expected Default Frequency Enhancements", New York: Moody's KMV, 2007, www.moody's.com/whitepape
Elizalde, A., „Credit Risk Models I:Default Correlation in Intensity Models", 2005a, www.abelelizalde.com
Elizalde, A., „Credit Risk Models II: Structural Models", 2005b, www.abelelizalde.com
Elizalde, A., „Credit Risk Models III:Reconciliation Reduced-Structural Models", 2006, www.abelelizalde.com
Ericsson, J., Reneby, J. (2005). *Can Structural Models Price Default Risk: Evidence from Bond and Credit Derivative Market*, McGill University Press
Hackbarth, D., Miao, J., Morellec, E., „Capital Structure, Credit-Risk and Macroeconomic Conditions", HEC University Press, 2004, http://papers.ssrn.com
Hochrainer, S., „Financial natural disaster risk management for developing countries", 2006, International Institute for Applied Systems Analysis Press, http://papers.ssrn.com
Peter, M., Grandes, M., „How important is sovereign risk in determining corporate default premia?", International Monetary Fund Press, 2005, www.imf.org.com/research
Rocha, K., Garcia, A., „Term Structure of Sovereign Spreads in Emerging Markets – A Calibration Approach for Structural Model", 2004, IPEA Press, Brazil, http://papers.ssrn.com
Saretto, A., „Predicting and Pricing the Probability of Default", UCLA Press, 2004, http://papers.ssrn.com
Schaffer, R., Sjolin, M., Sundin, A., „Credit-risk – a structural model with jumps and correlations", Lund University Press, 2007, http://papers.ssrn.com
Stein, R., „Evidence on the incompleteness of Merton-Type Structural Models for Deafult Prediction", New York: Moody's KMV, 2005, www.moody's.com/whitepapers
Stein, R., „The relationship between default prediction and lending profits: Integrating ROC analysis and loan pricing", *Journal of Banking and Finance*, 29, 2005, pp. 1213-123

Acknowledgements

This paper is part of the research grant PN2 -*The analysis of the economic and financial risk characteristic to companies located in CEE countries: impact on the finance making-up decision process*, code 1795, provided by UEFISCU – Romania, Project Manager Prof. PhD Petre Brezeanu.

Theoretical and Applied Economics
Volume XVII (2010), No. 10(551), pp. 15-24

Financial Development and Economic Growth: A Panel Data Approach

Nuno Carlos LEITÃO
Polytechnic Institute of Santarém, ESGTS, Portugal
nunocarlosleitao@gmail.com

Abstract. *The relationship between financial development and economic growth has been studied long time in economics (Adam Smith and Schumpeter). Structural reforms and the integration of financial markets have been attracting the interest of the academic community.*

This manuscript examines the link between financial development and economic growth. The European Union Countries (EU-27), and BRIC (Brazil, Russia, India and China) were examined, between 1980 and 2006. Using a static and dynamic panel data approach, the results demonstrate that the financial development contribute to economic growth. Our study also consider productivity and trade, these proxies confirm the positive effect on economic growth.

Keywords: economic growth; financial development; panel data and globalization.

JEL Codes: C33, E44, O16.
REL Codes: 8E, 11B.

Introduction

In the 1990´s emerged the empirical models that analyse the impact of financial sector on economic growth (King, Levine, 1993, Millner, 1998). This manuscript examines the link between financial development and economic growth. There are good reasons for studying this topic. In the 1980's we assisted financial reforms on OECD countries. International economics showed the rapid economic growth on Asian countries during the 1970s and 1980s. The domestic credit increased considerably as the result of financial reform. This study examines the *link* between financial development and economic growth using an unbalance panel data for the period 1980-2006. We select EU-27 countries d BRIC countries (Brazil- Russia, India and China).

In static panel data models, Pooled OLS, fixed effects (FE) and random-effects (RE) are used. The RE estimator was excluded because our sample is not random. Furthermore, the Hausman test rejects the null hypothesis RE versus FE. Therefore, the regression coefficients are estimated using fixed effects. The results presented in this paper are consistent with the predictions of financial sector development affect economic growth. We also decided to introduce a dynamic panel data. This methodology is most frequently used in the growth literature (GMM-SYS). The estimator used GMM-System permits the researchers to solve the problems of serial correlation, heteroskedasticity and endogeneity of some explanatory variables. These econometric problems were resolved by Arellano and Bond (1991), and Blundell and Bond (1998, 2000). To estimate the dynamic model, we applied the methodology of Blundell and Bond (1998, 2000). The remainder of the article is organized as follows: section 2 presents the theoretical background; section 3 explains the relationship between financial development and economic growth; section 4 presents the econometrical model; section 5 shows the estimation results, the final section provides conclusions.

Literature review and empirical studies

In this section we present a survey of theoretical and empirical models of financial development and economic growth. When we consider the relationships between financial development and economic growth we need to consider different opinions (Levine, 2003). There are not consensuses in the literature. According to Levine (1997) the financial development could be

explained by the access to credit and financial services. The classical models as in Schumpeter (1912) have the similar opinion. Schumpeter (1912) defended that financial development accelerates growth. In 2005, Levine refers a relevant consideration. The economy, i.e the market gives information about investment projects, risk diversification and international trade. Other points of view have Robinson (1952), Millner (1998), and Lucas (1988). Robinson considers that financial development simplifies the "channels" of economic growth. Millner (1998) refers that financial markets promote the economic growth, but it will be necessary to consider others explanatory variables. In other words, the financial development is endogenous across to real growth. Lucas (1988) has the similar opinion. Goldsmith (1969) and Mckinnon (1973) consider a positive correlation between economic growth and financial development. La Porta et al. (1998) and Levine et al. (2000) measure the impact of financial development on economic growth. The authors also found a positive correlation.

Levine et al. (2000) and Beck et al. (2000) explain the correlation between financial development and economic growth, with finance – endogeneity proxies. Levine et al. (2000), and Beck et al. (2000) introduced an excellent contribution; these authors create new instruments variables to financial development and apply a dynamic panel data approach, GMM estimator. Levine et al. (2000) analyse the correlation between financial intermediation and growth. Beck et al. (2000) study the link between financial development and the sources of growth as in productivity, physical capital, and savings.

La Porta et al. (1998) introduced the legal origin as instruments variables. The study of Neusser and Kugler (1998 applied to OECD countries for the period 1960-1993) does not support the idea that financial development could explain economic growth.

Modeling finance development and economic growth

We consider that economic growth (Levine, 1997, Beck et al., 2000, and Levine et al., 2000) is equal to:

$$Growth_{it} = f\left(CREDIT, BANK, IPC, TRADE, PROD\right) \quad (1)$$

$$\begin{aligned} &\partial f / CREDIT > 0, \partial f / BANK \succ 0, \partial f / IPC < \\ &< 0, \partial f / \partial TRADE > 0, \partial f / PROD \succ 0 \end{aligned} \quad (2)$$

where:

Growth is the growth rate of real GDP;
CREDIT is the private credit;
BANK is the deposit money banks;
IPC is the consumer price;
TRADE is the ratio of exports plus imports;
PROD is the productivity.

Econometrical model

Following the literature our study applies a static panel data (Fixed Effects), and a dynamic panel data (GMM-SYS). The dependent variable used is economic growth; this variable is measured as growth rate of real GDP per capita in country. The data for explanatory variables is sourced from the World Development Indicators (2009). The source used for dependent variable was World Bank.

Explanatory variables

Hypothesis 1: Financial development stimulates the economic growth.

We use two indicators of financial development: private credit (CREDIT), and commercial – central bank (BANK).

LogCREDIT is ratio of total credit to GDP, i.e. credit by deposit money banks and other financial institutions to private sector divided by GDP in logarithm form.

LogBANK is the logarithm of assets of deposit money banks divided by assets of deposit money banks plus central bank assets. According to the literature (Blanchard, 1981, Levine, 2003) we expected a positive sign.

Hypothesis 2: International trade and productivity promote the economic growth.

We use two proxies: TRADE and productivity (PROD):

LogTRADE is the ratio of total trade to GDP in logarithm form;

LogPROD is value added by the employer. Levine (1997) suggested that financial development promotes economic growth via international trade and productivity. Beck et al. (2000) also analyze the relationship between financial

development and productivity. According to the literature there is a positive correlation between international trade and economic growth. The same is validating between productivity and economic growth.

Hypothesis 3: Macroeconomic stability (instability) encourages (discourage) the economic growth.

We consider the ICP (consumer price): This is a control variable as measure of macroeconomic stability or instability. The expected sign is negative.

Static and dynamic panel data models

Model [1]

$$Growth_{it} = \beta_0 + \beta_1 (CREDIT)_{it} + \beta_2 (ICP)_{it} + \beta_3 (TRADE)_{it} + \\ + \beta_4 (PROD)_{it} + \delta t + \eta_i + \varepsilon_{it}$$

Where $Growth_{it}$ is either per capita GDP growth, X is a set of explanatory variables. All variables are in the logarithm form; η_{it} is the unobserved time-invariant specific effects; δt captures a common deterministic trend; ε_{it} is a random disturbance assumed to be normal, and identically distributed (IID) with E (ε_{it})=0; Var $(\varepsilon_{it}) = \sigma^2 \succ 0$.

The model can be rewritten in the following dynamic representation:

$$Growth_{it} = \rho Growth_{it-1} + \beta_1 (CREDIT)_{it} - \rho\beta_1 (CREDIT)_{it-1} + \\ + \beta_2 (ICP)_{it} - \rho\beta_2 (ICP)_{it} + \beta_3 (TRADE) - \\ - \rho\beta_3 (TRADE)_{it} + \beta_4 (PROD)_{it} - \rho (PROD)_{it} + \delta t + \eta_i + \varepsilon_{it}$$

Model [2]

$$Growth_{it} = \beta_0 + \beta_1 (BANK)_{it} + \beta_2 (ICP)_{it} + \beta_3 (TRADE)_{it} + \\ + \beta_4 (PROD)_{it} + \delta t + \eta_i + \varepsilon_{it}$$

The model can be rewritten in the following dynamic representation:

$$Growth_{it} = \rho Growth_{it-1} + \beta_1(BANK)_{it} - \rho\beta_1(BANK)_{it-1} + \\ + \beta_2(ICP)_{it} - \rho\beta_2(ICP)_{it} + \beta_3(TRADE)_{it} - \\ - \rho\beta_3(TRADE)_{it} + \beta_4(PROD)_{it} - \rho(PROD)_{it} + \delta t + \eta_i + \varepsilon_{it}.$$

Analysis of the static panel data estimations

In Table 1, the two equations of the growth can be observed. With the first model, all explanatory variables are significant (LogCREDIT, LogTRADE, and LogPROD at 1% level and LogIPC at 10% level). The variable total credit (LogCREDIT) presents a positive sign, confirming the theoretical forecast proposed by Levine (2005).

Table 1

Financial development and economic growth: fixed effects

Variables	Model [1]	Model [2]	Expected Sign
LogCREDIT	0.342 (2.96)***		(+)
LogBANK		0.087 (1.20)	(+)
LogIPC	-0.026 (-1.85)*	-0.034 (-2.75)***	(-)
LogTRADE	2.06 (4.01)***	1.759 (3.79)***	(+)
LogPROD	0.650 (4.71)***	0.857 (4.64)***	(+)
Adj. R^2	0.305	0.253	
Observations	491	491	

T-statistics (heteroskedasticity corrected) are in round brackets.
***/**- statistically significant, respectively at the 1%, and 10% levels.

Vaona (2007) also found a positive sign. The coefficient of consumer price analyses the level of inflation. This indicator affects GDP growth negatively. Our result supports this hypothesis. We also introduced the variables, international trade (TRADE), and productivity (PROD). Levine (1997), Beck et al. (2000) suggested that financial development promotes economic growth via international trade and productivity. A positive sign effect of international trade (TRADE), and productivity (PROD) were expected and the results confirm this. With the second model, the equation presents three significant variables (LogICP, LogTRADE, LogPROD).

Other considerations relating to the second equation:

i) ICP (consumer price): This is a control variable as measure of macroeconomic instability. The expected sign is negative and the estimated coefficient is negative;

ii) TRADE: We expected a positive impact on growth and the coefficient is positive;

iii) PROD (Productivity): The expected sign is positive, which is confirmed by the estimation.

Analysis of the dynamic panel data estimations

It is usual in the growth literature apply the GMM-System (Blundell and Bond 1998, 2000). The validity of instruments is tested using a Sargan test of over-identifying restrictions and serial correlation. First-order and second-order serial correlation in the first-differenced residuals is test using m1 and m2 statistics (Arellano, Bond, 1991). The GMM system estimator is consistent if there is no second-order serial correlation in the residuals (m2 statistics).

The dynamic panel data is valid if the estimator is consistent. We used the criterion of Windmeijer (2005) small sample correction to have consistent stand errors. As shown in Table 2, the two equations present consistent estimates, with no serial correlation for the GMM-SYS estimator (m1, m2, and statistics). The specification Sargan test shows that there are no problems with the validity of the instruments used for both equations. The instruments in levels used are LogCREDIT(2,7), LogGDP(2,7), LogTRADE (2,7) for first differences. For levels equations, the instruments are used first differences all variables lagged t-1.

The equation [1] presents seven significant variables: ($LogGrowth_{t-1}$, LogCREDIT, $LogCREDIT_{t-1}$, LogTRADE, $LogTRADE_{t-1}$, LogPROD, $LogPROD_{t-1}$). The equation [2] presents nine significant variables ($LogGrowth_{t-1}$, LogBANK $LogBANK_{t-1}$, LogICP, $LogICP_{t-1}$, LogTRADE, $LogTRADE_{t-1}$, LogPROD, $LogPROD_{t-1}$).

Other results relating to the financial development and economic growth:

i) Lagged dependent variable ($LogGrowth_{t-1}$): a positive sign was expected and the results confirm this;

ii) Private credit (CREDIT), and lagged credit ($LogCREDIT_{t-1}$): the expected signs are positive, which is confirmed by the estimations;

iii) Bank (BANK), and lagged BANK ($LogBANK_{t-1}$): the expected sign is positive, and the coefficients of these variables are significantly but with contradictory sign;

ICP (consumer price), and lagged ICP (ICP_{t-1}): the expected sign is negative, and the coefficients of these variables are positive;

iv) Trade (LogTRADE) and lagged trade ($LogTRADE_{t-1}$): the expected sign is positive and the results confirm this;

v) Productivity (LogPROD) and lagged variable ($LogPROD_{t-1}$) are according to the hypothesis formulated.

Table 2

Financial development and economic growth: GMM-SYS

Variables	Model [1]	Model [2]	Expected Sign
$LogGrowth_{t-1}$	0.322 (12.7)***	0.304 (4.04)***	(+)
LogCREDIT	0.146 (9.19)***		(+)
$LogCREDIT_{t-1}$	0.127 (7.95)***		
LogBANK		-0.157 (-11.5)***	(+)
$LogBANK_{t-1}$		-0.141 (-6.53)***	
LogIPC	0.0589 (1.11)	0.214 (3.26)***	(-)
$LogIPC_{t-1}$	0.095(1.34)	0.339 (3.63)***	
LogTRADE	0.108 (3.89)***	0.096 (12.0)***	(+)
$LogTRADE_{t-1}$	0.081 (2.93)***	0.100 (6.78)***	
LogPROD	0.098 (4.73)***	0.170 (16.6)***	(+)
$LogPROD_{t-1}$	0.090 (4.65)***	0.148 (9.10)***	
C	0.002(0.179)	-0.032 (-3.77)***	
M1	0.2795 [0.780]	-1.050 [0.294]	
M2	-0.2555 [0.798]	0.02580 [0.979]	
Wjs	485.8 [0.000] Df=9	539.2 [0.000] Df=9	
Sargan	-3.302 [1.000] Df=521	-2.439 [1.000] Df=521	
Observations	462	462	
Individuals	24	24	

T-statistics (heteroskedasticity corrected) are in round brackets. The null hypothesis that each coefficient is equal to zero is tested using second-step robust standard error. T-statistics (heteroskedasticity corrected) are in round brackets.

*** indicates statistically significance, respectively at the 1% level. P-values are in square brackets. Year dummies are included in all specifications (this is equivalent to transforming the variables into deviations from time means, i.e. the mean across the fourteen countries for each period). M1 and M2 are tests for first-order and second-order serial correlation in the first-differenced residuals, asymptotically distributed as N (0, 1) under the null hypothesis of no serial correlation (based on the efficient two-step GMM estimator). Sargan is a test of the over-identifying restrictions, asymptotically distributed as χ^2, under the null of instruments' validity (with two-step estimator).

Conclusions

The objective of this study was to analyze the link between financial development and economic growth. This relationship is stable, because the development of financial sector can play an important role to be an engine of economic process.

Comparing our findings with other empirical studies, we obtained similar results. Econometric estimations support the hypothesis formulated. Our results are robust with static and dynamic panel data.

The proxy (LogCREDIT) used to evaluate the financial development present a positive correlation on economic growth when we used the fixed effects, and GMM-System. This result is according to the literature (Levine, 2005, Vaona, 2007). Our finding also shows that financial development stimulates the productivity and international trade.

The study has however some limitations. A deeper analysis needs to include other control variables: economic freedom, language and cultural similarity, human capital, and globalization.

References

Arellano, M., Bond, S., „Some tests of specification for panel data: Monte Carlo evidence and an application to employment equations”, *The Review of Economic Studies,* 58, 1991, pp. 277-297

Beck, T., Levine, R., Loayza, N., „Finance and the Sources of Growth: Panel Evidence”, *Journal of Financial Economics,* 58, 2000, pp. 261-300

Blanchard, O., „Output, the Stock Market, and Interest Rates”, *American Economic Review*, 71, 1981, pp. 132-143

Blundell, R., Bond, S., „Initial conditions and moment restrictions in dynamic panel data models”, *Journal of Econometrics, Elsevier,* 87(1), 1998, pp. 115-143

Blundell, R., Bond, S., „GMM Estimation with persistent panel data: an application to production functions”, *Econometric Reviews, Taylor and Francis Journals,* 19(3), 2000, pp. 321-340

King, R.G.., Levine, R., „Finance and Growth: Schumpeter Might be Right”, *Quarterly Journal of Economics, 108(Aug)*, 1993, pp. 717-737

Miller, M.H., „Financial markets and economic growth”, *Journal of Applied Corporate Finance,* 11, 1998, pp. 8-14

Goldsmith, R.W. (1969). *Financial Structure and Development, New Haven*, CT: Yale University Press

La Porta, R., Lopez de Silanes, F., Shleifer, A., Vishny, R.W., „Law and Finance”, *Journal of Political Economy*, 106, 1998, pp. 1113-1155

Levine, R., „Financial Development and Economic Growth: Views and Agenda”, *Journal of Economic Literature,* 25, 1997, pp. 688-726

Levine, R., Loayza, N., Beck, T., „Financial Intermediation and Growth: Causality and Causes”, *Journal of Monetary Economics*, 46, 2000, pp. 31-77

Levine, R., „More on Finance and Growth: More finance, More Growth?”, *Review*, Federal Bank of St.Lous issue Jul, 2003, pp. 31-46

Levine, R., „Law, Endowments and Property Rights”, *Journal of Economic Perspectives*, 19(3), 2005, pp. 61-88

Lucas, R.E. Jr., „On the Mechanics of Economic Development”, *Journal of Monetary Economics,* 22: 1988, pp. 3-42

McKinnon, R.I. (1973). *Money and Capital in Economic Development, Washington DC*: Brookings Institutions

Miller, M.H., „Financial Markets and Economic Growth”, *Journal of Applied Corporate Finance*, 11, 1998, pp. 8-15

Neusser, K., Kugler, M., „Manufacturing Growth and Financial Development: Evidence from OECD Countries”, *Review of Economics and Statistics,* 80, 1998, pp. 638-646

Robinson, J. (1952). *The Interest Rate and Other Essays, London*: Macmillan

Schumpeter, J. (1912). *Theorie der Wirtschaftlichen Entwicklung, Leipzig*: Duncker & Humblot.

Vaona, A., Schiavo, S., „Nonparametric and semiparametric evidence on the long-run effects of inflation on growth”, *Economics Letters*, 94, 2007, pp. 452-458

Windmeijer, F., „Afinite sample correction for the variance of linear efficient two-step GMM estimators”, *Journal of Econometrics*, 126, 2005, pp. 25-51

Theoretical and Applied Economics
Volume XVII (2010), No. 10(551), pp. 25-36

Analysis of the Value Creation in Higher Institutions: A Relational Perspective

Raquel SÁNCHEZ-FERNÁNDEZ
University of Almería, Spain
rasanche@ual.es
M. Ángeles INIESTA-BONILLO
University of Almería, Spain
miniesta@ual.es
Walesska SCHLESINGER-DÍAZ
University of Zulia, Venezuela
walesskas@ouo.com
Pilar RIVERA-TORRES
University of Zaragoza, Spain
privera@unizar.es

Abstract. *Despite the growing interest in value creation, a review of the relevant educational literature reveals that there is no generally accepted and empirically confirmed relational model of the student value creation process. This paper contributes in this way, analyzing several antecedents and consequences in the value creation process between graduates and their universities. We therefore study the effects of the quality of the student-professor interaction, trust, and university image on student perceived value. Moreover, we analyze the impact of perceived value on student satisfaction and loyalty. An empirical study was carried out in order to test the proposed theoretical model. The findings provide relevant academic and managerial implications for strategic decision-making at universities.*

Keywords: perceived value; quality of the student-professor interaction; trust; image; satisfaction; loyalty; higher education.

JEL Code: M14.
REL Code: 4C.

1. Introduction

In a world where knowledge has become a key resource, governments have realised the importance of developing the intellectual capital of their citizens. In this context, the topic of value creation has become of great importance in the policies and practices of a lot of institutions in recent years (Sakthivel, Raju, 2006). Approaching higher education institutions as service providers to the very complex net of social agents to whom they must offer effective solutions and added value, determines the base for the application of the Relationship Marketing Theory. The concept of relationship marketing is at "the forefront of marketing practice and academic research" (Berry, 1995, p. 23, Verhoef, 2003). This is especially true in the field of services marketing (Henning-Thurau et al., 2001). Higher education institutions can be considered service organizations (Cave et al., 1997). However, a relational approach has only recently been applied to the specific field of services marketing (Helgesen, Nesset, 2007, Henning-Thurau et al., 2001).

Relationship marketing literature relates to variables such as trust, value, communication or loyalty (Bryce, 2007, Gwinner et al., 1998, Morgan, Hunt, 1994, Parvatiyar, Sheth, 1994, Webster, 1994). These variables are necessary to develop and maintain long-term relationships with stakeholders. However, as Fournier (1998) point out, such relationships are likely to remain elusive for most marketers without a more precise understanding of when and why consumers respond favourably.

This paper applies the precepts of the relationship marketing in an analysis of management education as a service encounter between the professor and the students. Moreover, this study wants to extend previous efforts in the analysis of value creation in education by examining this construct under a relational perspective, delving into its relationship with variables such us quality of the interaction, trust, image, satisfaction and loyalty. It attempts to contribute to the growing research on customer-company (specifically *graduate-university*) relationships (Bergami, Bagozzi, 2000, Bhattacharya, Sen, 2003) by analyzing the value creation process (Baker et al., 2003). Following Sakthivel and Raju (2006), for education to become excellent, perceived value should have the greatest impact on students' knowledge and personal development. But the growing body of knowledge of value is fragmented. Different points of view are advocated with no widely accepted way of pulling views together, especially in its relationship with other variables. There are only a few studies on value creation in the educational context (e.g. Baker et al., 2002,

Sakthivel, Raju, 2006, Unni, 2005). We suggest that this relational perspective provides a fresh and innovative view about how a higher education institution can improve its performance creating and adding value for an important stakeholder group: the students.

2. Conceptual framework and hypotheses

The examination of perceived value determination and value delivery has recently become a focal point in the marketing literature (Lee, Overby, 2004). Perceived value has gained considerable research interest as a stable construct to predict buying behaviour (Chen, Dubinsky, 2003, Pura, 2005). However, despite this growing interest in value creation, a review of the relevant educational literature reveals that there is a lack of analysis about this construct and, in particular, about its relationships with other variables. The value concept is multi-faceted and complicated by numerous interpretations, biases, and emphases (Hu et al., 2009, Huber et al., 2001). Zeithaml (1988) defined value as the consumer's overall assessment of the utility of a product based on perceptions of what is received and what is given. Regarding Sakthivel and Raju (2006, p. 557) in engineering education, perceived value is not merely transmission of technical knowledge or the degree that the student is pursuing, but something more: a value for the money that he or she has paid; he or she wants to hone leadership, communication, and interpersonal skills to acquire knowledge of the latest trends in technology, to have exposure to industrial climate, and to face challenges in life.

In order to delve into the value creation process in the educational context, we propose an integrative model of student perceived value that considers several antecedents and consequences of this construct (Figure 1). This integrative approach takes into account relationship marketing theory to include various aspects of educational research, thereby accounting for the special characteristics of educational institutions and their relationships with students as customers.

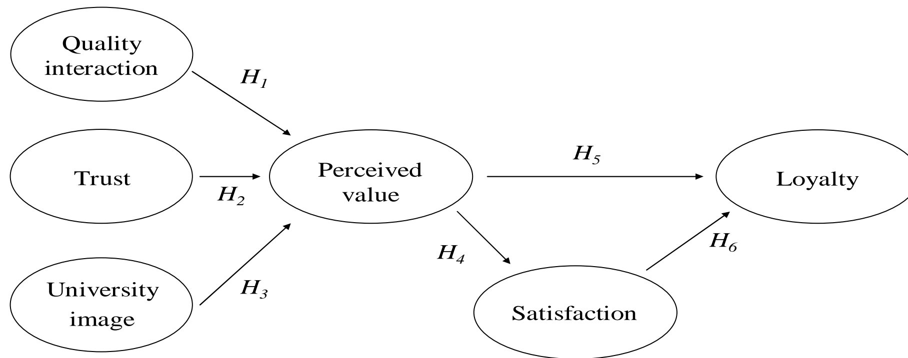


Figure 1. *Proposed model*

2.1. Quality of the student-professor interaction in the service encounter

A service encounter has been defined as the dynamic interaction between a service operation and its customers (Surprenant, Solomon, 1987). The importance of understanding the customer-contact employee service encounter has been discussed in marketing literature (Gil et al., 2008, Wong, 2004) though less frequently in the education context (Chung, McLarney, 2000, Venkatesh, Meamber, 2006). The service encounter between student and professor is analyzed like a specific and particular type of service, where an extended encounters and provision of extras and special attentions can be a significant factor in explaining service satisfaction and also positive feelings (Price et al., 1995).

Accordingly Chung and McLearny (2000, p. 485), "teaching is a service encounter", where reforms to the education process require that the student be treated as the consumer of a service (Krehbiel et al., 1997). In this way, is important that the professor recognize the student as an active participant in the service encounter (Chung, McLarney, 2000). Accepting that there is an important impact of service encounter on perceived value (Keng et al., 2007), and considering the lack of study of this relationship in an educational context, we hypothesize:

H1: The quality of the student-professor interaction has a positive and significant influence on student perceived value.

2.2. Trust

Trust has traditionally been considered as a key variable for long-lasting relationships. Moorman et al. (1992, p. 315) define this concept as "a willingness to rely on an exchange partner in whom one has confidence". In the educational context, and following the definition by Morgan and Hunt (1994), the students' trust in an educational institution can be understood as their confidence in its integrity and reliability, and it is based on the personal experiences of students with faculty members (Henning-Thurau et al., 2001).

Service literature shows evidence of the relationship between trust and perceived value (Lentz et al., 2004, Nijssen et al., 2003, Sirdeshmukh et al., 2002). Sirdeshmukh et al. (2002) affirm that trust creates value because it provides relational benefits derived from the interaction between the firm and the consumer, and it reduces uncertainty in consumers (Morgan, Hunt, 1994), but no studies exist where this relationship has been tested in the educational context. In this sense, we propose the following:

H2: The students' trust on the educational institution has a positive and significant influence on student perceived value.

2.3. University image

Kotler and Fox (1995) define image as the sum of beliefs, ideas, and impressions that a person has of an object. Corporate image is described as the overall impression made on the minds of the public about a firm (Barich, Kotler, 1991, Nguyen, LeBlanc, 2001). A Higher Education Institution (HEI) image is not absolute, but relative to the images conveyed by other HEIs. HEIs must understand the image that they portray, and make sure that the image is both an accurate and favorable reflection of the institution (Beerli et al., 2002). The various publics of universities draw conclusions about an institution's overall image from impressions they have about the strengths and weaknesses of the institution's offerings. These images are formed from word of mouth, past experience and marketing activities of the institution. This study will only consider the graduate's perception.

From the perspective of marketing, the impact of corporate image on consumer behaviour is well recognized in spite of the lack of empirical evidence. The relationship between corporate image and perceived value has not been the object of much attention in the educational literature. However, in other fields, corporate image has been studied as an antecedent or as a mediator

of constructs regarding the evaluations of organizations, products or services – perceived quality, perceived value, loyalty – individually or together with satisfaction (Beerli et al., 2002, Nguyen, LeBlanc, 2001, Pina et al., 2006). In particular, the image-value relationship has been validated in the service literature (Barich, Kotler, 1991, Nguyen, LeBlanc, 2001). In accordance with the arguments above, we hypothesize:

H3: The university image by students has a positive and significant influence on student perceived value.

2.4. Student satisfaction and loyalty

The importance of measuring the satisfaction variable stems from its relationship to customer loyalty (Galloway, 1998). In current competitive environments, repeated purchases by customers are necessary in order to guarantee the survival of the organisations, which means customer retention. This situation affects most sectors, and higher education is certainly not beyond being (Helgesen, Nesset, 2007).

Customer satisfaction has been widely debated in the literature, but there is no consensus about the definition of the concept of satisfaction with the service, specially in higher education (Hartman, Schmidt, 1995). An adaptation of the definition of student satisfaction is the one proposed by Elliot and Healy (2001), who indicate that it is a short-term attitude that results from the evaluation of their experience with the education service received.

The connection between perceived value and customer satisfaction has been debated. Apparently, there is a growing recognition that satisfaction is positively influenced by perceived value (Chen, Dubinsky, 2003, Sakthivel, Raju, 2006, Yang, Peterson, 2004). However, some researchers propose an opposite relationship (Bolton, Drew, 1991, Petrick et al., 2001). Based on the above discussions, the following hypothesis is proposed:

H4: The student perceived value has a positive and significant influence on student satisfaction.

Regarding loyalty, this can be defined as the consumer's relationship over time toward one specific object (a vendor, brand, service supplier) (Söderlund, 2006). Student loyalty has become essential for the survival of higher education institutions (Helgesen, Nesset, 2007). Maintaining long lasting relationships with students creates a competitive advantage for universities (Henning-Thurau et al., 2001). Given their current situation, the falling number of incoming

students, the increasing number of those that leave their studies, and the requirements of the Bologna Declaration (1999), among others, justify the importance of analyzing loyalty in this context (Helgesen, Nesset, 2007). In this study, the term „student loyalty" refers to the loyalty of a student after his or her time at the university.

In the value literature, empirical findings have denoted the indirect influence of perceived value on loyalty through the consumer satisfaction (Yang, Peterson, 2004), though some authors do not validate this relationship (Andreassen, Lindestad, 1998). Further, some studies show the direct effect of perceived value on loyalty (Cronin et al., 2000, Sirdeshmukh et al., 2002, Yang, Peterson, 2004), but others do not validate this relationship (Varki, Colgate, 2001, Wang et al., 2004).

In the services context in general, satisfaction and loyalty are closely related, and satisfaction is an antecedent variable of loyalty (Dick, Basu, 1994). Similarly, in the higher education sector, the concepts of loyalty and satisfaction are also closely related to each other, whereby the same causal relationship between them can become established (Helgesen, Nesset, 2007, Söderlund, 2006). A student who is therefore satisfied with the service received may develop various attitudes and behaviours that are indicative of loyalty, among which is positive interpersonal communication with other potential customers about the university (Guolla, 1999), and/or students may show the intention to return to participate in other courses offered by the same university (Patterson et al., 1997).

Consequently, the following hypotheses are set forth:

H5: There is a positive and significant relationship between student perceived value and loyalty.

H6: There is a positive and significant relationship between student satisfaction and loyalty.

3. Research method and results

A field study was conducted in two Spanish universities, collecting the data from a random sample of 1000 graduates. This exploratory analysis was developed in order to test the validity of the measurement scales and the relationships hypothesized. The scale of the quality of the student-professor interaction was adapted from Peiró et al. (2005). Trust to the institution was measured adapting the one proposed by Morgan and Hunt (1994), and image was measured through the scale of Nguyen and LeBlanc (2001). For the

measurement of perceived value we adapted the scale of Dodds et al. (1991), and for satisfaction the one used by Fornell (1992). Finally, loyalty was measured through the intention to return to the university and through the positive interpersonal communication that students may provide, adapting the scales of Martensen et al. (1999) and Henning-Thurau et al. (2001). For all constructs, a 11-item Likert-type scale (*completely disagree* to *completely agree*) was employed.

We used structural equation modelling with LISREL 8.80 to assess the measurement properties of the scales and test the hypothesized relationships. Reliability was calculated with Cronbach's Alpha (higher than .9 for all measures), Bagozzi and Yi's (1988) composite reliability index (all values were higher than .8), and Fornell and Larcker's (1981) average variance extracted index (higher than .7 for all the measures). The overall fit indices provide support for the fit of the proposed conceptual model (^{2} (194)=1321.46; p=.00; GFI=.89; CFI=.98; RMSEA=.07; NNFI=.98; IFI=.98). All items loaded on their hypothesized factors, and the estimates were positive and significant. The results demonstrated the convergent and discriminant validity of the scales.

Results of the structural equation model (^{2} (161)=1102.39; p=.00; GFI=.90; CFI=.98; RMSEA=.07; NNFI=.98; IFI=.98) lend support for all the hypotheses. Quality of the student-professor interaction has a significant influence on perceived value (.49, p<.01) and also trust and image influence value (.56, p<.01; .59, p<.01). Moreover, the results suggest that perceived value is an antecedent of consumer satisfaction (.47, p<.01) and loyalty (.14, p<.01), and that satisfaction also mediates the impact of perceived value on loyalty. The results of an appropriate structural equation model confirm the importance of the relationship among all these variables in the educational context.

4. Conclusions and implications

This work attempts to provide a better understanding of the management of the student-university relationship, delving into the value creation process through the identification of possible antecedents and consequences of students' perceived value. Results confirm previous findings in this field and others beyond the educational context, showing that perceptions of value in the educational service encounter are influenced by the quality of the student-professor interaction, the student trust, and the university image. Findings also reveal that perceived value contributes to students' satisfaction and loyalty. Therefore, the proposed model and associated measurement instruments can

reliably and consistently be applied for higher educational institutions, providing useful information for strategic decisions of universities.

These results have significant academic and managerial implications for universities and non profit organizations. Thus, quality of the student-university interaction, university image and students' trust are three of the key factors in creating satisfied and loyal students, through a value creation process. The findings show that creating and maintaining the link or closeness between student and university constitutes an attractive relationship for users with a great potential for generating behavioural and affective positive responses to the organization. Improving interaction between students and professors could be useful to generate user identification with the organization, perceived value and loyalty. These conclusions should encourage universities to dedicate effort and invest resources to reinforce the link with one of its main stakeholders: students, and thus, succeed in obtaining a higher identification with the educational institution and in their retention.

In light of the results, it would be interesting to replicate and extend this study to other contexts, including other related variables such as commitment or student-university identification. Moreover, further research would be necessary to consider the multidimensional nature of perceived value in the educational context, following the suggestions of Sakthivel and Raju (2006).

References

Andreassen, T.W., Lindestad, B., „Customer loyalty and complex services", *International Journal of Service Industry Management*, 9, 1, 1998, pp. 7-23

Bagozzi, R.P., Yi, Y., „On the evaluation of structural equation models", *Journal of the Academy of Marketing Science*, 16, 1, 1998, pp. 74-94

Baker, J., Parasuraman, A., Grewal, D., Voss, G.B., „The influence of multiple store environment cues on perceived merchandise value and patronage intentions", *Journal of Marketing*, 66, 2, 2002, pp. 120-141

Baker, S.M., Kleine, S.S., Bennion, M., „What do they know? Integration the core concept of customer value into the undergraduate marketing curriculum and its assessment", *Journal of Marketing Education*, 25, 1, 2003, pp. 79-89

Barich, H., Kotler P., „A framework for marketing image management", *Sloan Management Review*, 32, 4, 1991, pp. 94-104

Beerli, A., Díaz, G., Pérez, P., „The configuration of the university image and its relationship with the satisfaction of students", *Journal of Educational Administration*, 40, 5, 2002, pp. 496-505

Bergami, M., Bagozzi, R.P., „Self-categorization, affective commitment and group self-esteem as distinct aspects of social identity in the organization", *British Journal of Social Psychology*, 39, 4, 2000, pp. 555-577

Berry, L.L., „Relationship marketing of services – growing interest, emerging perspectives", *Journal of the Academy of Marketing Science*, 23, 4, 1995, pp. 236-245.

Bhattacharya, C., Sen, S., „Consumer-company identification: A framework for understaning consumers' relationships with companies", *Journal of Marketing*, 67, 2, 2003

Bolton, R.N., Drew, J.H., „A multistage model of customers' assessments of service quality and value", *Journal of Consumer Research*, 17, 4, 1991, pp. 375-384

Bryce, H., „The public´s trust in nonprofit organizations: The role of relationship marketing and management", *California Management Review*, 49, 4, 2007, pp. 112-132

Cave, M., Hannery, S., Henkel, M., Fogan, M. (1997). *The use of performance indicators in higher education: a critical analysis of developing practice,* Jessica Kingsley Publishers, London and Bristol, Pennsylvania

Cronin, J.J., Jr., Brady, M.K., Hult, G.T.M., „Assessing the effects of quality, value, and customer satisfaction on consumer behavioral intentions in service environments", *Journal of Retailing*, 76, 2, 2000, pp. 193-218

Chen, Z., Dubinsky, A.J., „A conceptual model of perceived customer value in e-commerce: A preliminary investigation", *Psychology & Marketing*, 20, 4, 2003, pp. 323-347

Chung, E., McLarney, C., „The classroom as a service encounter: Suggestions for value creation", *Journal of Marketing Education*, 24, 4, 2000, pp. 484-500

Declaration, B. (1999). *European space for higher education*, European Commision

Dick, A.S., Basu, K., „Customer loyalty: Toward an integrated conceptual framework", *Journal of the Academy of Marketing Science*, 22, 2, 1994, pp. 99-113

Dodds, W.B., Monroe, K.B., Grewal, D., „Effects of price, brand, and store information on buyers' product evaluations", *Journal of Marketing Research*, 28, 3, 1991, pp. 307-319

Elliot, K.M., Healy, M.A., „Key factors influencing student satisfaction related to recruitment and retention", *Journal of Marketing for Higher Education*, 10, 4, 2001, pp. 1-11

Fornell, C., „A national customer satisfaction barometer, the Swedish experience", *Journal of Marketing*, 56, 1, 1992, pp. 6-21

Fornell, C., Larcker, D.F., „Evaluating structural equation models with unobservable variables and measurement error", *Journal of Marketing Research*, 18, 1, 1981, pp. 39-50

Fournier, S., „Consumers and their brands: Developing relationship theory in consumer research", *Journal of Consumer Research*, 24, 4, 1998, pp. 343-373

Galloway, L., „Quality perceptions of internal and external customers: A case study in educational administration", *The TQM Magazine*, 10, 1, 1998, pp. 20-26

Gil, I., Berenguer, G., Cervera, A., „The roles of service encounters, service value and job satisfaction in achieving customer satisfaction in business relationships", *Industrial Marketing Management*, 37, 8, 2008, pp. 921-939

Guolla, M., „Assessing the teaching quality to student satisfaction relationship: applied customer satisfaction research in the classroom", *Journal of Marketing Theory and Practice*, 7, 3, 1999, pp. 87-98

Gwinner, K., Gremler, D., Bitner, M.J., „Relational benefits in services industries: the customer's perspective", *Journal of the Academy of Marketing Science*, 26, 2, 1998, pp. 101-114

Hartman, D., Schmidt, S., „Understanding student/alumni satisfaction for a consumers´ perspective", *Research in Higher Education*, 36, 2, 1995, pp. 197-217

Helgesen, O., Nesset, E., „What accounts for students' loyalty? Some field study evidence", *International Journal of Educational Management*, 21, 2, 2007, pp. 126-143

Henning-Thurau, T., Langer, M.F., Hansen, U., „Modelling and managing student loyalty. An approach based on the concept of relationship quality”, *Journal of Service Research*, 3, 4, 2001, pp. 331-344

Hu, H.H., Kandampully, J., Juwaheer, T.D., „Relationships and impacts of service quality, perceived value, customer satisfaction, and image: An empirical study”, *The Service Industries Journal*, 29, 2, 2009, pp. 111-125

Huber, F., Herrmann, A., Morgan, R.E., „Gaining competitive advantage through customer value oriented management”, *The Journal of Consumer Marketing*, 18, 1, 2001, pp. 41-53

Keng, C.J., Huang, T.L., Zheng L.J., Hsu, M.K., „Modeling service encounters and customer experiential value in retailing. An empirical investigation of shopping mall customers in Taiwan”, *International Journal of Service Industry Management*, 18, 4, 2007, pp. 349-367

Kotler, P., Fox, K. (1995). *Strategic marketing for educational institutions,* Prentice-Hall, Englewood Cliffs, NJ

Krehbiel, T., McClure, R., Pratsini, E., „Using student disconfirmation as a measure of classroom effectiveness”, *Journal of Education for Business*, 72, 4, 1997, pp. 224-230

Lee, E.J., Overby, J.W., „Creating value for online shoppers: Implications for satisfaction and loyalty”, *Journal of Consumer Satisfaction*, *Dissatisfaction and Complaining Behavior*, 17, 2004, pp. 54-67

Lentz, P., S., Teusner, Holzmueller, H.H., „Customer satisfaction, trust, value, and loyalty in relational B2B exchanges”, *EMAC Conference*, 18-20 May, 2004

Martensen, A., Gronholdt, L., Eskildsen, J., Kristensen, K., „Measuring student oriented quality in higher education: application of the ECSI methodology”, *TQM for Higher Education Institutions*, 1999

Moorman, C.R., Zaltman, G., Deshpandé, R., „Relationships between providers and users of market research: The dynamics of trust within and between organizations”, *Journal of Marketing Research*, 29, 3, 1992, pp. 214-329

Morgan, R., Hunt, S., „The Commitment Trust Theory of Relationship Marketing”, *Journal of Marketing*, 58, 3, 1994, pp. 20-38

Nguyen, N., LeBlanc, G., „Image and reputation of higher education institutions in students' retention decisions”, *The International Journal of Educational Management*, 15, 6, 2001, pp. 303-311

Nijssen, E., Singh, J., Sirdeshmukh, D., Holzmüeller, H., „Investigating industriy context effects in consumer-firm relationships: Preliminary results from a dispositional approach”, *Journal of the Academy of Marketing Science*, 31, 1, 2003, pp. 46-60

Parvatiyar, A., Sheth, J.N. (1994). *Paradigm Shift in Marketing Theory and Approach: The Emergence of Relationship Marketing*, In: A. Parvatiyar and J.N. Sheth (ed.): *Relationship Marketing: Theory, Methods and Applications*, Emory University, Atlanta

Patterson, P.G., Johnson, L.W., Spreng, R.A., „Modeling the determinants of customer satisfaction for business-to-business professional services”, *Journal of the Academy of Marketing Science*, 25, 1, 1997, pp. 4-17

Peiró, J.M., Martínez-Tur, V., Ramos, J., „Employees' overestimation of functional and relational service quality: A gap analysis”, *The Service Industries Journal*, 25, 6, 2005, pp. 1-17

Petrick, J.F., Morais, D.D., Norman, W.C., „An examination of the determinants of entertainment vacationers' intentions to revisit”, *Journal of Travel Research*, 40, 1, 2001, pp. 41-48

Pina, J., Martínez, E., De Chernatony L., Drury, S., „The effect of service brand extensions on corporate image. An empirical model”, *European Journal of Marketing*, 40, 1/2, 2006, pp. 174-197

Price, L.L., Amould, E.J., Tierney, P., „Going to extremes: managing service encounters and assessing provider performance”, *Journal of Marketing*, 59, 2, 1995, pp. 83-97

Pura, M., „Linking perceived value and loyalty in location-based mobile services”, *Managing Service Quality*, 15, 6, 2005, pp. 509-538

Sakthivel, P.B., Raju, R., „An instrument for measuring engineering education quality from students' perspective”, *The Quality Management Journal*, 13, 3, 2006, pp. 23-34

Sirdeshmukh, D., Singh, J., Sabol, B., „Consumer trust, value, and loyalty in relational exchanges”, *Journal of Marketing*, 66, 1, 2002, pp. 15-37

Söderlund, M., „Measuring customer loyalty with multi-item scales: A case for caution”, *International Journal of Service Industry Management*, 17, 1, 2006, pp. 76-98

Surprenant, C., Solomon, M.R., „Predictability and personalization in the service encounter”, *Journal of Marketing*, 51, 2, 1987, pp. 86-96

Unni, R.M., „Value perceptions and retention of textbooks among marketing and other business majors”, *Marketing Education Review*, 15, 2, 2005, pp. 71-79

Varki, S., Colgate, M., „The role of price perceptions in an integrated model of behavioral intentions”, *Journal of Service Research*, 3, 3, 2001, pp. 232-240

Venkatesh, A., Meamber, L.A., „Arts and aesthetics: Marketing and cultural production”, *Marketing Theory*, 6, 1, 2006, pp. 11-39

Verhoef, P., „Understanding the effect of customer relationship management efforts on customer retention and customer share development”, *Journal of Marketing*, 67, 4, 2003, pp. 30-45

Wang, Y., Lo, H.P., Chi R., Yang Y., „An integrated framework for customer value and customer-relationship-management performance: A customer-based perspective from China”, *Managing Service Quality*, 14, 2/3, 2004, pp. 169-182

Webster, F.E.J., „Defining the new marketing concept”, *Marketing Management*, 2, 4, 1994, pp. 22-31

Wong, A., „The role of emotional satisfaction in service encounters”, *Managing Service Quality*, 14, 5, 2004, pp. 365-376

Yang, Z., Peterson, R.T., „Customer perceived value, satisfaction, and loyalty: The role of switching costs”, *Psychology & Marketing*, 21, 10, 2004, pp. 799-822

Zeithaml, V.A., „Consumer perceptions of price, quality, and value: a means-end model and synthesis of evidence”, *Journal of Marketing*, 52, 3, 1988, pp. 2-22

Theoretical and Applied Economics
Volume XVII (2010), No. 10(551), pp. 37-48

Effects of the Formula for Common Consolidated Corporate Tax Base Apportionment

Gheorghe MATEI
University of Craiova
ghematei@yahoo.com
Daniela PÎRVU
University of Piteşti
ddanapirvu@yahoo.com

Abstract. *For solving the existing difficulties in corporate income taxation, the European Commission proposed the introduction of measures for coordination, solution contested by some Member States but supported by most professionals and many organizations representing the interests of European employers. Disputes in connection with the introduction of the "Common Consolidated Corporate Tax Base" system are determined by the uncertainty regarding its effects. In this context, we intend to present and analyze some effects of applying the EU formula apportionment.*

Keywords: fiscal coordination; tax base; consolidation; apportionment; effects.

JEL Codes: G32, H25.
REL Code: .

1. Introduction

In accordance with the European Union Treaty, Member States have a full autonomy in the direct taxation, including corporate income taxation. This autonomy may be limited only if the domestic taxes are not compatible with the EU law. In principle, the national tax legislation should not create obstacles to cross-border economic transactions. In fact, the existence of 27 corporate income taxation national systems is a significant obstacle to the proper functioning of the Single Market. The main difficulties generated from the lack of common rules on corporate taxation refers to the costs of knowing the tax legislation in each Member State, monitoring of the transfer pricing, the risk of double taxation, the general inability to offset the losses in one Member State with the revenues in another state and the possibility of transferring the tax base from countries with high tax to countries with low tax levels.

Many authorities have introduced regulations on the transfer pricing and intra-group loans (commonly used channels to move the tax base from one country to another), in an attempt to limit the handling of the corporate tax systems, but these rules has shown limited effectiveness because they have contributed to the increasing of the tax laws complexity and to the registration of additional costs for companies. Generally, the differences and incompatibilities of the national corporate income tax distort the efficient investment location and give rise to disputes between taxpayers and tax authorities and between tax authorities from different countries.

For solving the existing corporate income taxation problems, the European Commission proposed the introduction of measures for coordination, solution contested by some Member States but supported by most specialists, many organizations representing the interests of employers and public authorities in countries affected by migration of capital located in their territory under the influence of tax competition manifested in the European Union. A decision regarding the setting of the framework for coordination of corporate income taxes has not yet been taken, but there were made important steps in this direction.

To assess the effects introduction of some measures to coordinate the corporate income taxes in the European Union, numerous studies and reviews were developed either by independent specialists or by specialist services of the European Commission or at its request, but the results are uncertain because many of the "Common Consolidated Corporate Tax Base" technical aspects have not yet been established. The formula for common consolidated corporate

tax base apportionment between tax jurisdictions is one of those technical issues for the European Commission will have to make a clear choice between one or more specific possibilities.

2. The formula for common consolidated corporate tax base apportionment – general aspects

The formula for common consolidated corporate tax base apportionment generated many discussion among experts. It is necessary that this formula to be transparent and simple, do not involve compliance costs and excessive administration, to reduce the possibility of moving the corporate allocation factors from one location to another and do not cause distortions in the European Union business environment (Agúndez-García, 2006).

Starting from the practical experience of countries that provided a such formulation (US and Canada), the experts have proposed a formula for common consolidated corporate tax base apportionment, based on factors that characterize the individual companies or on value added by the company through the economic activity on the territory of a country (Hellerstein, McLure, 2004).

Using characteristic factors of individual companies allows the approach of a correlation between the real economic activity performed by a particular company on the territory of a country and the consolidated tax base state apportioned in that country. The concrete choice of one (some) of these factors is likely to generate significant differences between Member States because the use of home-based factors (labor and capital) will provide higher revenues in states with higher production than consumption, while the choice of sales favours the states with large consumer markets. In addition, there is a risk of manipulation by the authorities because the states may try to attract economic activities – even no profitable on its own territory – only to increase its share of consolidated tax base and to maximize the revenues (Negrescu, 2007).

For the allocation of common consolidated tax base on tax jurisdictions, the aggregate factors at national level (macro) as gross domestic product or value added tax may be used. Since the use of aggregate factors at national level does not take into account, in particular, the economic value created by the group companies that is the subject of the tax base consolidation in each country, the Working Group to design the "Common Consolidated Corporate Tax Base" has proposed an apportionment formula based on three factors: assets, sales volume and employment. The document presenting the European

Commission the mechanism for common consolidated tax base apportionment shows that the Working Group tried to create an easy apportionment mechanism to implement and to check both for taxpayers and tax administrations, a fair and equitable apportionment mechanism for all Member States in order to not generate undesirable effects in terms of tax competition. To avoid the manipulation of the system by taxpayers, the Working Group turned to the factors that cannot be artificially transferred between different tax jurisdictions.

The formula for tax base apportionment of the company A, as was shown in the document Working Group, is:

$$BFC_i^r = BFC \; \frac{V_i / \sum V_{grup}}{m} + \frac{1}{n} \; \frac{F_{S_i} / \sum Fs_{grup}}{2} + \frac{Na_i / \sum Na_{grup}}{2} + \frac{A_i / \sum A_{grup}}{o}$$

where:

BFC_i^r is the apportionment tax base in the tax jurisdiction of the “i” company, member of the group that is the subject of consolidation;

BFC is the common consolidated tax base of the companies group;

V_i is the sales of “i” company;

V_{grup} is the sales of companies group;

Fs_i is the wages fund of “i” company;

Fs_{grup} is the wages fund of companies group;

Na_i is the employees of “i” company;

Na_{grup} is the employees of companies group;

A_i is the assets of “i” company;

A_{grup} is the assets of companies group;

m, n, o are weights given to each factor, so $m + n + o = 1$.

All taxable income (both production activities and/or sale, as well as interest, royalties, dividends etc.) obtained by the companies that choose to use this system should be consolidated and distributed to the formula above. In other words, Member States should not allow further adjustments of the tax base allocated, to not increase the system complexity and to not offer the possibility of the profit movement within the group of companies.

Calculations for allocating the tax base will be made annually. A positive consolidated tax base (net profit) will be distributed immediately and a negative consolidated tax base (net loss) will be compensated in the future in the group

of companies with net profit. Where a company leaves the group of companies which chose for the consolidated tax base or where a company joins a group that has opted for the consolidated tax base, the consolidation and distribution of the tax base will be made for a fraction of the tax period in which the company was a member of the group.

3. The mechanism for common consolidated corporate tax base apportionment

To establish the formula for allocating the common consolidated tax base, the Working Group has opted for both inputs (labor and capital) as well as factors expressing the economic performance of the company (turnover).

In terms of workforce, the Working Group made the following comments:

- the coverage of this factor will be for the entire company's personnel (including managers, directors and employees with temporary labor contracts);
- the cost of workforce will cover all deductible expenses used to determine the tax base (both wages and social contributions, fringe benefits, etc.). Some experts in the Working Group argue that a proper allocation of the tax base depending on the cost of workforce required adjustments to correct the differences in wage levels between EU Member States;
- where a person is employed by a company, member of the group and resident of the State A, but he/she works for another company, member of that group and resident of the State B, he/she will be recorded (for the distribution base purposes) in the State B. Employees engaged in a company that has opted for common consolidated corporate tax base apportionment for a period less than the fiscal year will be recorded for a fraction of the tax period in which they worked for the company.

In terms of capital (assets), the Working Group made the following comments:

- to simplify the EU formula apportionment and to exclude the possibility of taxpayers to manipulate the tax system, the “Common Consolidated Corporate Tax Base” will be considered only the immovable assets, i.e. the tangible fixed assets (land and buildings, plant, equipment, etc.). Therefore, even if the stocks are an important part of the assets in certain sectors (e.g. retail trade), to avoid the manipulation of the system by the taxpayers (the establishment of some warehouses in the Member States with low corporate tax rate to

guide a part of the tax base in that State by increasing the "assets" factor), the European Commission recommended to exclude them from apportionment formula;

- the valuation of the assets will be realized by deducting depreciation from the asset's historical cost, but the Working Group has not ruled out the possibility of using other valuation methods;
- the location of assets will be established in the country where they are effectively used in business. Thus, in the apportionment formula, the assets will be assigned a company registered in terms of depreciation accounting. Such a rule would generate effects for leased assets between member companies of the same group or from other companies. In the first case, the owner of assets will make a statement on the place where the assets are used, so they will be accounted by the company that they actually use, in order to apply the apportionment formula. In the second situation, the lessee (the company which leased) will account the assets using a fixed rate: the 8th part of the annual rental rate.

In terms of sales (turnover), the Working Group made the following comments:

- most experts in the Working Group supported the use of the value of sales "at home" (considering the place from which the goods are delivered), in the apportionment formula. The European Commission however considers that the sales "at home" as factor have a poor conceptual base in terms of income generation, reproducing, significantly, the role of assets and workforce as factors that generate income. In addition, the location of sales "at home" could be easily manipulated, because the place of shipment to third parties is easily changed (although the eventual cost of transport must be taken into account). This risk is significantly reduced when the apportionment formula used sales "at the destination", but Member States where the population's purchasing power is greater will be favoured over other countries. When the destination of goods sold/services provided is a Non-member State or a Member State in which the group of companies does not have an economic entity as subject to corporation tax, the importance of the sales factor, which in fact reflects the company's business volume, will decrease for "workforce" factor and for "assets" factor. The existence of "Internet sales" was a challenge for the Working Group members. In this respect, they concluded that

only the companies that have a physical presence in the Member States may choose to use the "Common Consolidated Corporate Tax Base" system;

- the "sales" factor will only cover the receipts from the sale of goods and services, excluding the income from capital gains and extraordinary income;
- the intra-group sales will not be taken into account thus eliminating the problem of transfer pricing.

4. Opinions regarding the effects of the common consolidated corporate tax base apportionment

The introduction of the "Common Consolidated Corporate Tax Base" system will generate complex effects, both economic and social. According to studies prepared in this respect, the countries that will benefit from gains in GDP and in welfare, will also lose some tax revenue, and the countries that will suffer reductions in the GDP and welfare, will also get additional tax revenue (Brøchner at al., 2006).

Considering a simple example, we see the impact that it will generate common consolidated corporate tax base apportionment from income tax. We assume that there are a corporation formed by parent company and its subsidiary, which we know the following information:

The parent company		The subsidiary	
Turnover (thousand Euros)	200,000	Turnover (thousand Euros)	50,000
Payroll (thousand Euros)	30,000	Payroll (thousand Euros)	10,000
Number of employees (persons)	1,500	Number of employees (persons)	1,200
Assets (thousand Euros)	1,000,000	Assets (thousand Euros)	200,000
Taxable income (thousand Euros)	0	Taxable income (thousand Euros)	500
Tax rate	25%	Tax rate	16%

In the situation described above, the parent company will not pay anything (corporate income tax) because it has not been earning and the subsidiary will pay the income tax in the amount of 80 thousand Euros.

Giving an equal important for tax base apportionment factors we find the following situation:

The tax base of parent company = [1/3(200000/250000) + 1/6(30000/40000) +1/6(1500/2700) + 1/3(1000000/1200000)] x 500 thousand Euros = 381.02 thousand Euros

The income tax paid to the residence state of the parent company = 381.02 thousand Euros × 25% = 95.25 thousand Euros

The tax base of subsidiary = [1/3(50000/250000) + 1/6(10000/40000) + 1/6(1200/2700) + 1/3(200000/1200000)] × 500 thousand Euros = 118.98 thousand Euros

The income tax paid to the residence state of the subsidiary = 118.98 thousand Euros x 16% = 19.04 thousand Euros

Therefore, the parent company will pay tax in the amount of 95.25 thousand Euros to the resident state even if it has not recorded gains in its territory and the subsidiary will pay tax in the amount of 19.04 thousand Euros. Overall, the corporation will pay a higher tax, and the two states involved in the distribution will be positioned as a winner or loser.

The evaluation of the effects of the common consolidated corporate tax base apportionment is a very difficult step, but a number of scholars have made attempts in this regard.

The first study assessed the impact of the introduction and distribution rules to strengthen the tax base for corporations in the European Union was made by Fust et al. (2006). In the absence of a comprehensive database with information on companies in all EU Member States, the authors focused on the work undertaken by parent companies in Germany and their subsidiaries abroad between 1996-2001. Particular conditions of the analysis of the three German authors have generated the following results (Fuest et al., 2006):

- enhancing and sharing the corporate income tax base will generate losses of tax revenue for small states using tax incentives, because the attracted tax bases in these countries are high compared with real economic activity taking place on their territory (measured by assets, turnover and wage fund);
- compensation for loss of income in cross-border activities will generate a significant decrease in the total tax base. In the case of the analysis for 1,844 parent company in Germany and 5,827 foreign subsidiaries, reducing the total tax base was estimated at 20%.

Starting from the premise that the companies with cross-border activity will not change the location choices by introducing rules to harmonize corporate income in the European Union, Devereux and Loretz (2007)

estimated effects of the EU formula apportionment on corporate tax revenues in the 22 Member States. They have done a complete analysis (for all Member States) because the database used did not contain the information on the number of employees and payroll for companies in certain states (essential for determining the tax base shared by Member States). The study was based on financial results provided by some 400,000 companies that had assets worth at least two million and carried on business within the 25 states in 2000-2004 (using the database provided by the organization Orbis Bureau van Dijk).

The results reached by the authors of the study are presented in Table 1.

Table 1

Revenues from corporate income tax in the Member States of the European Union (total 2000-2004)

Country	Revenues from corporate income tax according to EUROSTAT (million $)	Revenues from corporate income tax paid by companies in the database (million $)	Revenues from corporate income tax after the consolidation and the distribution of the tax base (million $)	The collection degree of revenues from corporate income tax (%)
Austria	28,702	7,846	7,461.55	95.1
Belgium	51,813	30,701	28,644.03	93.3
Czech Republic	18,692	8,727	10,428.77	119.5
Denmark	29,642	20,727	19,732.10	95.2
Estonia	610	187	539.31	288.4
Finland	32,315	24,310	20,225.92	83.2
France	245,609	151,772	148,888.33	98.1
Germany	150,411	124,630	108,054.21	86.7
Greece	29,131	12,630	12,074.28	95.6
Hungary	8,559	3,867	4,621.07	119.5
Ireland	26,120	9,518	9,546.55	100.3
Italy	213,517	197,490	186,233.07	94.3
Latvia	929	657	655.69	99.8
Lithuania	995	309	321.98	104.2
Luxembourg	9,445	1,565	1,380.33	88.2
Nederland	84,755	22,399	22,331.80	99.7
Poland	21,926	17,104	17,565.81	102.7
Portugal	23,849	14,097	13,659.99	96.9
Slovakia	3,968	2,054	2,709.23	131.9
Spain	128,663	76,246	75,864.77	99.5
Sweden	42,920	25,782	28,772.71	111.6
United Kingdom	270,834	133,358	144,560.07	108.4
Total	1,423,405	885,799	864539.82	97.6

Source: Devereux, M.P., Loretz, S., The effects of EU formula apportionment on corporate tax revenues, Oxford University, Centre for Business Taxation, Working Paper no. 6, 2007, p. 16.

Therefore, the consolidation and the distribution of the corporate tax base analyzed will generate a reduction of revenues from corporate income tax by 2.4% due to cross-border offsetting of losses with profits. Most new Member States will register an increase in revenues from corporate income tax, while most states in the northern and western Europe will be faced with reducing their revenues from corporate income tax.

In 2008, Devereux and Loretz expanded the analysis on the corporate income taxation coordination impact with focus to the effects of business efficiency. Observations made at the 4567 group of companies (323,442 companies) operating in Member States (they used the same database), in 2001-2005, allowed the measurement of change in the ratio of income taxes paid and the value of corporate profits before tax in the current situation, when voluntary consolidation and in the consolidation and the distribution of the tax base situation.

Differences between the average effective corporate income tax rate in the current situation and the average effective corporate income tax rate in the consolidation and the distribution of the tax base situation are shown in Figure 1.

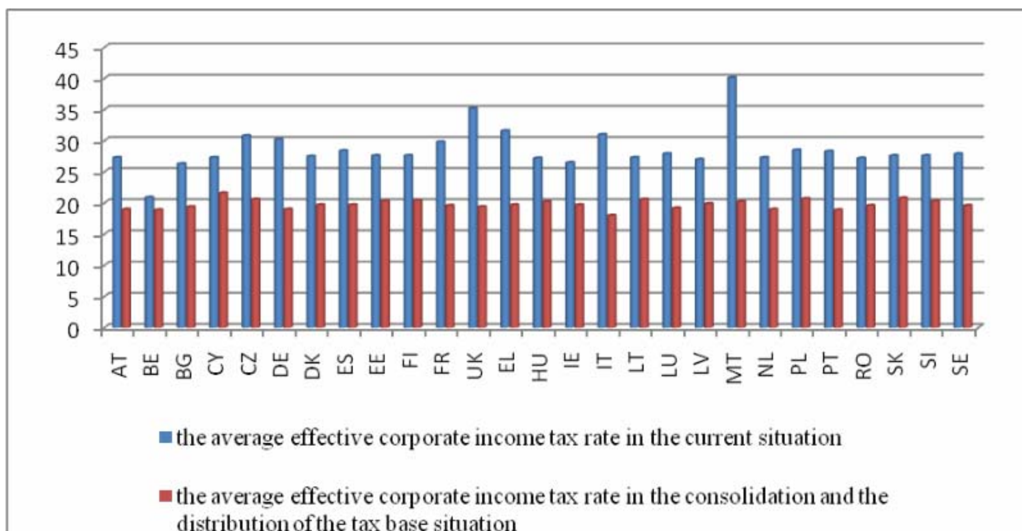


Figure 1. *The average effective corporate income tax rate in the current situation and in the consolidation and the distribution of the tax base situation (%)*

In the event of different national tax systems (current situation), the average effective corporate income tax rate registered a significant differences among Member States of the European Union (from 40.1% in Malta to 20.9% in Belgium). In the consolidation and the distribution of the tax base situation,

the average effective corporate income tax rate is reduced significantly (from 28.6% in the case of consolidation rules absence to 19.7% in the case of tax base consolidation and distribution). Also, the spread between effective corporate income tax rates existing in the European Union member countries would be reduced considerably (from 21.6% in Cyprus to 18% in Italy), creating the prerequisites to ensure some neutral fiscal conditions in the European Union. So, the analysis conducted by Michael P. Devereux and Simon Loretz in 2008 shows clear evidence of the positive impact (in terms of increased economic efficiency on the single market) that the introduction of the "Common Consolidated Corporate Tax Base" system will generate.

5. Conclusion

The idea of coordinating the corporate income tax systems is currently an important topic of discussion on the agenda of the European Commission, but also in theoretical approaches of specialists. The extreme diversity of these approaches is an important indicator of the complexity of problems that prevent the formulation of solutions widely shared, irrespective of considerations of political feasibility.

The consolidation and the distribution of the tax base will generate losses of tax revenues across the EU because losses and profits of companies arranged in groups are compensated, but the magnitude of these losses could be lower than those estimated by various experts (or even could be recorded gains of tax revenues) when a part of currently tax deductions and exemptions are eliminated. Balancing the loss of income from companies' income tax (which have a low share in GDP in most Member States of the European Union) and the benefits from the increasing business efficiency and from the eliminating opportunities for handling corporate tax base through transfer pricing and intra-group loans, we appreciate that the introduction of common consolidated corporate tax base will have a positive impact on the tax system of the European Union.

References

Agúndez-García, A. „The Delineation and Apportionment of an EU Consolidated Tax Base for Multi-jurisdictional Corporate Income Taxation: a Review of Issues and Options", European Commision, Taxation Papers, *Working Paper* no. 9, 2006

Brøchner, J., Jensen, J., Svensson, P., Sørensen, P.B., „The dilemmas of tax coordination in the enlarged European Union", *CESIFO Working Paper* no. 1859, 2006

Devereux, M.P., Loretz, S., „The effects of EU formula apportionment on corporate tax revenues", Oxford University, Centre for Business Taxation, *Working Paper* no. 6, 2007, p. 16

Devereux, M.P., Loretz, S., „Increased efficiency through consolidation and formula apportionment in the European Union?", Oxford University, Centre for Business Taxation, *Working Paper* no. 12, 2008, p. 23

Fuest, C., Hemmelgarn, T., Ramb, F., „How would formula apportionment in the EU affect the distribution and the size of the corporate tax base? An analysis based on German multinationals", Deutsche Bundesbank, *Discussion Paper*, Series 1: Economic Studies, no. 20, 2006, pp. 19-20

Hellerstein, W., McLure, Ch.E. Jr., „The European Commission's Report on Company Income Taxation: What the EU can Learn from the Experience of the US States", *International Tax and Public Finance*, Vol. 11, 2004, pp. 199-220

Negrescu, D. (coord.) (2007). *Tendin e de armonizare fiscal la nivelul Uniunii Europene. Provoc ri pentru România*, Proiect SPOS 2007 – Studii de strategie şi politici, Studiul nr. 5, Institutul European din România, pp. 61-63

Common consolidated corporate tax base working group (CCCTB WG), CCCTB: possible elements of the sharing mechanism, Brussels, 1

Theoretical and Applied Economics
Volume XVII (2010), No. 10(551), pp. 49-72

European Economics, Update. Another Ten Theses on the Economic Integration

Liviu C. ANDREI
National School of Political Studies and Public Administration, Bucharest
liviuandrei@yahoo.com

Abstract. *These theses, in their enunciation and debate sound like:*
I. There are both "incipient" and "advanced" integration processes; II. Integration changes its outline; III. There is also the „second European economics"; IV. The Communitarz Agricultural Programme (CAP), as a "mettre à l'abîme" of the whole integration process; V. The national economies convergency reads the condition of the Union itself; VI. The EU budget might be a political stake; VII. The European Monetary System (EMS) is a... paradox; VIII. The public economy might be a "thorn in the unique market's eye"; IX, Is the economic integration predestined to an unachieved strategy example?! X. Beyond all skepticism, it would be better out of the (need of) integration

All of these above try to describe the picture of a half century process, in Europe. Plus, this tries to explain why Europe is different from the rest of the world, not necessarily more or less developed or well to do, as for a usual pattern.

Keywords: economic integration; incipient & advanced integration; European economics; European Monetary Sytem (EMS); Common Agricultural Policy (CAP); "European type" taxation; public economy.

JEL Codes: E00, E52.
REL Code: 20B.

Here there is a kind of a provocation to be faced. Some rushed oppinions claim the European Union to be as different from the rest of the world economy, as even the current world-wide integration and the old economics dealing with early stages of integration might have become useless for clarifying this brand new model. I would not think about an appropriate retort to this, if there weren't not one – see, this joining the EU – but two large and shock processes, as successive, in this part of the world that we were "forced" to econter – the previous one had been the post-communist economic transition, as part of the world-wide concept of *emmerging* market economy.

So, let us first remember the nineties, in which there was not only about the "shock", versus „gradual" therapies of joining market economy to talk about, but there were also hearing some voices claiming a renewal of the "old" economics. The result was something much less spectacular: just a short polemics between apparently some individual theorists, in reality between the old schools of thinking economics – see especially neoclassics, with their liberal thinking structure, and neo-Keynesians; see liberals and social-democrats, on another plan – all likely to express as: "finally, I was right...", despite the remaining differences in their views.

Unfortunately, this one is the handicap of economics, itself: a kind of "ideology sickness", for which there were precedents in the former communist economic system. I mean that there were even brilliant mind economists forced to design solutions inside that system constraints, whereas afterwards the same scholars were taken for "Marxian-Leninist" type thinkers.

Just coming back to the integrated Europe's economy, in which even post-communist national economies now have found their place. Should we believe that it is to talk about "another economics"? No, I believe that neither the Europe's history, nor all the other histories allow such a thinking temptation. But, there is one, a truth of this "different kind" of issues. And this truth should be said as a whole.

Then, see below a syntethic description of what the author of these lines thinks that it might be the today United Europe specificity[1].

Thesis one: There are both "incipient" and "advanced" integration processes

Tsoukalis (2000, p. 268) sees three specific effective stages of integration in the Europe's case – as a world-wide extended process, integration might face different effective stages for each region in part. But this is different for

"incipient", versus "advanced" integration processes, due first to basic conceptual terms. Then, the same classification extends from the basic conceptual picture which makes things common for all circumstances and areas of integration.

As for conceptual terms, first, Balassa (1961) stays in place with his "five stages" of economic integration[(2)]. So, the Hungarian native economist's theory was almost a programme document for this process, despite critics that there might be today. As for this moment, the "five stages" conversion into only two would relate the early incipient period to the free exchange area and the customs union, and the advanced integration to the unique (common) market, with economic convergence and optimum currency area (Andrei, 2009a).

And beyond the conceptual part of the issue, there is to be noticed that Europe really becomes a unique area, whereas the "incipient" integration equals such a project-initiative enlarged world-wide (Andrei, 2009a, pp. 65-66), together with its conceptual basics. Of course, Europe was the ultimate source for developments all over. Developments change when integration splits into incipient, versus advanced, the last.

Splitting the *incipient* from the *advanced* integration comes on the latter claimed by the EU only, so "Europe is unique" world-wide. In correct terms, all knowledge about this part of integration process works on the European corresponding region, up to a "universal definition" of the concept. No precedent of or retort to integration, as European so far. In other words, on the one hand, the distinciton between advanced and incipient integration is equally a geographical one between Europe and the rest of the world.

The other aspect of such an inside distinction of the two parts and time terms of integration comes on the one (see, the incipient one) in which the project of integration rather expects initiative, objectives formulation, strategy and action on, and on the other (see, the advanced one) in which the same subjective factor is rather going subordinate to facts and events acting by themselves as necesary and, sometimes, even urgent.

In the incipient integration conditions, the member state yet feels free to quit the agreement and come back to its former non-member state (on its own) and individual subject of the international law status – and that acting according to the national interest. Such events have already occured out of the EU (ibidem). On the contrary, in the advanced integration conditions, the member state is forced to act together with the other member states (with the union, as entirely) and any crucial initiative taken apart from the union – all the more, leaving the union for its former internatinal status – produces higher costs to be

beared. Actually, these costs get higher on both sides: the one of the member state and the one of the union.

The *advanced integration* is something special in any way. The *customs union* evolves towards and does not feel as achieved in the absence of the *common-unique market* achieved. This meaning that facts like member states leaving customs unions world-wide were mostly due to the customs union specific phenomena of "*trade perversion*"[(3)]. The common market, in its turn, paradoxically, calls *policies,* in its favour, clearing the way for a later non-liberal evolving of the integration. The monetary and fiscal policies were coming later, but their precedent in the policy matter was the much earlier *Common Agricultural Programme (Policy/CAP).*

The unique European currency was coming a couple of decades later than that, as for a monetary union achieved. However, here there are some critics to be mentionned about. I skip the ones yet complaining about the "hard loss" of the nation's monetary policy instruments of foreign exchange and related, as against foreign inflows-outfows and globalizing, for the "new type" critics arguing that the monetary union might also miss the unique currency (Vaknin, 2000), that the monetary integration thus has got one more step further than the real economy one and that the unique currency Union achieved would end the member states' economic cooperation in the area (de Silguy 1998, 1999).

But this also is a debate that will be skipped in these lines in favour of another standpoint. It is largely agreed that the monetary unification in Europe still keeps a political content as heavy as the early postwar integration initiative of the fourties and fifties itself – and here there might be equally found the pretended "rushed" initiative for the euro just at the limit between the two centuries and milleniums. Agreed, in the same order, that on the other hand the old *European Monetary System* (EMS: 1979-1999) wasn't yet quite over (Story, Walter, 1997), the way that the Breton Woods IMS (1944-1971) had been at its time (1971-1972).

Actually, I re-assert here a previous idea of the "*monetary union calling for fiscal union*" (Andrei, 2000b) and the latter presumable undertaking might take another couple of decades, as a retort-process to the monetary unification, by its importance on both causes and effects. Nobody yet talks about fully achieving the fiscal reform in the EU, despite that this process, in its turn, keeps its precedents in late sixties (Tsoukalis, 2000, p. 105 and on) – the monetary union, in its turn, had its precedents in early seventies (see the monetary "snake" and on). The author sees an also "incipient" fiscal harmonising in late sixties, as called by the trade flows – trade was fully basing the European

integration at that time-stage – and so focusing on the indirect taxation of the *value-added tax (VAT)* type.

Or, *achieving the fiscal reform* for the Union is actually called by the unique currency support need, together with the *EU budget* deep restructuring, as equally needed by consequent. And the next presumable stage of this reform will certainly focus on the other part, the *direct taxation*. Oterwise, the unique European currency, the emblematic performance of 1999-2002, is hanging on an increasingly thinner support, which is the Maästricht (1992) set of *Convergence Criteria*[(4)].

That is why I preferred to skip the above debate on a monetary union arriving or not too early. On the contrary, the *monetary union* was anyway called by the unique market achievement, as well as it calls for the *fiscal union*, in its turn, with an increasing force resulting from a "snow ball effect". It is true that either Balassa (1961) and other authors have skipped, or the EU's representatives yet keep silent about such an aspect. As for its presumable effects, a fiscal union achieved would be even much more than that the monetary union was and still is. It would be the real "climate change" of the United Europe of the twenty-first century: the Commission would be going to reinforce its position against the member states' one and something of the older "curtain" between "west and east" (actually, between the Euro area and the rest of the Union) would be remade, as for a real new provocation of the next future.

Just re-emphasising that the *advanced integration* is both European only[(5)], as so far, and an undertaking increasingly less appropriate to ruptures – given their unbearbly high costs. Paradoxically, here the Euro-skepticism is also increasing in democratic conditions.

Thesis two: The integration "outline" is (also) changing

This description will be tightly linked to the above one, as by context. Balassa (1961) here remains a significant reference, as a genius with his "mistery" sign. I personally admire an economist who foresaw the monetary union in 1961[(6)], when an international monetary system (IMS) and order setlled by the Breton Woods Agreement (1944) were in place and still well functionning. Not easy to foresee the future international money spoiling and need for regionalisation.

In other words, the lenght of the integration process, allowing a passage through several specific periods since the end of the second world war, implicitly allowed mentalities evolving in the meantime as well. Meaning that

the old anty-war goal of Europeans of the fourties and fifties were turning little by little during the second half of the twentieth centrury into the awarness that regionalising has become the lonely alternative of reinforcing as against a so unpredictable world dynamic. Despite all these, it is just one process of integration to talk about – and we will detail on this aspect below.

The European Comunity's retort to Balassa (1961) was hardly coming in early seventies, the year of braking terms of the Breton Woods Agreement (1971). Exchange rates were back to their floating of 1931, as for a symptom of what was called at that time "international monetary disorder" (Triffin, 1973, p. 165 and on) (7). It is also true that the current perception on floating exchange rates is also different. But at that time, in 1971, the Europeans' stupefaction was that of finding their dependence on America remade for a crisis time, as well as for the previous times of troups' landing in war, Marshall plan for American investments and gold convertibility of the dollar for ensuring the international monetary order in place. That was the time of the "*Monetary Snake*" (1971) (8).

Balassa had foreseen the monetary union since 1961, whereas the Community's authorities were taking their first monetary step one decade later on, and still not hundred percent aware of what would be happening some other decades later (Tsoukalis, 2000, p. 143) (9).

The *monetary* approach of the integration is a significant one, for this paper, but here there come equally critics on the Balassa (1961)'s basic theory of integration. Tsoukalis (2000, pp. 62-63) is right when criticizing the "five steps" outline: this was about "distinct" stages, a "concentric circles" image or a full integration of the successive descriptions, the one into the next. In other words, each new stage description was containing the previous ones, as entirely.

Or, as much as the European authorities were unable to prove the Balassa's foreseeing capacity of a decade earlier, their primary approaches of the *Snake* (1971) and *European Monetary System* (EMS/1979)(10), as preceeding the final monetary union fulfilled another two decades later, skipped the same basic integration theory. There might be some voices arguing that the monetary union would have developped between 1999 and 2002 and be in place as the last stage of integration, whereas the "Snake" and IMS would have been just some meaningless preceedent episodes as specific for crisis times – but this is as superficial and false view, as misleading for practice and decision making.

Factly, the monetary policy approach of the Union neither is coming as the last in order, nor its environment contains all that the integration is ever assumed and expected to perform. A correct and comprehensive view about

facts first sees the primary monetary approaches of the seventies as concomitant not only with several crisis matter symptoms and accumulations, but also with strategy steps for the unique market approach, for founding different policies and for the fiscal harmonisation and budget of the Union building.

Second, the *monetary approach* was going on in the next nineties, but as no longer concomitant with a similar context of developments. As for instance, the fiscal approaches were not continuing in nineties, but they might be expected onwards, when the monetary approach will be over (see the above "thesis one"), but the *"Convergency Criteria..."* (Maästricht 1992) work for the unique currency, but previously in order for reinforcing the financial condition of the Union.

Third, here recall from above the *fiscal approach* – as a "virtual" one, for the time being, whereas its corresponding *monetary approach* is supposed to be the one already in place. Recall that the fiscal approach was starting when the monetary one was not yet and that due to some incipient trade base integration stages with requirements on the *indirect* part of *taxation*, in detail on the *value-added tax (VAT)* (11).

Today, in the aftermath of the monetary union achieved, the Maästricht *Criteria...* would be supposed to weaken, as a real support of the unique currency and the problem of "to whom does the unique currency belong to?" would come up instead as an increassing pressure on transforming the *EU budget* into the one of supporting the euro as directly. It is equally true that, on the one hand, the unique solution would come on completing the fiscal approach through a "European taxation" and that would act directly to the other part of taxation – the *direct* taxes – and that, on the other hand, developments on taxation have been mostly absent during the last period (Andrei, 2009b). "... adopting a common income tax system hasn't been followed by harmonising the taxation bases and corresponding coefficients... the next pace, in a logical order, ought to be the *rates* harmonising" (Tsoukalis, 2000, pp. 106-107).

As summarising, the fiscal approach is directly called by the monetary one and directly resulting from. Plus, the two might be compared as two several decade time strategies, both finding precedents in the earlier developments of the integration process.

This above comparative analysis is just an example, in a larger context or events, for suggesting that the previous description of "successive stages" (Balassa, 1961) is becoming obsolete. The Balassa's "stages" turn into integration objectives, whereas the real stages change description. During some stages, the objective approaches work together, whereas during other stages, the

objectives association change – this being the real specific of each period, as significant. There are developments of some objectives during some stages, whereas the same or other objectives might not develop during some periods. The long process of economic integration also meets strategies starting much earlier than their expected achievement and this makes the long strategy components.

The view of Balassa (1961) is also incomplete(12) by limiting to the *liberal* part of the integration. Or, this is to be deepen below.

Thesis three: There also exists the "*second European economics*"

The below analysis and idea are linked to the previous above ones – the integration is compulsorily undetached from the liberal type strategy: free exchange and customs areas, common market, together with all its complementary environment concepts, from economic convergence to monetary union achieved through the unique currency. This is the "capitalism" of the integration, as translated into the left politics, but it is just one face of it and so limited to such issues.

But, at such a point an analysis like the above ones is likely to start assessing the effective developments of facts, whereas the current one is first assumed to take the liberal strategy as fully achieved. So, assume a hundred percent common market, its unique currency as well functionning and competition acting as well. Then, what can be expected from? Of course, economic development, technological advance as in world-wide terms – in the largest competition with the America, Japan and China, in recent terms, areas – and *welfare* produced. But the last (welfare) would encounter a very problem: the market economy equally produces economic inequality, as for a deepen description. And this means inside regions, companies and people, all of them yet related to the member States of the Union. In the absence of any interventionism, the unique market will engender more and less developed and prosperous regions, as all over at the national scale.

No state stays indifferent to this collateral phenomenon, but for the union of States this problem becomes as essential as "yes or no" existing on. Beyond any written status of the union, each member State looks for a higher and unique economic level to achieve by the common strategy aceepted. No differenciations, as of principle, no discrimination against any member State, region or group of people, no "different speeds" of performances and achievements. All these would cause new tensions, remake something of the previous conflictual landscape, and jeopardise the union, as existant, by interests ruptures within the area. Crises inside the union would come up even

in the non-crisis economic conditions, as reflected by statistics. That is why the union is never supposed to stop to the liberal strategy achieved. Its job is to work well on this primary strategy, but also to step further "beyond".

But, there is one more aspect to here take into account. This step "further beyond" the liberal strategy is not a distinct stage as in the Balassa's view. Meaning that the *liberal strategy* is not supposed to be achieved for this second, non-liberal work to do, but this is about a true *complementarity* between the two – liberal and *non-liberal (interventionist)* – ways of thinking and acting, as from the very beginning. Just recall that the EU is "something different" than the rest of the world – a rest of the world which might equally contain integration initiatives and processes, but the integration strategy is all over forced to assess and face its horizon from the very beginning, as well. Some strategies might limit to non advanced integration, whereas the others (see the European case) would work much more thoroughly about and consider the *mixed economy* as a job weighted at the same with the *liberal strategy.*

The European economic integration process of the second half of the twentieth century up to the end of the century and millennium has worked something out for the general economics topic. See the double language, liberal and non-liberal, as joint together – *liberal:* integration, globalising, unique market, together with its labour and financial markets, competition, economic convergence and unique currency; *non-liberal:* the union's budget, mixed economy, interventionism and policies, structural funds and policies, social inclusion and cohesion and the European social model(13). All these for considering two distinct areas of the *economics* of the integration – instead of two strategies of stages for practice and decision making –, meaning two areas of concepts, methodologies and approaches. The communion of these is supposed to be searched for in the one of the European aimings, beyond differences expressed by the *European social model* (Dinu et al., 2004). None of these characteristics of the advanced integration is dominating the other, whereas contradictions between the "two strategies" are iminent in practice.

Besides, the two aspects are different descriptions. The liberal strategy is chronically more coherent in its objectives and construction, whereas the other yet keeps more "white spots" in its definition and its commandements arise mainly from outside economics.

So, let us summarise about an economic integration process, once seen as emblematic for the "contemporary capitalism", the way that it inevitably turns into a kind of "neo-socialism" *sui-generis,* as for a postponed satisfaction for the dead communist regime of the Eastern and Central Europe.

Thesis four: The Common Agricultural Policy (Programme/CAP), like a "*mêttre à l'abri*" of the integration as a whole

There is to appologise here for this French formula, due to the critics of the famous writer André Gide, for his novel called "*Lex Faux Monnaieurs*" – see a literary style procedure through which the author was reflecting the essential idea of his book in a short episode of the story. Or, here there is about the Common Agricultural Programme (CAP), as a part of and as related to the whole story of the economic integration in Europe.

First of all, the CAP (started in 1961) can be taken as similar to the unique currency implemented (1999-2002), as for their strong political emphases (Tsoukalis, 2000, pp. 170-194). The integration itself had started mainly for political reasons in 1947, by the two Treaties of Rome. The programme objectives atributted to CAP were a true opportunity for the Communities, at that time, to assert themselves as a counterpart of the member States' authority(14).

The essential difference between CAP and the euro currency implemented and issued is the one of time and perpetuity of the previous. CAP started almost founding the set of European policies (Pelkmans, 2003), so preceeding the advanced integration for a significant lenght of time. It was through this Programme that the difference was made between the European and the other integration initiatives throughout the world. The Community's budget was going to allow mostly of its resources to CAP; even currently the CAP's part of the Union budget keeps about 41%.

As a quite long term undertaking, CAP beared important changements and restructuring along; here included even its expectations and objectives of its "zero time" (Bârsan, 2005). Or, the time way between the CAP foundation and the present seems to be a kind of strategical equivalent between an expected shield against the immediate postwar poverty – a large geographical area world-wide has not been able to escape from – and the current commandments of efficiency and the sector's "restitution to the States' authority", as expressed by some analysts. But let us see two more characteristics of CAP, as "painfully" similar to integration in the region.

This is first about the "*knot*" *of contredictions* faced by the Programme, as for its real endless fight against a not friendly at all environment and reality around. Its generous aiming of feeding the European populations was quickly encountering the need of interventionism and subsidies for supporting a traditional and quite special industry, like agriculture – it was about both a price

level expected to satisfy both consumers and producers. Then, the need for subsidies was harming the Statutory market and competition, as declared and required. Then, the contradictions that the Community was so pushed against the rest of the world – as strictly with GATT and its WTO successor, as an international organisation caring for the free trade, but also with the United States, in the same context.

Then, on the contrary, as playing for competition, other contredictions and obstacles came up: Spain and Portugal were joining the Community and their tyde climate was favouring productions significantly more than the temperate and oceanic climate of France and other northern countries. And this when the French farmers were already constrainted by their life condition even in the absence of such new competitors.

There was also a time when the Community was seeing itself forced to impose production "quotas"(limits) to producers, as a new defy for competition on market – this procedure was ended as a result of international pressures.

When the Community was extending on, in seventies, some other contredictions arisen, but on another plan than the one of competition – the UK's "arrival" in the area, after so long negociations, and with new problems, instead of happyness. The UK has almost no agriculture, except for some livestock-breeding, so the British taxpayer was called to contribute to a new budget feeding, let us say, the French farmers' business, and so on.

The other aspect to be here emphasised, on the contrary, invites to some reflection about facts. Let us admit, for the above described reasons, that the previous euphoria and "glory" of CAP is over for a longtime already. There is rather no stage or strategy reform to perform without paying a new harmful price in new problems and inconvenients.

But, despite all these, this Programme is still working – or, this is what makes a new difference, as compared to the euro currency and other strategy components of the European integration. CAP is even representative for an undetaking exposing so many opportunity costs and facing more and more difficulties – "everything has a price to be paid" seems to be the hidden slogan of CAP.

In conceptual terms, the Programme is just one policy, a "policy among the other policies", but there might be to conclude that it is something more than that. We can assert that the integration itself keeps its bases of understanding either in *theories* of the *international trade* and *customs union* – on the theoretical side of the integration bases –, or in *CAP*. The last comes on the practical strategic side of the integration and the integration has a lot of things to learn from. In a word, see CAP in order to understand the integration itself, as a whole.

Thesis five: The convergence of the member States′ economies discloses the Union′s condition

All our current students memorise the *"Criteria..."* of Maästricht (1992) for supporting the unique euro currency[(15)]. Recall the specialits of the Union comparing the *budget deficit* and *public debt* with the water pipe feeding the recipient. Or, this is about *inflation* in all ways, here including the conditions of *interest rate* and *exchange rate*, as the two expressed prices of the same money. Actually, this is *monetary* inflation, as much as *"Criteria..."* cover one part of the economic *convergence*, meaning the *nominal* one.

Or, for nearly two decades time everybody understands the *"Criteria..."* as a lecture of economics and money topics. But there is also another aspect to be here noticed, as starting in the nominal convergency area and continuing in the other *real economic convergence* area. This is *inflation,* once more: it is to be found in the correlation among budget deficit, public debt, interest and exchange rates, on the one hand, but once more listed by the *"Criteria..."* , as distinctly, on the other.

Then, let us read here two more aspects, as consequently. First, the aspect that the member States are not supposed to limit their preocupation to available political instruments and expect results on inflation, as confirming the European authority's theory about. Second, the aspect that listing inflation as a distinct criterion equals identifying the „other part" of causing inflation, in theoretical terms, once more. A zone on which the member State authority can manage on its own, whereas the other *nominal criteria* were listed as a common preocupation for all the member States and Union.

Then, all that still needs to be clearifyed is this last "other part" of causing inflation and why did the Treaty authors prefer a less transparent expression on this criterion. Or, this is certainly the *non-monetary* inflation[(16)]. We might think about even the *demand* inflation, which can arise on market, despite its volatility, but especially to the *cost inflation* and its deeper determinants, as identifyed in the *basic resources*, plus *labour* price levels. So, the conception of the *"Criteria..."* is now fully obvious: the real economy origin of inflation is assumed to be managed by the member States, and their assignment in this way is consistent with the existing Status of all parts. Once more, the Union is preocupied on both some transparent performing on the monetary side of all economies and keeping the member States' competences on controlling the price of resources and wages in their areas of exercise.

In other words, there is no management preocupations of the Union for issues like these above, and that in the context of the advanced integration state. Then, stepping outside the *“Criteria...”* into the *real convergence* area, the Treaty’s and other European explicit requirements are just over. This clears the way to a real and necessary academic debate[(17)], whereas, the further the *“Criteria...”* remain back, the more obvious the reality that their claiming for the lesson of economics definition and status vanishes.

And this because, actually, there was no intended lesson of economics on the Union side, but the aim of explicitate a condition and an attitude. There is another kind of *asymetry* between the nominal and real economic convergence, but this is especially regarding the Union’s perception and bias. Conversion defines the advanced integration, the “supranational” notion linked to the EU is even older, plus, the Maästricht Treaty and its *“Criteria...”* were born nearly two decades ago. However, the Union’s authority in the region has not stepped further than the „old” and unchanged relationship between the central authority of Brussels and the capitals of the member States.

Or, there is a new problem, and here recall the question rised above: *“to whom does the unique currency belong?”* And, as a pale and largely incomplete answer to this question, two things are already certain. First, the existance of the *European Central Bank (ECB),* as the unique monetary authority reached by the Union. Second, the fact that the above referred *“Criteria...”* might not even have been expected to do more than reflecting a situation as existant... in 1992, at least.

Besides, it is less certain wether the interval since the Treaty and current times might be invested with enough significance for a presumably change in strategic terms. Once in the next future there will be the time for answering this question.

Thesis six: Might the budget of the EU become a real political and strategic stake?

The EU budget is “additional” to the national budgets, it mostly comes from the direct contribution of the member States and results from negociations and amiable terms between the Union and States’ authorities. It serves for the Union’s policies runned in the region by the Commission and – among a list of principles[(18)] rules and procedures – is defined by no deficit – formally, the Treaty expresses the “no excedent”, as well.

Then the two actual handicapes of the "additional" and "no deficit" characteristics are completed by a third one: this budget stays far from supporting the euro currency, as for a well known rule of correlation between budgetary and monetary policies. Or, instead of such a policy correlation, there results the vicious correlation among the three handicaps of the Union's budget. This works as significantly and efficiently against the policymaker, the European Commission, in its position of the statutory "Government" of the Union. This Government is pretended to be "*supranational*" and imposes its "Criteria..." to the member States, in the region. In reality, it steps off the Union's currency game, whereas its monetary counterpart, the EBC, works on the euro management together with the Governments of the *member States* – and these are a plurality, unequal with one-another and not unitary coordinated action, except for the Union formula itself.

Fortunately, the monetary authority of the Union, the EBC, is an institution proven as very reliable (Soto, 1999). And fortunately, again, there is no any inconsistency in the Union's budget regime to talk about either. But these favourable facts, on their side, don't do, but paradoxically underline the *de facto* institutional rupture surounding the unique currency functionning.

On the contrary, the former *European Monetary System (EMS)* seemed to have been more appropriate to the current institutional picture of budget, here including the Commission and even (and paradoxically) *"Convergence Criteria",* newly born after the EMS' end. As much as the step further to the unique currency is recorded as a political and even historical success of the years 1999-2002, this seems to act equally as an increasing pressure on reinforcing the political and legal entity of the Union face to its member States.

Recall from above that we see in such a respect no alternative to the achieving of the *fiscal union*, as a successor of the monetary union (Andrei, 2009b), and this one will produce its appropriate and deep consequences – among which turning the EU *Government* and *budget* into something else… which yet makes everybody in the area scared to talk about.

But whether, on the contrary, the existing institutions ought to be preserved as they are, here including the budget, whether the policies of the Union ought to stay dependent on the relationship between the Union and member States, then another sacrifice would become possible. Paradoxically again, that would be just the common currency, as the most recent and explosive success of the Union.

Though, it is equally true that, despite all ups and downs and hesitations of the past, the Union has never given up an already reached target. What we can here assert is that it is now confronted with a kind of "knife-edge" experience. Is this for the first time?

Thesis seven: The European Monetary System (EMS), as one more paradox

Tsoukalis (2000, pp. 143-148) tells, in his turn, the story of the *European Monetary System (EMS/1979-1999)* with its constructive ups and downs. Meanwhile, in a description of the contemporary international money history, McKinnon (1993) argues against the *international monetary system (IMS),* as needed by the contemporary international economy – called as *theory of the IMS.* Such a need was for the extreme economic situation of the immediate post-war period[(19)],whereas today the *optimum currency area* was to be approached as more appropriate Mundell (1961, 1968). A comparative analysis between the immediate postwar IMS (1944-1971) and the yet existing *EMS* at the time of the study was resulting into an interesting structural similarity. Ironically, that came up in the aftermath of a two and a half decades IMS filled by both an unprecedented development and a substantial literature of criticizing the same IMS.

Moreover, despite its temporal and economic advance based advantage against the "old" IMS, the EMS supporting and supported by the *fixed exchange rate*, in its turn, was even missing the highest appropriate foundation of it: the *metal parity* of money. The rethoric question, as resulting too from the McKinnon (1993)'s story, was not "whether", but "when, exactly,..." the EMS would be supposed to crack down, in its turn.

Or, there is absolutely no need to sustain any theory against the other in order to understand that acting for a workable fixed exchange rate system, in the absence of the metal parity of money, would be a kind of "Sissif endeavour", see the way from proper difficulties to losing motivation, sense and logics. However, McKinnon[(20)] was supporting the *optimum currency area* (OCA) theory against the one of the IMS – so, he showed that the EMS rule was actually less important, here including its fixed exchange rate system, but determined by the prior OCA. Besides, the OCA is limited life, due to the continuous and increasing pressure on the *nominal anchor* currency of the area.

Then, the next following reality, in the late nineties, was going to be different than expected by McKinnon. The removal of the EMS by the new common European currency made this specifically European history different

than the one of the old IMS: there was *no collapse of the EMS,* but a strategy of the progress between an “old type” international (see, regional) monetary system and the brand new condition of a currency, as implemented (Andrei, 2007). Moreover, throughout the passage between the EMS and euro currency, the previous was paradoxically not over, but actually it is still in place by the so called *second exchange rate mechanism (ERM2)* – this is about the member state not yet or expected for joining the *Euro Area*. So, in reality, the EU strategists were surprisingly enough considering both the OCA and the Germany’s and the DM’s excess of responsibility for the whole EU monetary condition: a DM’s destiny, as similar to the US dollar’s one, would be supposed to threaten the whole integration process. Once more, the McKinnon’s arguing was right, in its basic principle – it was the EU’s undertaking responding and retorting it through facts. As much as the EMS’ removal by the unique currency was curing the European money from the asymetric pressure on the DM, the Europeans looked not only forward, to what a new currency context means by definition, but equally backwards, to the no future for the old type monetary system, based on nominal anchor, versus the rest of national currencies.

But then, the problems of the new currency quickly came up and stay on – see successive depreciations and apreciations against the dollar, just as expressions of the euro’s ups and downs. On the other hand, the euro implemented does not miss its own specific criticism in the literature – some critics argue that so the monetary strategy would have left the real economy integration behind; others argue that the cooperation spirit in the area will come to its end, and so on.

Or, in an increasingly contradictory context, here including the one of the events of the Greek economy in 2009-2010, when there are voices claiming this country’s leaving the Euro Area, the memory of a still valid EMS in 1999-2002 might reinforce its significance, as theoretically and not only. As for another aspect, the current EU region is extended already and still extending, so making the “outside Euro Area” larger and heavier.

Let us take these above description and assertions just like some notes of *looking back, as well.* All monetary systems, as international, regional or national, are part of the financial system, and this is a genuine historical construction, meaning a step by step and stage by stage one – the today built up floor is actually founded on the other down floors; not all of floors are equally vulnerable. There is to reflect about one more question: does the EMS still belong to the past?

Thesis eight: The public economy might be a "thorn in the unique market's eye"

The public economy is a distinct area all over the national economies. As roughly, this is formed by public spending-purchasings from the rest of the economy, plus production of the public sector, as the State area of the economy – this might require some academic distinction of the State and the public areas, this below description is not for this.

On the contrary, this current debate starts where the State sector is alleged as threatening market and competition on. It actually does it on several ways: see, from turning the market usual condition into distinct parts – see, special price levels, high quantities in contracts and other conditions – to "agreeing" – as a positive discrimination of – some suppliers, as against the rest of competitors[(21)]. In a word, the State economy is undermining market, as in a "natural" way.

Let us also, once more, admit such a pattern as valid all over, whereas the difference is made by the differenciation of the State weight in the economy as a whole. Plus, the State sector gets multiplied between the central and local public administrations, while both quantitative ratios and subordination between play their own roles for. The question to be here rised is about how this pattern does act in an economic integration, see the plury-State economy context. Or, actually, what does it really become?

Or, whether the basic economic principle, as above described, is assumed to stay on, there is one more aspect, as doubly-defined, to be taken into account. First, the solid links between central and local administrations stay at the member States level; on the contrary, the EU public administration economy is not similar, as seen in the *central Union*, versus the *member States* report description. As a result, there will be, at least, as numerous *public economies* as the number of member States (n), and no inter-relations amongst. The same for parallel markets, as defined and founded inside... national (internal) boundaries.

The second aspect finally includes the Union itself, with its central administration and bureaucratie, as respecting the same above rule of non-report with the member States administration. Actually, the central Union administration will just be the $(n+1)$ component of the public economy in the economic integration context, and still unable to restructure any of the given context.

As so described, the *public economy* of the economic integration gets some specific on its *qualitative* side. The *quantitative* side of this story is not less important, but even more complex to be described in numbers like: weights of the member States' economies in the total of the EU's one; weights of the State sector in each of the member States' economies, as expected to differentiate from one-another; weights of the central member States' administration in the total State economy and so on.

Thesis nine: Is the economic integration predestined to an unachieved strategy example?!

Aged people, like the author of this text, can easily remember the discourse and deep analyses of communist ideologists as regarding the "contemporary capitalism", as going to stick into its own internal contradictions of development, which would get impossible to be fighted once in the future. Now there is, first, to be more easily understood that the artifice here used was the very concrete example and landscape of the European Community at that time for the seventies and eighties periods, in which either the basic economic problems of the region were getting more painful, or the integration strategy was facing significant specific problems.

Second, things look different today: there are also significant performances of the Union, and they come from a unique continuous endeavour. But not only.

It might look like a tragic fate such an endeavour of Europeans for changing another historical tragedy: a geographical landscape boiling in warrior and revenge attitudes that was once in the past. Now, those have got replaced by strategies and programme components yet unfinished when new problems and historical needs come up; there are rather no periods without apparently unsolved problems. So, the same question rises once again: which exactly can be the common explanation or denominator, the definition for an European economy, as apart from the rest of the world.

But I believe that such an answer exists and even it is less complicated than expected. Actually, the integration process starts like a limited internationalisation of national economies and so avoids both the closed economy and its unlimited, as imaginable, opposite internationalising. Neither of these are aimed for integration, in which conditions the aim of it gets off the area of well defined or pre-defined concepts – whereas both the closed and the open economies are very well (pre-)defined.

Then, the *unique market* that the same process is searching for suffers on conceptual and structural ways just as the result of *defining integration:* it gets limited and closed at the same, in a present economic development in open and globalising context. As directly linked to the market design, *competition* suffers as well, very deep inside its basic principles.

The *liberalism* is suffering, as in a domino principle: it sees itself mutilated for distorted market and competition on, on the one hand, unsufficient and criticised for a presumable Union, as compromised from the very beginning and forever, when limited to liberalism, on the other one.

Back to the nations ready to integrate their economies, as for a limited internationalising, integration extends from the strictly economic dimmension – the States formation here resulted passes first throughout *cooperation* for thinking about a *common Governance* on the next following step. But, either cooperation yet stays not entirely put into value, or the common Governance gets stuck, as reminding of a very old reflection of Aristotle about the Europeans of his time – just see the example of the interests rupture threat between populations of center and of outskirts of the region when the Union's extension results into an also increasing people migration within the common area.

Then, the same story might continue on other issues, as here finding a space defined as common for unachieved principles and issues that the integration is – ironically, the last is supposed to be a systemic type construction, here including a construction-reconstruction of some basic principles of economics, and not only. Plus, wherever "constructions" of such a kind, as non pre-defined, *ideology* makes itself present, whereas such a scenario reveals at least to a part of today Europeans some not so old controversial memories. Or, as much as the European integration tends to be unique, let us do not forget that all ideologies, together with their products, see themselves as "unique".

An alternative to an ideological based construction working with incomplete concepts might be the same States formation turning into a new State of (on the contrary) a classical and pre-defined structure, as the example of *federalism*. It would be the end of the story, in all (good and bad) senses. Concepts will be finally clearifyed (see once again: market, competition, currency, national, versus international, cooperation, governance and so on). Besides, it would not be a vicious circle, as it appears to be, but a full cycle of reaching resources, territories and populations for a transformed area in the twenty-first century.

Nevertheless, the most difficult thing that here remains is asserting that such an alternative really exists, that it stays viable and that it is really unique. Recall that the today astronomers still recognise how difficult is to measure cosmic distances among stars and planets, even using the highest performing telescopes.

Thesis ten: Beyond all skepticism, it would be better out of the (need of) integration

The 1944-1945 immediate postwar euphoria, correlated with the awareness of the time, were able to give birth to some world-wide management institutions, among which the Breton Woods *international monetary system (IMS),* founded in 1944(22). Some decades time later this system was going to crack and critics were coming up in place. Overall, these critics explained that such an international monetary order had been appropriate and limited rather to the economy just destructed by the war, than to the forthcoming development of the aftermath. Then, in 1971-1972, when the terms of the Breton Woods Agreement (1944) were falling, the primary symptom world-wide was interestingly looking like what had happened four decades earlier, in 1931-1933, when the older IMS of the gold standard was falling in its turn.

However, since the middle seventies the international landscape was changing: the US $ stepped back, but not in the same proportion with the previous pound sterling, in thirties. On the other hand, the *dollar's* step back equalled the step forward – into the international money top – of other national currencies, like the *Japanese yen* and the *Deutsch mark*. Besides, the old *French franc* and *pound sterling*, once more, were making their new appearences. Actually, there was designing a "*new international money*" landscape, in which all these currencies – together with the dollar – were reaching specific *currency areas* – to be noted that the US dollar, despite its relative fall at the world-wide scale, was still keeping the largest currency area, as aferent.

Europe was a different story world-wide, once more, in a kind of a parallel context to the integration process, as within. Meaning that there was not only the Deutsche mark to talk about, internationally, but also the old French franc and pound sterling. These latter were still keeping, together with their former colonies outside Europe, specific *currency areas* (Guitton, Bramoulé, 1987).

Then, the seventies were followed by the eighties, as here representative by the "*La Platza-Louvre*" international Agreement (1984)[(23)]. It was a real success for the objectives proposed by organisers for its fully different monetary and financial world – it was proven that the international monetary order was able to be remade in the absence of an IMS, just by a new exchange rates stability „among the few big" currencies.

As concomitantly, the old integration, started in Rome (1957) on rather political ambitions and commandments, was now finding a new opportunity for relaunching its basic ideas. The European Community of that time was founding its proper *European Monetary System (EMS)* at the end of seventies, especially due to redefining the corresponding *currency area.* Then, the unique European currency were here coming at the twentieth century end to replace the EMS – the "new" European region, as previously re-birth in 1957, so stopped being just an illusion.

It became a true "culture", as a distinct space. Other multy-country regions of the world were also getting distinct by monetary bases, and not only – even the underdevolpment here played a role for "distinctions" achieved.

Once more back to the wold-wide propensity euphoria of the mid twentieth century, let us think about what would be supposed to happen whether our post-war history had not provided as much economic frustration world-wide, but a (finally) harmonised development and well spread welfare. Why if the Breton Woods IMS had proven a viable money order as international and very deliberate way. This is for making another aspect as obvious as it worths. I mean that, whether instead of this harmful world there had been a good and frendly environment world-wide, what would be the European distinction, as regionally based? Let us admit the cultural reality of this, but things would really be much different than today perceptible, no matter how much are we able to realise it.

Notes

(1) See Tsoukalis (2000, p. 263 and on) for a previous expression like “ten theses on integration...”.

(2) (1) free exchange area; (2) customs union; (3) common market; (4) economic union; (5) economic and monetary union (Balassa 1961).

(3) This is mostly about the advantage of companies residents in the member states area and exporting to the region, as tax exempted, face to similar companies from the rest of the world. In basic theoretical terms, this kind of competition vice is not able to be repaired even in the later advanced stages of integration.

(4) We will come back to this aspect below, with more details.

(5) See Andrei (2009a, pp. 30-43) for details.

(6) However, such ideas were going together with the ones of Mundell (1961).

(7) Actually, it was about a floating exchange rate as off all authorities’ controll and that was considered at that time the consequence of the international monetary systems (IMS) bankruptcies. All IMS were supporting the fixed exchange rates. McKinnon (1993) had a different oppinion, while he was supporting the *optimum currency area* theory, as the alternative of the IMS theories: the international monetary disorder was due (not to the IMS falling, but) to a bankpruptcy of the “nominal anchor”. Or, that was the cases of both the pound sterling (1931) and US dollar (1971).

(8) See also Urwin (1991) and Baker Peace (1999).

(9) See the so-called „Monetary Snake” (Bale Agreement, 1971).

(10) According to Story & Walter (1997).

(11) See also Robson (1987).

(12) Not only by no reference on the fiscal approach.

(13) See also (Tsoukalis, 2000, pp. 194-231).

(14) As for the unique currency, the political aspect comes by definition regarding all about the currency concept. Since the ancient times towards nowadays, any new currency issued has come as tightly linked to the corresponding political endeavour of the issuer, as for large perspectives expected.

(15) (1) Budget deficit under 3% of the GDP value; (2) public debt up to 60-65% of the same GDP value; (3) reduction of the intrest rate on the short term to under 3% difference, as compared to member States economies with the lowest interest rate levels, plus stability of the same interest rate on the long term; (4) exchange rate stability for three years before joining the Euro area, meaning no devaluations; (5) inflation rate dropping under the 3% difference, as compared to member states with the highest price stability.

(16) Recall that John Maynard Keynes, himself, was seeing inflation priory on the non-monetary economy.

(17) See especially Iancu (2006).

(18) See the principle called “*juste retour*”, meaning the equality between the individual member State’s contribution and benefit from the budget’s benefits – this is another expression of “no deficit” principle –; the “*capacity of payment*”, regarding expences reductions and so on – see the Fontainbleu Agreement (1984) and the European Council session of Brussels (1988).

(19) See also Mossé (1967).

[20] As an American professor at the Standford University.
[21] See also the “positive” economic policies (Hardwick, 1992) etc.
[22] As aimed for the after war period, but founded when the World War II was yet during.
[23] According to Corden (1984) i Wolf (1984).

References

Andrei, L.C. (2008). *The international money, between world-, region-wide and…Euro*, in *European Construction of Romania: New Projects and Clallenges/The 18th International Scientific Session*”, Ia i, 29-31 May 2008

Andrei, L.C. (2009a). *Economie european* , Editura Economic , Bucure ti

Andrei, L.C., „Avem uniunea economic i monetar . Dar uniunea fiscal i viitorul Europei unite? (The EMU is done. How about the fiscal union and the next future of the united Europe?), *Economie Teoretic i Aplicat* , Nr. 1(530), 2009b

Balassa, B. (1961). *The Theory of Economic Integration,* London: Allen & Urwin

Baker, P., „Condi ia noului Euro în economia global ”, Concluziile Conferin ei anuale cu acela i nume (conhist@ohiou.edu *& ohiou.edu/conhist/chi2.htm),* 1999

Bârsan, Maria (2005). *Integrare Economic European* . On line: idd.euro.ubbcluj.ro/interactiv/cursuri/MariaBarsan/cap2html

Corden, M. (1984). *Economic Policy, The Exchange Rate and the International System,* Oxford University Press

de Silguy, Y.T. (1998a). *Economic and Monetary Union in Europe,* Washington, Warburg Dillon Read

de Silguy, Y.-T. (1998b). *Les conséquences de l'UEM sur le système monétaire international,* Helsinki

de Silguy Y.-T. (1999). *L'euro, enjeu stratégique pour l'Europe,* Paris, Forumul „Les Echos”

Dinu, M., Socol, C., Marina , M. (2004). *Economie European . O prezentare sinoptic* , Editura Economic , Bucure ti

Guitton, H., Bramoulé, R. (1987). *La Monnaie,* Paris, Daloz, The sixth edition

Hardwick, P., Bahadur, K., Langmead, J. (1992). *An Introduction to Modern Economics,* London-New York, Editura. Langman

Iancu, A. (coord.) (2006). *Convergen Economic* , Editura Academiei Române

McKinnon, R., „International Money in a Historical Perspective”, *Journal od Economic Literature* (29), Mar. 1993, pp. 1-45

McKinnon, R. (2001). *Optimum Currwncy Areas and the European Experience,* Stanford University, Oct. 2001

Mossé, R. (1967). *Les Problèmes Monétaires Internationales, tudes et Documents,* Payob

Mundell, R., „A theory of optimum currency areas”, *American Economic Review* (51), New York, November 1961, pp. 509-517

Mundell, R. (1968). *International Economics,* Macmillan, New York

Pelkmans, J. (2003). *Integrarea European . Metode i Analiz Economic* , Traducere IER Bucure ti

Robson, P. (1987). *The Economics of International Integration,* Ed. III, London: Alien & Urwin

Soto, M. (1999). *The Euro. History and Implications of the New Currency,* Texas Tech University, Lubbock TX

Story & Walter (1997). *Political economy of financial integration in Europe,* Cambridge MA. The MIT Press

Thygesen, N., „The Emerging European Monetary System: Precursors, First Steps and Policy Options”, *Bulletin of the National Bank of Belgium*, Apr. 1979

Triffin (1973). *Our International Monetary System. Yesterday, Today and Tomorrow,* Yale University Press

Tsoukalis, L. (2000). *Noua Economie European Revizuit ,* Traducere în limba român a „Open Society Institute”, Editura CEU Press

Urwin, D. (1991). *The community of Europe: a history of the European integration since 1945,* London, Longman Group

Vaknin, S., „Deja-Vu Euro. The History of Previous European Currency Unions”, Narcissus Publications, *Central Europe Review*/CEENMI, Mar. 2000

Wolf, M. (1994). „Eloge du Non-Système Monétaire International”, *Problèmes conomiques,* Nr. 2394, 19 Oct. 1994, Preluat de *Financial Times* din 28 martie, 1994, cu titlul: *In prize of the international monetary system*

Theoretical and Applied Economics
Volume XVII (2010), No. 10(551), pp. 73-82

Importance of Partnership and Cooperation for Territorial Development

Anna VA   OVÁ
University of Matej Bel, Slovakia
anna.vanova@umb.sk
Kamila BORSEKOVÁ
University of Matej Bel, Slovakia
kamila.borsekova@umb.sk
Miroslav FORET
Mendel University of Agriculture and Forestry in Brno, Czech Republic
foret@svse.cz

Abstract. *Partnership of public and private sector should contribute by solving problems in local or regional self-governments. By using methods and tools of places marketing and relationships marketing it is possible to increase synergy effect of activities. Through marketing methods and tools, especially marketing research, market segmentation and marketing promotion is possible to find out, analyze and publish opinions, needs and imagines of local public-citizens, entrepreneurs, investors, organizations and local self-government. Then it is advisable to find optimal way of partnership realization of impletion public needs and self-government duties in the interest of providing local development. According to importance of partnership and cooperation between various sectors by territorial development, authorities of Slovak and Czech public and non-profit marketing association settle on common project. The keystone and plans are presented in the text.*

Keywords: partnership; local development; marketing research; promotion; relationship marketing.

JEL Code: L16.
REL Code: 16B, 17G.

1. Introduction

The main mission of local self-government is an assurance of sustainable development of territory and superior conditions for citizens' life. From the development in various territories, which have different level and quality, is apparent that it does not go well in every territory. Follow from our researches, the most frequent reason is the lack of professionals and ideologues on positions, which decide about happening in territory; setting-out political, or regular and subjective interests, expectance and dependence on help of state and European union; absent effort and abilities how to use strategic marketing planning; insufficient participation and involvement of important subjects in territory development, which is often the result of insufficient quality of relationships and communication between territorial representatives and important subjects actuating in territory – big entrepreneurs, interest association of legal and natural persons, citizens etc. (Va ová, 2006, p. 17).

Territory of town, city, and region consists of various types of goods, as free, public (collective) and private goods. For its development, their owners or administrators respond – public, private and non-profit subjects (Va ová, 2006, pp.17-42).

Territorial government can be a subject of regulation and economics guidance in the own territory, or can be a subject which has authority and responsibility for some kind of public goods (Švantnerová, 1997, p. 23), which are managed through its authorities.

Municipal authorities govern the territory as a unit and try to coordinate activities in the territory effectively and try to use territorial resources with the aim to ensure its sustainable development and prosperity. Development in the territory is influenced by owners of private goods as well – personalities, several private, non-governmental and non-profit companies and organisations. A difference between them and municipality in contribution of territory development is that municipality responds to handled territory generally, but others introduced subjects influence the development of territory only mediate – following its own, individual goals and its development influence only partially (Va ová, 2006, pp. 43-45).

The needs of these groups are often different, what should be the source of problems and barriers of territorial development. Sometimes individual interests should be in conflict with interests of territory as a unit. The challenge of local government is to overtake these difficulties and to solve them through the finding of consensus. Resolution is a creation of partnership on local level and relevant part of public should be interested on participation by territorial development and by solving problems of public life.

Aims and methodology

Project *partnership for local development* is related to experience and results reached in international project Communicating city from second half of 90s (Foret, Foretová, 2006) which was realized in Czech Republic. In Slovak Republic, the project is related with the international comparative project OSF Communicating city (Va ová, Kološtová, 2001); international project of British KHF Marketing for self-governments I, II (Va ová, Bernátová, 1999, 2000); faculty grant FG 77. The level of relationship marketing with stakeholders in small and medium enterprises, 03/2007-11/2008 realized on EF UMB in Banská Bystrica and international project Relationship marketing in MSE´s along with territorial self-governments -international comparison. The paper is running issue from solving project VEGA n. 1/0726/08 The influence of decentralization of public administration in Slovak Republic is given by condition of behavior local self-governments and possibilities of their endogenous development. Results is given from these projects are mentioned on possibilities of using marketing methods (market research) and tools (especially marketing promotion) in self-governments by finding consensus between needs of various parts of public and by creating and sustaining relationships (relationship marketing) on behalf of creating functional partnership on a local level.

The aim of project *Partnership for local development* is a contribution in solving local problems by using marketing tools – especially marketing research (research of common repute), marketing promotion (public relations) and relationship marketing. With their help, findings should be more objective, opinions and imagines of entrepreneurs and local self-government should be presented to local publics. Then all these subjects together with their initiatives should try to find optimal realization of these initiatives. So we can find here partnership of local public, entrepreneurs and public administration as a basic assumption for local development.

Solutionists of local partnership in this way will be specialized collage workplaces. Their practical application of marketing tools and processes would appear from unified and consistent methodic processes and models. The staff of the collage would active cooperate on solving problems of local development and their partnership will contribute to local development. In this connection, we should speak about nation solving specialized collage workplaces partnership. At the same time, these workplaces and other relevant institutions should be expert referee, consultant and assistant by achieving maximal methodological quality.

In case of interest more members of IAPNM international cooperation should be covered by International Association for Public and Nonprofit

Marketing (AIMPN/IAPNM). This association will contribute to reach and wide new abroad experience and knowledge with practice using of marketing processes in public sector, especially in partnership, cooperation and promotion local development. Also this will be the third level of partnership – partnership of international solving academic workplaces, their cooperation and changing experience.

The project will not be orientated only on cities, in which are collages, but also will be able to show in other places, how effective and useful in practice way this transfer of marketing tools in public sector should be.

Partnership and territorial development

The centre of municipal interest is a citizen. Kotler presented in one of his publication an idea that when authorities of public sector are interested on needs, problems and preferences their citizens, then they know to satisfy them better (Kotler, Lee, 2007, p. 13). Citizens are more satisfied and loyal; their trust in authorities of this sector is increasing. Morgan and Hunt (1994) say that trust together with "commitment" is keys to relationships. Good relationships are an assumption to partnership and cooperation on a local level and these are an assumption for successful realisation of marketing development strategies.

Most presented form of partnership is a public-private partnership, what means partnership between authorities from public and private sector. Public-private partnership (PPP) is according to proposal of European Committee defined as a form of cooperation between public and private sector with a purpose to finance building-up, reconstruction, service and maintenance of infrastructure and delivering of public services by this infrastructure.

In case of presented project, it's not only about this type of partnership, but also about partnership which aim is a cooperation and a participation on public events with an ambition to achieve sustainable development of territory and satisfaction of all concerned parties.

To define the term partnership on a local level according to literature is not clearly possible from this point of view. So we will come from "general" conception of partnership. As a partnership on a local level we will understand "free and coequal partnership of two or more subjects, which by coaction (by finding consensus on the principle of complementarity) fulfill common purpose or purposes." Partnership as a form of relationship should respected some kinds of principles and rules. No one from subject should feel the partnership as a liability or as a treat of its own identity. Partnership on a local level can have a character of formal or informal relationship.

Purpose of partnership on a local level is to share resources, abilities, skills and experience between subjects of partnership in the interest of achieving common purpose, or common defined purposes. The subjects of partnership share responsibility, contribution and risks. It means that the relationship should be free, each other profitable, bringing innovative impulses and reward to all parties concerned.

When we are speaking about partnership on a local level as about relationship, it is needed to define subjects of this relationship. By defining these subjects, we will come out from relationship marketing (Va ová, Petrovi ová, 2008, pp. 157-158).

Relationship marketing as a new line of marketing has a big potential of utilization not only in private commercial sphere, but also in public sphere in local self-governments. Relationship marketing topic in public administration is defined in foreign literature (Box, 1999, Wright, 2001, Kotler, Andersen, 1991, Walsch, 1991, Rees, 2000, Va ová, Petrovi ová, 2008, 2009 etc.).

In relationship marketing, subjects of relationship are defined on the basis "six markets model" (Christopher, 1991, In: Payne, 2005), which was audited by Payne (2005, p. 862). As a parties concerned, called stakeholders, we will understand especially authorities of local self-government and citizens in a wide sense. If we come out from original conception of ownership goods in territory, owner of public goods is a public administration. From the relationship marketing point of view, stakeholders will be representatives of public administration – local self-government and state administration: elected members (mayor, chief magistrate and deputies), administrative staff from bodies of self-government and state administration. Representatives of private sector are particularly inhabitants living in the area, entrepreneurs, investors, non-profit and non-government organisations, civil formal and informal initiatives, financial settlement, churches, academic institutions, research units etc. The quality of partnership should be influenced also by political party through its authorities on positions in local self-government and state administration. All of these subjects influence development of territories and are influenced by territorial development. So we will regard them as stakeholders, as attendants of relationships in territory, whose can enter in partnership and cooperate.

Within realisation FG 77 Standard of relationship marketing with stakeholders in small and medium enterprises, 03/2007-11/2008 we investigated in quantitative research through qualitative interviews, with which subjects is a local self-government in some kind of relationship, it means, which subjects are considered as stakeholders. In the question, with what subjects have local self-government establish long-term relationship, by voluntary

answer 100% of respondents designated as stakeholders offices of state administration. Other self-governments and entrepreneurs noticed 93% of respondents. "Only" 87% of respondents noticed that they have establish long-term relationships with citizens and other subjects (schools, hospitals etc.), as next stakeholders self-governments consider organizational associations in sport and culture field (80%), church and non-profit organisations in social sphere (67%), financial institutes (60%), administrative staff and advertising media (53%), political parties and universities (33%) (Va ová, Petrovi ová, 2008, pp. 158-159).

By appeared answers, respondents (magistrates, mayors, chief of city administration) presented that the most important subjects for the reaching their aims in the local municipalities are citizens and office staff (Table 1), on the third place are employment agencies and then other subjects (represented by schools, hospitals etc.) and state administration. The least important subjects are according to respondents in term of reached values universities and political parties. We, as representatives of academic ground, can not be satisfied with relation to collage workplaces. Detailed results are in Figure 1.

Table 1

Rate of relationship importance with subjects in fulfilling aims of local authorities

Stakeholders	Rate of relationship importance		
	A	SD	Rank
Citizens	10.0	0.0	1.
Self-governments (micro-regions)	7.2	2.4	9.
Church	5.3	2.2	13.
Entrepreneurs, enterprises	7.7	1.8	5.
Other subjects (schools, hospitals...)	8.0	2.1	4.
Financial institutions (banks, insurance companies...)	6.1	2.1	11.
Non-profit organisations (social sphere)	5.5	2.0	12.
Other non-profit organisations (sport, culture)	7.3	2.1	7.
State administration	7.7	1.8	5.
Employment agencies	8.1	1.8	3.
Deputies	7.3	3.4	7.
Political parties	4.2	2.5	15.
Office staff	9.7	0.9	2.
Media	6.2	3.1	10.
Universities, research departments	5.2	2.7	14.

Source: Va ová, Petrovi ová, 2009, Košice.
Note: A = average, SD = standard deviation.

Similar as by assessment of importance value of particular stakeholders by reaching self-government purposes, we asked representatives of local self-governments how they would assess the quality of mutual relationships with stakeholders by 10-index scale (1 means the lowest and 10 means the highest

quality of relationship). The results prepared in accordance to average and rank of relationships quality with stakeholders' are presented in Table 2.

As the best quality, respondents evaluate quality of their relationship to their own employees, employment agencies and non-profit organisations. Average of relationship quality ranking in relation to citizens reached 7,4 point, what means in final rank only 5th place. Lowest quality of relationships evaluates respondents with enterprises and business subjects (Va ová, Petrovi ová, 2009, pp. 257-263), non-profit organizations, deputies and political parties.

Table 2

Level of relationship quality with subjects in fulfilling aims of local authorities

Stakeholders	Level of relationship quality	
	A	Rank
Citizens	7.4	5.
Self-government (micro-regions)	7.3	6.
Parish	6.3	11.
Entrepreneurs, enterprises	6.2	12.-13.
Other subjects (schools, hospitals...)	7.5	4.
Financial institutions (banks, insurance companies...)	7.0	7.
Non-profit organisations (social sphere)	5.1	14.
Other non-profit organisations (sport, culture)	7.6	3.
State administration	6.7	8.
Employment agencies	7.8	2.
Deputies	6.2	12.-13.
Political parties	3.9	15.
Office staff	8.3	1.
Media	6.5	9.
Universities, research departments	6.4	10.

Source: Va ová, Petrovi ová, 2009, Košice.

One of the general valid deductions of project Communicating city and Marketing for self-government was that a local development is depending on partnership, cooperation and communication of general actors:

1. local public, especially citizens,
2. various civil initiatives, non-government organisations, local media, university and research departments, development, consulting and information centres, financial institutions etc.,
3. political subjects,
4. entrepreneurs and investors, including local associations (chamber of trade),
5. public administration and
6. local self-government, which guide and respond to local development.

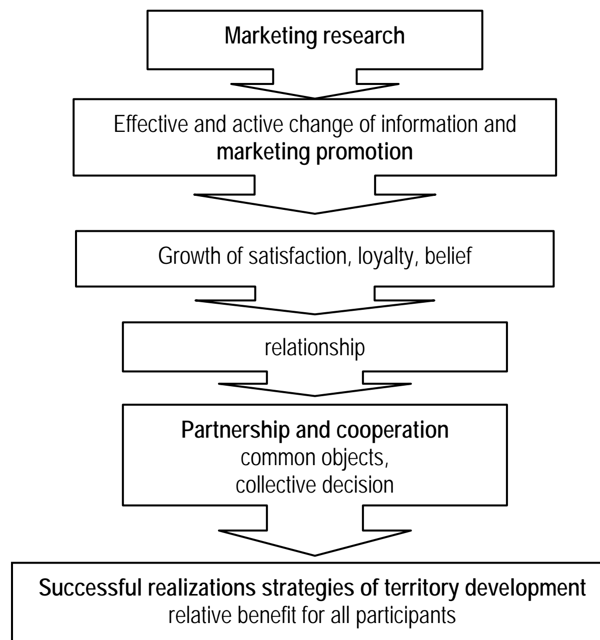
When we compare these researches, we have to say that, in field of creation and maintenance of partnership and cooperation between public and

private sector in the interest of territory development, it is needed to improve the current situation in this field.

As confirming former researches, one of assumptions of integrated access to territorial development, to a dynamic progressive development based on interactive cooperation of subjects in the territory, their participation, cooperation and partnership is effective, is a social and marketing promotion of all subjects concerned in territory, but also in neighbourhood and their respectable relationships.

In order to achieve effective and active marketing promotion between various stakeholders in territory, it is needed to know opinions and needs of target segment. For this aim used to be realising a marketing research. As a starting point of the whole project, we will consider realisation of marketing researches oriented on chosen groups of stakeholders. The object will be to find out their needs and opinions on happening in territory, opinion on other stakeholders, quality of relationships with them etc. These findings will be serving as a basement for active and effective promotion, as an assumption for building interaction relationships of partnership for local development.

Compiling base principles of project Partnership for local development, we come to next diagram:



Source: own work using.

Figure 1. *Base principles of project Partnership for local development*

Conclusions

For successful realisation of project Partnership for local development it is inevitable to create organisational, institutional and promotion background. Organisation and institutional covering of this project will provide Slovak and Czech IAPNM branch with site on EF UMB in Banska Bystrica and SVŠE in Znojmo.

References

Box, R., „Running Government like Business: Implications for Public Administration Theory and Practice", *American Review of Public Administration*, 29, 1, 1999, pp. 19-43

Foret, M., Foretová, V. „Marketing Communication in the Czech Republic and Slovakian Localities: Ten Years of the International Project Communicating Town", *International Review on Public and Non Profit Marketing*, Vol. 3, Number 1 (June 2006), pp. 81-92, ISSN 1812 – 0970

Foret, M., „Marketingová komunikace", 2. aktualizované vydání, *Computer Press*, Brno 2008, p. 371, ISBN 80-251-1041-9

Foret, M., „Marketingový pr zkum – Poznáváme svoje zákazníky", 1. vydání, *Computer Press*, Brno 2008, 124 s., ISBN 978-80-251-2183-2

Kotler P., Andersen, A. (1991). *Strategic Marketing for Nonprofit Organizations*, 4 th Edition, New Jersey: Prentice Hall, 1991

Kotler, P., Lee. N.R., „Marketing in the Public Sector: The Final Frontier, Public Manager"; *Spring*, 36, 1, 2007, ABI/INFORM Global, pp. 12-17

Payne, A., Ballantyne, D., Christopher, M., A stakeholder approach to relationship marketing strategy: The development and use of the "six markets" model, In: *European Journal of Marketing*, 39, 7/8, 2005, ProQuest European Business, pp. 855-871

Petrovi ová, J., Va ová, A. Využitie vz ahového marketingu v podmienkach miestnych samospráv. In: Strišš, J. (ed) et. al. *Aktuálne marketingové trendy v teórii a praxi, vedecký monografický zborník*, Žilina: EDIS – Vydavate stvo Žilinskej univerzity, 2009, pp. 156-162. ISBN 978-80-8070-964-8

Rees, P., „Marketing in Local Government – From a Local Government Officer´s Perspective", *Australia and New Zealand Marketing Academy Conference*, 2000, Gold Coast

Švantnerová, ., „Predpoklady municipálnej ekonomiky", *Studia oeconomica* 22, *Banská Bystrica: Ekonomická fakulta UMB*, 1997, ISBN 80-8055-078-6

Va ová, A., „Strategické marketingové plánovanie rozvoja územia", *Banská Bystrica, EF UMB*, 2006, p. 126. ISBN 80-8083-301-X

Va ová, A., Bernátová, M., „Marketing pre samosprávy I. Marketing území", *Banská Bystrica, Ekonomická fakulta UMB*, 2000, 180 s. ISBN80-8055-337-8

Va ová, A., Bernátová, M., „Marketing pre samosprávy II. Komunikácia s verejnos ou", *Banská Bystrica,* Ekonomická fakulta UMB, 1999, 96 s. ISBN 80-8055-338-6

Va ová, A., Bernátová, M., „Experience of Local Governments in Slovakia with Learning about Citizens Preferences", In *Government, Market and the Civic Sector - The Search for a Productive Partnership:* zborník z 9. vedeckej konferencie NISPAcee, Riga: NISPA cee, 2001

Va ová, A., Kološtová, A., „Výsledky projektu Komunikujúce mesto v Slovenskej republike", In Bernátová, M. et al. (2001). *Komunikujúce mesto na prelome tisícro í,* Banská Bystrica: Ekonomická fakulta UMB, 2001, pp. 8-16, ISBN 80-8055-609-1.

Va ová, A., Petrovi ová, J., „Attitudes and expectations of municipal offices towards companies", In: Lukášová, R., Bajdak A. (eds.) *Relationship Marketing in Micro and Small Enterprises and Local Authorities – International Comparison (*scientific publication. Katowice: Publisher of the Karol Adamiecki University of Economics in Katowice 2009, ISBN 978-83-7246-443-9

Va ová, A. – Petrovi ová, J., „Importance and Quality of Relationships among Local Self-Governments and Their Stakeholders", In: *CERS 2009*, *Zborník z mezinárodnej vedeckej konferencie*, Košice: TU, 2009, (v tla i)

Wright, G., Taylor, A., „Informing Effective Performance Management", *Journal of Finance and Management in Public Services*, Vol. 1, 2001

Theoretical and Applied Economics
Volume XVII (2010), No. 10(551), pp. 83-92

To Differentiate or Not to Differentiate: A Question When Some Consumers Are Loyal

Yan MENG
Gongshangnansuo Jiashuyuan, Juancheng, Shandong Province, China 274600
munyanmeng@yahoo.com

Abstract. *I analyze a duopoly that competes first in product characteristics and then in prices. I show that when there exist consumers that are loyal to specific brands with no regard for product characteristics, the second-stage price game doesn't have a pure-strategy equilibrium or symmetric mixed-strategy equilibrium and the firms choose to maximize their product differentiation in the first stage, contrary to what is usually assumed in the price dispersion literature.*

Keywords: pricing; product differentiation; price competition.

JEL Codes: D43, L13, M31.
REL Codes: 7B, 14G.

Introduction

Since Hotelling's seminal paper in 1929, there has been a long debate over whether firms tend to minimize or maximize product differentiation at equilibrium (D'Aspremont, 1979, pp. 1145-1150). But none has studied firms' equilibrium product differentiation decisions when some consumers are loyal to specific brands with no regard to whether the products are differentiated or not. On the other hand, it has been assumed in the price-dispersion literature (Varian, 1980, pp. 651-659, Rosenthal, 1980, pp. 1575-1579, Baye, Morgan, 2001, pp. 454-474) that firms sell homogenous products but each possess a number of loyal consumers.

This paper combines the two lines of literature. It sets up a model with two firms competing in a linear city of unit length and two types of consumers: shoppers and loyals. It shows that even when some consumers have no regard for product characteristics, it pays for the two firms to differentiate their products. What is usually assumed in the price dispersion literature, that the firms sell homogeneous products, is therefore never a result of firms' equilibrium choice behavior.

Santore (1999, pp. 43-52) uses a similar model set-up and analyzes firms' pricing strategies when some consumers swithes with transportation costs. It shows that a mixed-strategy equilibrium generally exists and a pure-strategy equilibrium exists if and only if the number of swithers is small.

I'm able to algebraically solve for the firms' equilibrium profits using mixed strategy in the second stage, when there are both shoppers and loyals, and compare them with the case of homogeneous products to show that the firms would choose to maximize product differentiation and that selling homogeneous products, as is assumed in the price dispersion literature, is not an equilibrium choice.

The model

There are two firms located on a linear city of unit length. The two firms sell identical products with constant marginal cost of production, which is normalized to zero. Firm 1 is located at distance a from one end of the city and Firm 2 is located at distance b from the other end of the city. Without loss of generality, I restrict a and b to be between $0, \frac{1}{2}$. That is, the two firms are located on different halves of the line city. The two firms charge prices of

respectively p_1 and p_2 for their products. I assume both firms earn strictly increasing profits up to a unique monopoly price r.

There are two types of consumers: shoppers and loyals, both of whom have unit demand. That is, they buy exactly one unit. There are S shoppers uniformly distributed along the linear city. Shoppers incur unit transportation cost c to buy from the firms. I assume the transportation cost is proportional to the square of distance. That is, a shopper located at x will incur transporation cost of $c(x-a)^2$ to buy from firm 1 and transportation cost of $c(x+b-1)^2$ to buy from firm 2. Shoppers buy from the firm that offers the lower delivery price. Delivery price is the sum of mill price (p_1 or p_2) and transportation cost. There are L loyals who buy from one and only one firm. I assume half of the loyals buy from firm 1 and the other half buy from firm 2. Loyals don't pay for transportation. Or, they are located at the same place on the linear city as their prefered firm. For them, delivery price is the same as mill price.

At the first stage of the game, the two firms choose their respective locations on the line city and commit. At the second stage, given their respective locations, the two firms compete in prices. I consider only the case when r is large enough and/or c is small enough for the model to be interesting. I analyze the case by backward induction. That is, I work out the price equilibria for the second stage of the game first and then go back to the first stage of location choices.

Note that when $S=0$ the model is trivial, with both firms serving their respective loyal consumers at the monopoly price. When $L=0$, the model degenerates into the Hotelling (1929) model, with equilibrium prices $p_1^* = \frac{c\left[(b-2)^2-(a+1)^2\right]}{3}$, $p_2^* = \frac{c\left[(a-2)^2-(b+1)^2\right]}{3}$ and equilibrium profits $\Pi_1^* = \frac{c(1-b-a)(3+a-b)^2}{18}S$, $\Pi_2^* = \frac{c(1-b-a)(3+b-a)^2}{18}S$. It can be checked that $\frac{\partial \Pi_1^*}{\partial a} = -\frac{c(3+a-b)(b+3a+1)}{18}S<0$, $\frac{\partial \Pi_2^*}{\partial b} = -\frac{c(3+b-a)(a+3b+1)}{18}S<0$.

This shows that the firms tend to maximize product differentiation and would choose to locate at the two ends of the city at equilibrium.

For the rest of the paper, I'll assume neither S nor L is zero. Actually, I'll assume there are a large number of both loyals and shoppers in the paper.

I first look at the case when $a=b=\frac{1}{2}$. That is, when the two firms both choose to locate at the center of the city and to sell homogeneous products. It can immediately be seen that this is a copy of the Varian (1980) model.

The demand function for firm i in this case is then

$$D_i = \begin{cases} \frac{L}{2} & if\ p_i > p_j \\ \frac{L+S}{2} & if\ p_i = p_j \\ \frac{L}{2}+S & if\ p_i < p_j \end{cases} \quad \text{where } i = 1, 2;\ j = 1, 2 \text{ but } i \neq j.$$

This price game doesn't have a pure-strategy equilibrium but mixed-strategy equilibria generally exist. I only look at the symmetric mixed-strategy equilibrium where both firms set their prices according to the same density function. Let $f(p)$ be the density function from which both firms draw their prices and $F(p)$ the correspondent cumulative distribution function.

Proposition 1: There exists a unique symmetric mixed-strategy equilibrium for the game where both firms' pricing strategy is given by the atomless, strictly increasing cumulative distribution function $F(p) = \frac{1}{S}\left(\frac{L}{2} + S - \frac{Lr}{2p}\right)$ with support on $\left[\frac{L}{L+2S}r, r\right]$ and the equilibrium expected profits for both firms are $\Pi_1^{**} = \Pi_2^{**} = \frac{L}{2}r$.

Proof: First, the two firms would never price the same at equilibrium. This is true because one firm could price an ε lower, capture all of the shoppers and make a larger profit.

Second, the two firms would never price above the monopoly price r or below $\frac{L}{L+2S}r$ at equilibrium. The latter is also true because at equilibrium the firms can earn at least their monopoly profit of $\frac{L}{2}r$. Therefore, for the firms to serve both shoppers and loyals, we must have $p\left(\frac{L}{2} + S\right) \geq \frac{L}{2}r$, or $p \geq \frac{L}{L+2S}r$.

When firm i sets its price at p, with probability $F(p)$, it will get only its loyal consumers, and with probability $1 - F(p)$ it will also get all of the shoppers. Therefore the firm's expected profit is $E\Pi_i = p\left[\frac{L}{2}F(p) + \left(\frac{L}{2} + S\right)(1 - F(p))\right] = p\left[\frac{L}{2} + S - SF(p)\right]$. For it to be a stable equilibrium, it must be true that the firm makes the same expected profit

everywhere on the support of $F(p)$. In particular, this is true when $p = r$. Substituting into the above equation, I have $\Pi_i^{**} = \frac{L}{2} r$ and $F(p) = \frac{1}{S} \; \frac{L}{2} + S - \frac{Lr}{2p}$.

I prove the existence and uniqueness of the symmetric mixed-strategy equilibrium by stating that $F(p)$ is an atomless function which is strictly increasing in p and which is the unique solution to the equation $E\Pi_i = \Pi_i^{**}$.

Next, I look at the case when the two firms do not choose to locate at the center of the city at the same time. A consumer located at x is indifferent to buy from either firm 1 or firm 2 when $p_1 + c(x-a)^2$ is the same as $p_2 + c(x-1+b)^2$. Setting the two equal and solving for x, we get

$$\bar{x} = \frac{p_2 - p_1}{2c(1-b-a)} + \frac{1+a-b}{2} \tag{1}$$

Therefore the demand function for the two firms are respectively

$$D_1 = \begin{cases} \frac{L}{2} & \text{if } p_1 > p_2 + c\left[(1-b)^2 - a^2\right] \\ \frac{L}{2} + S \; \frac{1+a-b}{2} + \frac{p_2 - p_1}{2c(1-b-a)} & \text{if } p_2 + c\left[(1-b)^2 - a^2\right] - 2c(1-b-a) \le p_1 \le p_2 + c\left[(1-b)^2 - a^2\right] \\ \frac{L}{2} + S & \text{if } p_1 < p_2 + c\left[(1-b)^2 - a^2\right] - 2c(1-b-a) \end{cases}$$

$$D_2 = \begin{cases} \frac{L}{2} & \text{if } p_2 > p_1 - c\left[(1-b)^2 - a^2\right] + 2c(1-b-a) \\ \frac{L}{2} + S \; \frac{1+b-a}{2} + \frac{p_1 - p_2}{2c(1-b-a)} & \text{if } p_1 - c\left[(1-b)^2 - a^2\right] \le p_2 \le p_1 - c\left[(1-b)^2 - a^2\right] + 2c(1-b-a) \\ \frac{L}{2} + S & \text{if } p_2 < p_1 - c\left[(1-b)^2 - a^2\right] \end{cases}$$

This game doesn't have a pure-strategy equilibrium but mixed-strategy equilibria exist. I first look at the symmetric mixed-strategy equilibrium where both firms set their prices according to the same density function.

Proposition 2: There doesn't exist a symmetric mixed-strategy equilibrium for the game.

Proof: I assume there exists a symmetric mixed-strategy equilibrium for the game. Let $g(p)$ be the density function from which both firms draw their prices and $G(p)$ the correspondent cumulative distribution function.

When firm 1 sets its price at p, with probability $G\left(p-c\left[(1-b)^2-a^2\right]\right)$, it gets only its share of loyal consumers; with probability $1-G\left(p-c\left[(1-b)^2-a^2\right]+2c(1-b-a)\right)$ it gets all of the shoppers as well as its share of the loyal consumers, and with probability $G\left(p-c\left[(1-b)^2-a^2\right]+2c(1-b-a)\right)-G\left(p-c\left[(1-b)^2-a^2\right]\right)$ the firm gets some shoppers as well as its share of the loyal consumers. Therefore, we could write the equilibrium expected profit of firm 1 as

$$
\begin{aligned}
E\Pi_1^* &= p\frac{L}{2}G\left(p-c\left[(1-b)^2-a^2\right]\right) \\
&\quad + p\ \frac{L}{2}+S\ \left[1-G\left(p-c\left[(1-b)^2-a^2\right]+2c(1-b-a)\right)\right] \\
&\quad + p\ \frac{L}{2}+S\ \frac{1+a-b}{2}+\frac{E(p)-p}{2c(1-b-a)} \\
&\quad \left[G\left(p-c\left[(1-b)^2-a^2\right]+2c(1-b-a)\right)-G\left(p-c\left[(1-b)^2-a^2\right]\right)\right] \\
&= p\ \frac{L}{2}+S\ -pS\ \frac{1+b-a}{2}-\frac{E(p_2)-p}{2c(1-b-a)}\ G\left(p-c\left[(1-b)^2-a^2\right]+2c(1-b-a)\right) \\
&\quad -pS\ \frac{1+a-b}{2}+\frac{E(p_2)-p}{2c(1-b-a)}\ G\left(p-c\left[(1-b)^2-a^2\right]\right) \\
&= k
\end{aligned}
$$

where k is a constant and $E(p_2)$ is the expected value of the other firm's price. The last equality is true because at equilibrium the expected profit of firm 1 must be constant everywhere on the support of the density function.

Since $p+2c(1-b-a)\geq p$, $G(p)$ is an atomless and increasing function by assumption and that $G(r)=1$. Subsituting $p=r$ into the above equation, I have

$$
k=\frac{L}{2}\left\{r+c\left[(1-b)^2-a^2\right]\right\}
$$

Analogously, I have

$$
\begin{aligned}
E\Pi_2^* &= p\frac{L}{2}G\left(p+c\left[(1-b)^2-a^2\right]-2c(1-b-a)\right) \\
&\quad + p \;\frac{L}{2}+S\; \left[1-G\left(p+c\left[(1-b)^2-a^2\right]\right)\right] \\
&\quad + p \;\frac{L}{2}+S\; \frac{1+b-a}{2}+\frac{E(p_1)-p}{2c(1-b-a)} \\
&\quad \left[G\left(p+c\left[(1-b)^2-a^2\right]\right)-G\left(p+c\left[(1-b)^2-a^2\right]-2c(1-b-a)\right)\right] \\
&= p \;\frac{L}{2}+S\; - pS\; \frac{1+a-b}{2}-\frac{E(p_1)-p}{2c(1-b-a)}\; G\left(p+c\left[(1-b)^2-a^2\right]\right) \\
&\quad - pS\; \frac{1+b-a}{2}+\frac{E(p_1)-p}{2c(1-b-a)}\; G\left(p+c\left[(1-b)^2-a^2\right]-2c(1-b-a)\right) \\
&= l
\end{aligned}
$$

where l is a constant and $E(p_1)$ is the expected price of the other firm.

Substituting $p = r$ into the above equation, I have

$$
l=\frac{L}{2}\left\{r+c\left[(1-a)^2-b^2\right]\right\}.
$$

Lemma 1: If the game has a symmetric mixed-strategy equilibrium, it must be true that the two firms are located at the two ends of the city with a = 0, b = 0.

Proof: This is true because $\frac{\partial k}{\partial a}<0,\ \frac{\partial 1}{\partial b}<0$, where k and l are expected profits of the two firms if a symmetric mixed strategy equilibrium exists.

Substituting a = 0, b = 0 into equations for the expected equilibrium profits, we have

G (p + c) = G(p – c),

which contradicts our assumption that G(p) is an atomless and strictly increasing function.

This completes the proof that the game doesn't have a symmetric mixed-strategy equilibrium.

Proposition 3: There exist asymmetric mixed strategy equilibria for the game.

Proof: It suffices to show that the game has mixed strategy equilibria.

According to Glicksberg (1952, pp. 170-174) the game has a continuous pay-off function and compact action sets, and therefore has a mixed strategy equilibrium.

Let h(p) and i(p) be the respective density function from which firm 1 and firm 2 draw their prices and H(p) and I(p) be the cumulative density function respectively. Then we have

$$
\begin{aligned}
E\Pi_1^* &= p\frac{L}{2}H\left(p-c\left[(1-b)^2-a^2\right]\right) \\
&+ p \quad \frac{L}{2}+S \quad \left[1-H\left(p-c\left[(1-b)^2-a^2\right]+2c(1-b-a)\right)\right] \\
&+ p \quad \frac{L}{2}+S \quad \frac{1+a-b}{2}+\frac{E(p)-p}{2c(1-b-a)} \\
&\left[H\left(p-c\left[(1-b)^2-a^2\right]+2c(1-b-a)\right)-H\left(p-c\left[(1-b)^2-a^2\right]\right)\right] \\
&= p \quad \frac{L}{2}+S \quad -pS \quad \frac{1+b-a}{2}-\frac{E(p_2)-p}{2c(1-b-a)} \quad H\left(p-c\left[(1-b)^2-a^2\right]+2c(1-b-a)\right) \\
&- pS \quad \frac{1+a-b}{2}+\frac{E(p_2)-p}{2c(1-b-a)} \quad H\left(p-c\left[(1-b)^2-a^2\right]\right) \\
&= h
\end{aligned}
$$

for firm 1's expected equilibrium profit and

$$
\begin{aligned}
E\Pi_2^* &= p\frac{L}{2}I\left(p+c\left[(1-b)^2-a^2\right]-2c(1-b-a)\right) \\
&+ p \quad \frac{L}{2}+S \quad \left[1-I\left(p+c\left[(1-b)^2-a^2\right]\right)\right] \\
&+ p \quad \frac{L}{2}+S \quad \frac{1+b-a}{2}+\frac{E(p_1)-p}{2c(1-b-a)} \\
&\left[I\left(p+c\left[(1-b)^2-a^2\right]\right)-I\left(p+c\left[(1-b)^2-a^2\right]-2c(1-b-a)\right)\right] \\
&= p \quad \frac{L}{2}+S \quad -pS \quad \frac{1+a-b}{2}-\frac{E(p_1)-p}{2c(1-b-a)} \quad I\left(p+c\left[(1-b)^2-a^2\right]\right) \\
&- pS \quad \frac{1+b-a}{2}+\frac{E(p_1)-p}{2c(1-b-a)} \quad I\left(p+c\left[(1-b)^2-a^2\right]-2c(1-b-a)\right) \\
&= i
\end{aligned}
$$

for firm 2's expected equilibrium profit.

Substituting $p = r + c[(1 - b)^2 - a^2]$ into the equation of firm 1's expected equilibrium profit, we have $\Pi_1^{***} = h = \frac{L}{2}\{r + c[(1-b)^2 - a^2]\}$ as the expected equilibrium profit for firm 1.

Analogously, we have $\Pi_2^{***} = i = \frac{L}{2}\{r + c[(1-a)^2 - b^2]\}$ as the expected equilibrium profit for firm 2.

Proposition 4: When there are both shoppers and loyals, the firm will choose to maximize product differentiation and locate at the two ends of the city.

Proof: This is true by comparing the two firms' equilibrium profits when the two firms choose to locate at the center of the city at the same time and when they don't and to note that $\Pi_i^{**} < \Pi_i^{***}$, $\frac{\partial \Pi_1^{***}}{\partial a} < 0$, $\frac{\partial \Pi_2^{***}}{\partial b} < 0$.

Subsituting a=0 and b=0 into the equation for both firms' expected equilibrium profit, we have

$$p\left(\frac{L}{2} + S\right) - pS\left[\frac{1}{2} - \frac{E(p_2) - p}{2c}\right] H(p + c) - pS\left[\frac{1}{2} + \frac{E(p_2) - p}{2c}\right] H(p - c) = \frac{L}{2}(r + c) \quad (2)$$

and

$$p\left(\frac{L}{2} + S\right) - pS\left[\frac{1}{2} - \frac{E(p_1) - p}{2c}\right] I(p + c) - pS\left[\frac{1}{2} + \frac{E(p_1) - p}{2c}\right] I(p - c) = \frac{L}{2}(r + c) \quad (3).$$

Let $\underline{p}_1$ be the lower support of firm 1's pricing strategy and let $p+c=\underline{p}_1$, we have $\underline{p}_1 = c + \frac{L(r+c)}{L+2S}$.

Similarly, we have $\underline{p}_2 = c + \frac{L(r+c)}{L+2S}$.

Although I cannot algebraically solve for H(p) and I(p), they are determined by equation (2) and equation (3) respectively, with support $[\underline{p}_1, r]$ for firm 1 and support $[\underline{p}_2, r]$ for firm 2.

Conclusion

The above analysis shows firms will choose to maximize product differentiation even when there exist loyal customers who don't care whether the two firms are differentiated or not. An important result of the paper is that when firms are allowed to differentiate their products, they would always do so and it's not an equilibrium for the firms to sell homogeneous products, as is assumed in most of the price dispersion papers.

References

Baye, M.R., Morgan, J., "Information Gatekeepers on the Internet and the Competitiveness of Homegeneous Product Markets", *The American Economic Review*, June 2001, 91 (3), pp. 454-474

Dasgupta, Partha, Maskin, E.E., „The Existence of Equilibrium of Discontinuous Games II: Applications", *Review of Economic Studies*, Vol. 53, No. 1, January 1986, pp. 27-41

D'Aspremont, C., Gabszewicz, J.J., Thisse, J.-F., „On Hotelling's 'Stability in Competition'", *Econometrica*, 47 (5), September 1979, pp. 1145-1150

Glicksberg, I.L., „Minimax Theorem for Upper and Lower Semi-continuous Payoffs", *Research Memorandum Rm-478*, 1950, Rand Corporation

Glicksberg, I.L., „A Further Generalization of the Kakutani Fixed Point Theorem with Application to Nash Equilibrium Points", *Proceedings of the American Mathematical Society, no. 38*, pp. 170-174

Hotelling, H., „Stability in Competition", *The Economic Journal*, 39 (153), March 1929, pp. 41-57

Rosenthal, R.W., „A Model in Which an Increase in the Number of Sellers Leads to a Higher Price", *Econometrica*, 48 (6), September 1980, pp. 1575-1579

Santore, R., „Pricing Differentiated Products with Indifferent Consumers", *Economics Letters*, 62 (1), January 1999, pp. 43-52

Varian, H.R., „A Model of Sales", *American Economic Review*, 70 (4), September 1980, pp. 651-659

1. The principles of Activity-Based Costing method (ABC)

The principles of Activity-Based Costing method represent a management analysis that is reflecting with accuracy the production costs of products, works, offered services to customers in report of resource consume of enterprise and, also, allows to identify causes to improve performance and profitability through reporting insufficiencies of classical used management accounting methods.

One of the reasons, maybe the most important one, relates to allocation of indirect costs with arbitrary keys which lead to an inaccurate and incorrect allocation of its on costs carriers. Also, it can be identified as cause and the simple methods character of elaboration of charges, estimations and internal transferring prices. So, because the traditional methods do not take into account of the expenditure incurred over several years (conception costs of a new product, research and development cost etc.), and so the information from enterprise's administration does not take into account the strategic segments, this leading to absence of precise analysis of profitability of different categories of customers which makes impossible to determine an image as a real economical-financial performances obtained by the enterprise itself.

Starting from these causes which underlie the improvements in profitability, the ABC (Activity-Based Costing) has proposed to undertake and carry to achieve more cost effective, by eliminating the arbitrary criteria for the allocation of indirect costs, an improved ways substantially separating the direct costs of indirect and precise delimitation of actions included in operation's composition of the activities.

Technical literature presents arguments underlying relevance of the production costs obtained using the method ABC (Activity-Based Costing), focusing mainly on the fact that costs are variable depending on the multiple causes and that the fixed costs are only on a very short time. So, we conclude that the use of "activity" concept allows consideration of non-use of some functional department from the enterprise and also the opportunity to determine multiple ways of costs calculation (on products, on customers, on distribution networks, etc.).

If managers will take into count in their decisions the principles of ABC (Activity-Based Costing) method, then it will be observed profitability improvement of the enterprise from the first stages of its application. Over time, managers will find some effects that will benefit them against the competition, namely: cost reduction, product loss reduction. All these are based on knowledge of all causes which are leading to increase the production volume, sub-activity diminution and finally reduction of products selling prices. The well known "subsidized" effect and used in the classic methods is completely

eliminated in the ABC method and so is a correct imputation of effective consumed resources costs (salaries, raw materials, equipments, etc.) per products and customers. As result of this aspect, the enterprise can make an election of customers, choosing the most profitable ones (from point of view of sales volume) and giving up to the less profitable ones.

One of the most important contributions of the ABC method is that it remedies weaknesses of traditionally approaches of production calculation costs. To meet the needs and requirements of users of accounting information, it has been made a very careful analysis of the main causes that led to choosing ABC (Activity-Based Costing) method in comparison with traditionally cost methods and that are the base of profitability improvement of the enterprise, as follows:

A. Sharing analysis of allocated indirect costs with arbitrary cost drivers

Traditional methods used for the distribution of indirect expenses only one key for the assignment or criteria. This meant that, in fact, certain products or certain customers actually bear a percentage of 10-15% of indirect costs, while other customers supported by up to 40% of indirect costs. Share of indirect costs and the total fixed cost of production was very low. All these proportions resulting from the use of allocation bases that were unsuitable type of expenditure choice. The number too small of keys distribution used for indirect costs allocation has lead to a decrease in their reliability, giving rise to much higher costs for certain products and spending too little for others. Just this situation has generated appearance of the phenomenon of *subsidization* between products (customers). In other words, some products, according to its technological process requiring many operations were imputed much bigger structural costs, taking into account the actual consumption of resources made to achieve them.

B. Coherency analysis between provided administrative information and strategically segmentation of the enterprise

To extend the services offered to the customers and also to be still competitive, many small and midsized enterprises agree to divide the enterprise on strategic segments. This phenomenon often met in the most majority of the developed countries in economic terms does not represent a monopoly of large enterprises. Benefits offered by the enterprise in each chosen strategic segment are approximately the same, but the degree of customs complexity is variable. So, in the honor of some customs, the administrative service can be much more important for a strategic segment than to another. An activity costs analysis inside of the administrative service allows to fix a way of determination and much more correct allocation, and also to obtain profitability at the level of each strategic segment(1). According to traditionally methods, the analytical

result (not delimited on customers and customs segments) were determined like this:

Analytical result = M – (IPCRA + MC + DC)

Where:

M = margin of direct costs, based on the relation: M = (Sales – Direct Costs);

IPCRA = indirect production costs rationally allocated;

MC = management costs; DC = distribution costs.

Starting from this calculation relation of analytical result, this allows us to take only an overall decision for the whole enterprise. In opposition with this, the Activity-Based Costing method, which makes delimitation on customers segments, allows visualization and decision much more extensive on activities. Thus the relationship for calculating the operating result, according to ABC method, is as follows:

$$Result = M_S - \sum_{a=1}^{n} (A_c)_S ,$$

where:

$$M_S = (S - DM)_S$$

And M_s = margin of the strategic segment; S = Sales (turnover); DM = direct materials;

Ac = activity costs; a = activity type; n = number of activities; s = strategic segment.

Lack of identification of strategic sectors, which consume the resources of a heterogeneous manner, do not allow to the manager to perceive the real profitability of each segment. In this way it is realizing an improvement of the informative system through the ABC method demarche. This type of demarche allows to the manager to react fast, to choose revaluation of the selling prices before launching of products in one strategic segment or another.

C. Analysis of customer's profitability

To adapt at customer's needs in continuous growth, the small and midsized enterprises are tempted to differentiate commercial approaches by setting their coordinates on competition market in terms of purpose. Commercial service can aim bigger or smaller customers, or business to seek the same level, interested in providing the same range of benefits. These aspects

have a very important impact on enterprise profitability because each strategic segment "will use" resources of commercial service in a specific manner.

Trade costs of approaching various categories of customers are different and are reflected in the costing and pricing offer benefits. These arguments militate in favor of surrender to apportion indirect costs related to commercial service based on turnover, an arbitrary criterion, often used in traditional methods of computer costs. Contrary, Activity-Based Costing method (ABC) is recording a much more correct allocation because the used allocation criteria is a well chosen one and also is considered a more accurate identification of the customers.

A carefully effectuated analysis allow enterprises to identify and evaluate all new actions which have been elaborated for penetrating new market segments, and on the other hand, to retain the fidelity of the customer's segments precedent obtained. Such activities are not destined to all enterprise customers. The ABC (Activity-Based Costing) method allows analyzing with accuracy the impact which has the activities on real profitability, according to a specific purpose, as well as very precise identification of costs, generating effects of new activities and their way of allocation on customers.

D. Transparency analysis of selling prices

The customers don't know the production costs of the enterprise; they do know only the final selling price. As is known, the production cost represents the starting base for establishing the selling prices. For example, the repair made for equipment was provided in the case of traditionally methods by specialized firms or by persons especially trained in equipment repairs, meanwhile, in the Activity-Based Costing (ABC) method, these repairs are made by workers which work and maintain that equipment. In other words, in the case of the ABC method, it appears the "overqualified workers[2]" specific to Japanese method J.I.T. (Just-In-Time). This is a first aspect at what occurs internally, which aims the justification of lower costs. A second aspect is connected to "protection" and attraction of new customers through assurance of supplementary services. For example, in the selling price of a product is included transportation, installation or even guarantee and post-guarantee services. This success has leaded to appearances of the following three phenomenons:

- Industrial organization of technical services that is based on costs;
- Constitution of a dense network for emphasizing proximity toward customers;
- Development of advantages for customers according to services.

In conclusion, the proposed method of the ABC (Activity-Based Costing) constitutes the reconfiguration way to establish the selling price and solution to profitability improvement of traditionally cost calculation methods. The ABC method allows to operate either on the methods by which a "sell" in production costs or benefits to which sells the selling price is displayed and transparent and/or cost benefit crash risk is not borne by the customer, but the provider. This new method of determining the selling price has been drafted having regard to the two main directions: the identification of customer benefits and low cost of production calculated from the activities.

E. Analysis of price transparency for internal transfer

The approach proposed by the ABC (Activity-Based Costing) method allows calculation of transfer prices which are integrated in addition to other activities "bought" by another service or another subsidiary of the group. Therefore, resources of the commercial nature are not participating in the internal transfer price. This argument is applied to commercial activities, but it can be extrapolated to all activities connected to products and/or all management activities. This debate on calculation of more pertinent production cost has established the difference by setting of the margin. This thing depends on the policy chosen by the enterprise's manager or group of enterprises.

F. Integration analysis of plural-annual costs

The research and development costs, design of new products, manufacture of moulds, equipments, creation and brands launching are engaged costs during an exercise, are the relevant costs incurred during the year, but whose cost can be justified only in the years ahead. The model of general accounting insists to record costs in the engagement year for allowing fiscal deduction of them. Indeed, they depend on the intangible costs, like expenses for education and wages, when those who have conceived are part of the staff.

In the case of traditionally methods, these costs were not taken into account, or if they were, they had a very small volume, almost insignificant. The ABC (Activity-Based Costing) method considers that these costs can be integrated in the planned production during all administrative period and updated every year. So, the customers will no longer pay the product's manufacturing costs from the last year. This type of re-treating allows intervention in the management accounting. All these costs can be identified in time to achieve them, but not always they match to the allocated resources.

The enterprises should undertake studies in design and sale of products which present the lowest degree of risk in case of failure. This can be done by establishing certain typology, after conducting some studies on marketing, on

which to draw conclusions on their merchantability. If the production cost of products reflects the real cost of conception activity of them, then the selling price is determined as consequence of taking efficient decisions to offer the opportunity that those products compete with similarly once, but with a higher profitability degree.

2. The principles of ABM (Activity-Based Management)

The basic principles of ABM and ABC methods have been developed based on a research project sponsored by fifty organizations through the world under direct guidance of CAM-I director, Tom Pryor, the current chairman of Integrated Cost Management Systems (ICMS) during the course of three years (1986-1988). The result of his research was made public in 1988 by publishing an article in "Business magazine" which announced the launch of software, some books and providing training in the ABM quality field for all organizations regardless of their sizes.

A. The principle of identification of activities causes

According to this principle, the "*root*" of activities causes is found very rarely under control of staff and elimination of a part of the employees can not resolve the problem of costs generated by those activities. ABM is based on principle that "*activities consume costs, products and services and they are consumed by the customers*".

B. The principle of identification of customer related to activity/process

According to this principle, it is proceeding to evaluation of customer satisfaction degree about costs, quality, and services level and product delivery time. After identification of satisfied customers, they pass on to identification of specific value activities. To carry out improvement activities and to meet the requirements of customers it can be used the ABM method closely connected with TQM (Total Quality Management), BRP (Business Process Reengineering) or benchmarking.

C. The principle of jointly management

According to this principle, it is proceeding to establishing of manager responsibilities by creating managerial teams (communities) which will lead functional activities synchronized through functional connections. These will create simple, efficient and flexible managerial processes whose purpose is to satisfy multiple requests of the customers.

D. The principle of culmination performances

According to this principle, the benchmarking activities related to best appropriate methods in the area may contribute to obtaining of high performances and the limit (culmination) of performances can be reached by using the methods from previous year in the recent year, and even improve of the actual performances.

E. The principle of elimination of non-value

According to this principle, it is proceeding to minimize and even eliminate of those non-value activities. As a result, it will proceed to reallocation of resources for increasing and improving performances (profit) of activities.

F. The principle of cooperation and disciplinary liability

According to this principle, it is proceeding to cooperation between departments in order to detect deviations (errors) and the roots of activity causes and establishing of disciplinary liability. To avoid the reiteration of negative deviations or variable planning it will be considered: defining the causes and settlement of negative deviations related to non-value activities, excessive costs and low quality.

G. The principle of permanent improvement of activities

According to this principle, the competitiveness is maintained through permanent activity improvement of an enterprise. This is a continuous analysis of the process, action and counting of all obtained results during the conduct of activities and search for those ways to improve the performances of an enterprise.

H. The principle of updating information

According to this principle, all information must be updated and avoided any irrelevant statistical data, any unfounded comparisons. Performances measurement should be based on updated data to enable effective decision making.

I. The principle of objectives identity

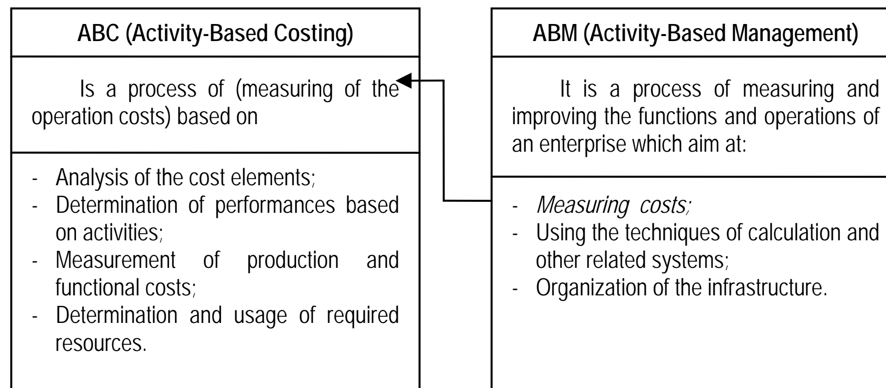
According to this principle, it refers to keeping check those activities that enhance the performances and correspond to the established objectives of the enterprise. It is defined as the measurement units of activities necessary to achieve a strategic plan and budget activities.

J. The principle of professional satisfaction

According to this principle, the staff of an enterprise will make an effective activity as long as their work will be rewarded and awarded properly to obtained results. They will provide to the employees all the tools necessary to obtain the desired results to increase effective the add-value activities. All these will lead to keep a favourable climate and will contribute to increase performances of the enterprise.

3. ABM method – tool of ABC method

Is the Activity-Based Management (ABM) a tool of Activity-Based Costing method (ABC)? The opinions are divided. Some specialists consider that the base of extension of the ABC method relies in the ABM method, meanwhile another part of the specialists consider that ABC method has undergone a separate evolution of ABM. Starting from the definitions of those two concepts we are submitting to your attention the next scheme meant to facilitate the proper understanding of them:



As it can be seen on the scheme above, the ABC method (Activity-Based Costing) represents in fact *an instrumental extension* of the ABM method (Activity-Based Management). The Activity-Based Management method (ABM) is an excellent way to improve the quality of managerial decisions mostly based on information provided by the ABC method. The ABM method permits the proper allocation of the resources to activities, helping to improve production and reduce their costs, based on analysis done through ABC method.

The objective of ABC method is not to influence the level of costs (as with the method of cost centre costs, for example), but rather the allocation of effective action on activities that determine the cost: "*People can not manage*

costs; they can only manage activities that determine costs”. So, the ABC method acquires a new dimension: Activity-Based Management (ABM). The calculation aspect doesn’t constitute the main element of the method but, by adding a strategic and managerial dimension, it is increased.

The ABC method consists in providing some informational costs more relevant, obtained with accuracy far greater then through traditional approaches. In this new approach, cost calculation is still considered a significant tool of the management, but doesn’t constitute an end in itself. Once again, we must perform an activity analysis of the enterprise.

Taking actions over activities, the ABM method enables possible direction of the actions concerning the long term objectives. All costs that present the characteristic of being variable become useful in the process of making decisions. This is the terminology origin of the Activity-Based Management. These statements call for a definition of the movement of the circulation process of the resources through activities and variety products of the enterprise, which is very close to the reality. So, it becomes possible to measure the resource consumption for each activity and its value determination.

Notes

(1) Strategic segment – target market segment chosen by the enterprise.

(2) Overqualified workers – trained workers for execution of an extensive number of work tasks.

References

C pu neanu, S. „Principiile managementului costurilor în condi iile integr rii europene”, *Seminarul tiin ific Na ional „Octav Onicescu”* , simpozionul tiin ific interna ional, *Revista Român de Statistic* , Bucure ti, 2007, pp. 50-57

Ebbeken, K., Possler, L., Ristea, M. (2008). *Calcula ia i managementul costurilor*, Editura Economic , Bucure ti

C pu neanu, S. (2008). *Elemente de management al costurilor*, Editura Economic , Bucure ti

Cokins, G. (1996). *Activity-Based Cost Management – Making it work – A manager’s guide to implementing and sustaining an effective ABC system*, The McGraw-Hill Companies, Inc., 1996, pp. 134-137

Hicks, D.T. (1999). *Activity–Based Costing. Making it work for small and mid-sized companies*, Second Edition, USA

Ravignon, L., Bescos, P.L., Joalland, M., Bourgeois, S., Le, Maléjac, A. (2003). *Méthode ABC/ABM*, Ed. d’Organisation, Paris