

# **ROMANIAN ECONOMIC AND BUSINESS REVIEW**

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The *Romanian Economic and Business Review* (ISSN 1842-2497) intends to provide a forum for academic analysis of the economic phenomena and institutions affecting the world economy in general, and Romania, in particular. *REBE* examines a wide variety of phenomena related to economic growth and business development and attempts to publish high quality research focusing on the role of institutions and public policy, within both a national and international context. *REBE* encourages cross-disciplinary research work of Romanian and foreign scholars.

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## CREATING JOBS

Walter E. Block<sup>1</sup>

### Abstract

*Purpose: For most commentators, creating jobs is a good thing. The more jobs the better, the fewer the worse. Public policies are commonly evaluated on this basis. The purpose of the present paper is to argue the exact reverse: employment is bad, albeit it a necessary evil. Forced unemployment is a very different matter; that is indeed a bad. And, it is caused by government. The solution is laissez faire capitalism.*

*Findings: It makes no economic or any other sense to elevate jobs as the *sumum bonum* of economics. They are, instead, an expenditure of a valuable resource, labor. They are a necessary evil, not a positive good. If only we could have all of the goods and services we wanted, jobs would be a thing of the past, and good riddance to them too.*

*Design/methodology/approach: The design/methodology/approach of this paper is to utilize logic; this is not an empirical paper. Rather, it fits into the tradition of Austrian or praxeological economics. It employs the method of *reductio ad absurdum*.*

*Social implications: The social implications are laissez faire capitalism. If the analysis of this paper is incorporated into public policy, the government would adopt a strict hands-off policy toward labor markets, neither trying to create employment (e.g., through subsidies), nor to undermine it (e.g., by boosting required wages above productivity levels)*

*Value of paper: To combat the view that is all too often in currency among commentators, professional economists and others, to the effect that jobs are the *desideratum*, in contradistinction to the products that employment makes possible.*

**Key words:** Jobs, unemployment, necessary evil

**JEL category:** J64

### 1. Introduction

There is a major dispute concerning the possible construction of the Keystone XL pipeline that would transmit Canadian crude from the oil sands of Alberta to refineries located on the Gulf of Mexico in Texas and Louisiana: will this harm the environment? That is not the topic for discussion today.

Instead, we focus on a minor disagreement regarding this issue. This sideshow concerns the question of how many jobs would this project create. According to

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TransCanada (2012), the Canadian firm pushing for the pipeline, the correct answer is in the neighborhood of 20,000 new jobs. But a study emanating from the prestigious labor economists located at Cornell University reaches a far different conclusion: 20 full time positions,<sup>2</sup> plus 2500-4600 temporary employment slots of two years duration on average (Skinner and Sweeney, 2012; see also Wald, 2013).

Both parties agree that the more jobs created by this or indeed any other source would be a good thing by far. They are joined in this error<sup>3</sup> by Nobel Prize winning economist Paul Krugman who goes so far as to say that a fake Martian scare would be a good thing in that it, too, would create a massive number of defense industry jobs (Mirkinson, 2011; Spiegel, 2012.). And of course John Maynard Keynes bought into this idea when he averred that if people dug holes in the ground and then filled them up again, this would also boost economic welfare, through job creation (Keynes, 1936; for an excellent critique, see Hazlitt, 1983, 2007).<sup>4</sup>

All of these worthies are entirely wrong.

In section II we attempt to make the point that jobs, per se, are not a desiderata; rather, they are a necessary evil, given that we live in an economy of scarcity. The burden of section III is to cast light on the causes of joblessness. We conclude in section IV.

## 2. Jobs, a detriment

Jobs, no matter how many of them there are, or how few, are a *bad* thing. They are an *expenditure* of human resources. They lead away from, not toward, economic prosperity. They are a *debit*, not a *credit*. What we really need on the positive side of the ledger is not employment, but the goods and services labor brings.<sup>5</sup> Refined oil of course and defense services to be sure, but also toys and food, transportation and clothing, medical care and vacations, movies and shelter, etc. As for holes in the ground, they too are necessary, but only for mines, oil wells or foundations for dwellings. Not to be filled back up again, an economic grotesquery. To attain these goodies we must of course expend labor power. But wouldn't it be great if matters

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<sup>2</sup> That is not a typographical error.

<sup>3</sup> This is not a typographical error either.

<sup>4</sup> One may be forgiven for wondering why the advocates of such policies such as Keynes, Krugman, did not follow their own advice in their personal careers. That is, why did these scholars create books or articles and then publish them? Why didn't they create books or articles and then throw them away? The world might have been a far better place had they followed their own advice. And, *reductio ad absurdum*, their own careers might well have prospered even more than they actually did.

<sup>5</sup> The author who has done more perhaps than anyone else to stress this point is Henry Hazlitt. See on this Hazlitt (1946).

were otherwise? Would not it be wonderful if we could have everything that makes life worthwhile, such as the aforementioned goods and services and many others to boot, without having to *work* (ugh!) for these things? Then we could play all the daylong; we could create music and art, engage in sports, play chess, try to get to the moon, cure disease, tra la la. But we do not live in the Garden of Eden. We must work, at jobs (disgusting) in order to obtain what we need for our sustenance and happiness. Bread, and roses too. So, yes, let us for all that is holy have employment, but only as an evil, not a good; it is but a necessary evil.

Fighting against imaginary Martians, digging up holes and filling them up again, will provide occupations alright, but none of the things we need to preserve and enrich our lives. Better, far better, to not waste precious and scarce labor resources on such fripperies.

### 3. The causes of unemployment

Why do we have so few opportunities to create the products we need via the utilization of scarce manpower? Why are there so few jobs<sup>6</sup> creating real wealth, compared to our need for, our desire for, real wealth? It is all the fault of the government. The state apparatus is an unemployment machine. They do so in a myriad of ways. This institution prevents people from expending their limited labor capacity to produce the material antecedents of prosperity by mandating wages above productivity levels. One way it accomplishes this nefarious task is through the minimum wage law.<sup>7</sup> If a person is capable of producing at the rate of \$5 per hour, but a potential employer is compelled to pay him \$7 hourly, he will lose \$2 per hour on the deal. The latter will decline to hire the former under such institutional arrangements. If he perseveres, he will lose money and tend to go bankrupt which will incapacitate him from employing anyone at all, at any price. If the minimum wage is raised to \$12 per hour, then even those with productivity levels of \$8 - \$11 per hour, who can now hold jobs with a \$7 per hour minimum wage, will be rendered unfit for employment.<sup>8</sup>

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<sup>6</sup> A necessary evil, in case you have forgotten, dear reader

<sup>7</sup> See on this Becker, 1995; Block, 1987, 2000, 2001, 2002; Block and Barnett, 2002; Burkhauser, Couch, Wittenburg, 1996; Cappelli and Block, 2012; Deere, Murphy and Welch, 1995; Gallaway and Adie, 1995; Klein and Dompe, 2007; Landsburg, 2004; McCormick and Block, 2000; Neumark and Wascher, 1992, 1995; Rothbard, 1988; Salihu, 2013; Sohr and Block, 1997; Sowell, 1995; Vetter, and Gallaway. 2001; Vuk, 2006; Wenzel, 2013A; Williams, 1982, 2013.

<sup>8</sup> Governments, under union pressure, have proven remarkably obdurate in terms of incorporating this analysis into their public policies. E.g., they have refused to reduce the level of the legal minimum wage, much less entirely eliminate this pernicious legislation. However, there is perhaps one crack in this iceberg of indifference to the plight of the unskilled, Spain of all places. See on this Jimenez, 2013 and Wenzel, 2013B.

But this is the mere tip of the iceberg. There are other ways to boost wages above productivity levels and create unemployment thereby. Labor unions<sup>9</sup> use force, violence and pernicious legislation to accomplish this task. The rust belt is a dramatic testimony to this unfortunate fact. Before the bailout, rank and file Detroit auto workers earned some \$70 per hour, including benefits. In the south, less welcoming to organized labor, the pay is something like \$15 per hour. Is there any question as to why car manufacturers would prefer the territory to the south of the Mason-Dixon line, or to why those who could not escape “down the river” would be bankrupted? Statist bailouts “saved” Detroit,<sup>10</sup> but statism put them in their precarious position in the first place.

Unemployment is also enhanced by so-called “unemployment insurance.” Supply curves slope in an upward direction. Other things equal, the more reward offered for anything, the more of it will be forthcoming. Labor is no exception to this general rule. If unemployed people are offered \$100 per year, very few people will take the bait. But if that amount of money is presented every month, week, day, hour, more and more of them will engage in this act of being unemployed. A greater and greater number of people will “supply” this “service.”<sup>11</sup>

Still another source of joblessness is, also paradoxically, making it difficult for employers to fire employees. One would have thought that this would protect workers, but in point of fact the exact opposite is true. In some European countries it is very difficult indeed to remove anyone from a job. A case must first be built, notice must be given, separation payments must be made,<sup>12</sup> demonstration must be made to the judges who themselves lose no money if they are mistaken that the firing was warranted. (States Thomas Sowell (undated): “It is hard to imagine a more stupid or more dangerous way of making decisions than by putting those decisions in the hands of people who pay no price for being wrong.”) It is so difficult to arrange for a reduction in the labor force that it takes great courage to hire anyone in the first place. Thus, fewer people are taken on to the payroll than would otherwise be the case.

There is also the fact that various laws mandate greater benefits for full time vis a vis part time work. Vacation days, medical coverage, unemployment “insurance” eligibility, pensions, all come into play regarding this distinction. As a result, employers are more willing to hire part time rather than full time – presumably the exact opposite of what those who championed these laws intended, precisely the same phenomenon as making it all but impossible to dismiss workers.

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<sup>9</sup> For a critique of organized labor, see Baird, 1990, 2000; Block, 2008, 2010; Evans and Block, 2002; Heldman, 1977; Heldman, Bennett and Johnson, 1981; Hutt, 1973, 1989; Petro, 1957; Reynolds, 1984, 1987, 2009; Schmidt, 1973; Shea, 2010; Rothbard, 1993, n.d.

<sup>10</sup> At tremendous cost to other industries

<sup>11</sup> See on this Anderson and Block, 1993; Block, 1993; Feldstein, 1975, 1976, 1978; Grubel and Walker, 1976; Riddell, 2005

<sup>12</sup> Often in cases where justice would indicate that the money flow ought to be in precisely the opposite direction

Yes another cause of unemployment is “regime uncertainty” (Higgs, 1997). The government continually changes regulations, tax obligations, introduces new interferences with economic freedom. Businesses act as deer caught in the headlights. They simply don’t know what to make of the situation. The last thing they want to do is take on new responsibilities such as adding to their payrolls. A case in point is the introduction of Obamacare, the nationalization of some 15% of the entire economy. Information as to who, exactly, will be compelled to pay for which programs is hard to come by. In the face of such massive uncertainty, it often appears that the best thing to do is to hunker down and take on nothing additional.

Let us consider one last source of joblessness.<sup>13</sup> When the Federal Reserve System artificially lowers interest rates, it induces entrepreneurs to increasingly invest in interest sensitive (e.g., long run) projects. But the savings-consumption decisions, the time preferences which determine market interest rates, have not changed on the basis of this bureaucratic interference with the free enterprise system. These longer term investments incentivized by artificially low interest rates are not compatible with consumer decision-making. They cannot long endure. Eventually, at least some of them must be liquidated as the mal-investments they are. This is the source of the depression phase of the business cycle. It brings with it massive unemployment, as the economy cannot withstand this pressure put on it by the central bank. Adjustment is never instantaneous, unemployment results. Even if this were somehow, miraculously, not the case, still there would be a gigantic waste of wealth, as resources were misallocated.

To summarize: let us not focus on job creation. Employment is but a necessary evil. Instead, let us cast our baleful eyes on governmental programs that make it difficult or impossible to attain these necessary evils.

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<sup>13</sup> The previous causes of unemployment would be subscribed to by most economists. This one is a unique Austrian contribution to the analysis. See on this Barnett and Block, 2012; Garrison, 2001; Hayek, 1931; Mises, 1912, 1949; Rothbard, 1975, 1993; Woods, 2009

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## ANALYSIS OF JAPAN'S EXISTING AND FORTHCOMING FREE TRADE AGREEMENTS IN THE ASIA – PACIFIC AND GLOBAL CONTEXT

Florin Bonciu<sup>1</sup>

### Abstract

*The paper analyzes the rise of interest for free trade agreements and economic cooperation agreements following the failure of Doha Round and the different impact of the economic crisis on various countries and regions, focusing on the participation of Japan to such agreements. Given the high economic dynamism of the Asia – Pacific area the interest for finding operational solutions for trade facilitation is even higher than in other parts of the world economy. More initiatives that aim at supporting trade and cooperation among the countries in the area are under way and they contribute in various forms to the economic integration of the participants. The conclusion of the paper is that the current trend towards free trade agreements does not represent a dispute between multilateralism and bilateralism in international trade but an imperfect quick fix for something too important to be postponed (that is the regulation of international trade). In our opinion is that despite a certain level of duplication of efforts these initiatives represent in fact building blocks for a future multilateral framework with global scope.*

**Key words:** free trade agreements, economic cooperation agreements, world trade, post Doha Round, Regional Comprehensive Economic Partnership (RCEP), Trans – Pacific Partnership (TPP), ASEAN plus Three – APT, Free Trade Area Asia – Pacific (FTAAP).

**JEL classification:** F13, F42, F53

### The global economic context and its implications on trade

The current decade (2011 – 2020) of the world economy has started under less auspicious signs of an ongoing crisis although the scope and significance of that crisis give way to numerous interpretations. While such interpretations on the economic crisis are not the subject of this paper, suffice is to make two comments. **The first comment** result from the analysis of the International Monetary Fund data for the world domestic product year on year change during the 1980 – 2013 period. This

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analysis reveal that during a time span of 34 years in just only one year there was a negative growth: in 2009. And even in 2009, at the level of world economy as a whole the negative growth was of only - 0.59 % in constant prices and a bit higher in market prices: - 2.151%<sup>2</sup>. Under such circumstances one can hardly speak about a crisis at the level of the whole system of the world economy. At the same time, the projections of the International Monetary Fund from 2014 till 2018 indicate for the world domestic product a continuation of growth in the range of 4.404 – 4.489 % .

**The second comment**, which is based on the first one, refers to the rather differentiated economic dynamics of the main groups of countries within the world economy, differentiation that has led to changes at least in the global balance of economic power. This comment is supported by the fact that even in 2009 when the world domestic product expressed in constant prices contracted with 0.59 %, the developed countries contracted with 3.47 % and the Euro zone with 4.387 %, while the developing countries registered a growth of 2.668 %<sup>3</sup>.

The conclusion based on these two comments is that in the long run and also in perspective the world economy is functioning well. At the same time, the relative importance of the main players is changing. In this context it is noteworthy that in 2010, just at the time border between the first and the second decade of the 21st century a change took place in the sense that China became the second largest economy, thus replacing Japan that had hold the second position for almost 40 years, since the 1970s<sup>4</sup>. The spectacular evolution of China's position in world output has been matched by its position in world exports: from 1 % in 1980 to 11 % in 2011. Also as result of the changes in the economic balance of power of the world, by the end of 2010 China became the 3<sup>rd</sup> largest member country in the IMF and four emerging economic powers (Brazil, China, India and Russia) are among the top 10 largest shareholders in IMF<sup>5</sup>.

The change in the relative importance of global players can also be found in international trade. In 1980 the developing countries represented just 34 % of world exports while in 2011 their share rose to 47 %.

As regards the correlation between the economic output of the world economy (expressed by GDP) and the evolution of international trade we can note that in the past 27 years there a permanent growing trend of the ratio of world exports to world GDP, trend interrupted only in 2009. After 2009 world trade returned rather fast to the pre-crisis levels. The growing trend of ratio of world exports to world GDP is reflected in Figure 1.

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<sup>2</sup> International Monetary Fund, World Economic Outlook Database, April 2013, at <http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/download.aspx>

<sup>3</sup> Idem.

<sup>4</sup> David Barboza, China Passes Japan as Second Largest Economy, The New York Times, August 15, 2010

<sup>5</sup> Factsheet IMF Quotas, March 31, 2013 at <http://www.imf.org/external/np/exr/facts/quotas.htm>

**Figure 1. Ratio of world exports of merchandise and commercial services to world GDP, 1980-2012 - ratio of current \$ values**



**Source:** World Trade Organization, World Trade 2012, Prospects For 2013, Press Release PRESS/688, 10 April 2013

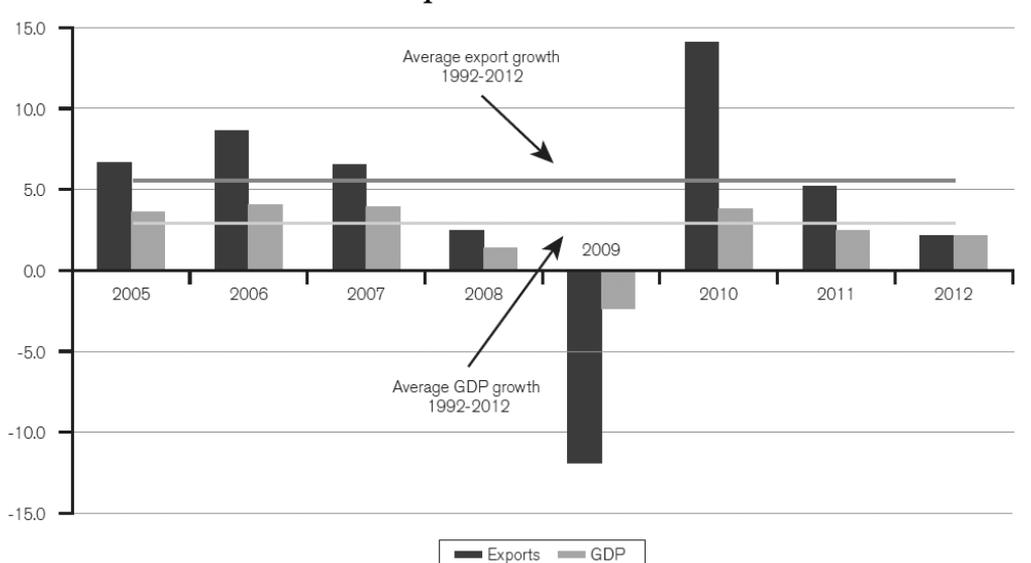
The growing trend in the ratio of world exports to world GDP was possible due to the much faster growing rate of world trade as compared to world GDP. According to World Trade Organization, for the period 1980 – 2012 world trade has grown on average twice as fast as the world GDP. This very impressive evolution materialized into an average annual growth rate for trade in goods of 7 % for the period 1980 – 2011 and even higher, of 8 % for the average annual growth for the trade in services<sup>6</sup>.

This phenomenon is explained by the elimination of numerous tariff and non-tariff barriers from the international trade flows but also by the impact of globalization, and particularly by the impact of the activity of transnational corporations that allowed the connection to world economy economic circuits almost all parts of the globe.

At the same time, this faster growth of world trade as compared to world GDP made much larger the amplitude of variations for the year on year evolution of the trade flows as compared to GDP levels. This is particularly evident in case of decline registered in 2009 by both world trade and world GDP and the subsequent resuming of growth. This difference is reflected in Figure 2.

<sup>6</sup> World Trade Report 2013 – Factors Shaping the Future of World Trade, World Trade Organization, [www.wto.org](http://www.wto.org)

**Figure 2. Growth in volume of world merchandise trade exports and GDP for the period 2005 - 2012**



**Source:** World Trade Report 2013 – Factors Shaping the Future of World Trade, World Trade Organization, [www.wto.org](http://www.wto.org)

### **World trade: from the Doha Round to a growing interest for free trade agreements**

The dynamics of world economy represents a mirror reflection of the state of the world trade and, at the same time, of the state of globalization. If globalization is ever more present and world trade grows also, then the world economy is growing too. The correlation among the three elements is direct and evident in all directions. A logical result of this correlation is that international cooperation in one form or another is needed in order to find the dynamic balance of interests among numerous and diverse participants<sup>7</sup>.

Therefore the well functioning of world trade presents a keen interest for all participants as the well being of the vast majority if not all of them depends in various degrees on the world trade. The participants to world trade are of various economic sizes and they may have different perspectives and interests but all these refer more to the “how” of participating to international trade, rather than to the “why” of participating to it.

Under these circumstances, the launch of the Doha Round of trade negotiations in 2001 was accompanied by ambitious goals referring at the same time at the large scale liberalization and regulation of international trade<sup>8</sup>. According to some

<sup>7</sup> World Trade Report 2013 – Factors Shaping the Future of World Trade, World Trade Organization, 2013

<sup>8</sup> Doha WTO Ministerial Declaration, WT/MIN(01)/DEC/1, 20 November 2001

estimates made during the negotiations the success of Doha Round would have generated at a global level potential gains of about 280 billion \$ per year<sup>9</sup>.

While such an association of terms may seem absurd (“liberalization” and “regulation”) in fact it is not while the “liberalization” part refers to eliminating obstacles from the normal flow of international trade, while the “regulation” part refers to the common understanding of terms and procedures as well as to common approaches to various trade issues.

But 12 years later it is a common fact that the Doha Round failed for many reasons among which there are often mentioned the large number of participants as well as the strict observance of the principle “Nothing is agreed until all is agreed”. Given the diversity of participants to negotiations the combination of the two aspects has been an almost perfect recipe for failure.

Despite the failure of Doha Round, the world trade continued and all participants are looking for alternatives for world trade regulation that maybe less ambitious but anyway operational.

More and more a partial solution emerges internationally under the form of **Free Trade Agreements**. Although free trade agreements have been traditionally bilateral agreements, in practice one can find two situations:

- **Free trade agreements as such** that involve usually two parties (two economies). There are cases when there are more than two parties involved but each of them is an economy. Examples of this type can be: the Japan – Mexico free trade agreement in force since April 2005; the United States – Singapore free trade agreement in force since January 2004. An example when there are more than two participants but all of them are countries is the North American Free Trade Agreement where the participants are the United States, Canada and Mexico.

- **Free trade agreements where at least one of the parties is represented by an organization of economic integration that includes several countries**. In such a case the agreement is still bilateral from a theoretical and legal point of view, but, at the same time, the agreement is multilateral so far as the number of involved parties is concerned. Examples of this type can be: The Free Trade Agreement China – ASEAN, in force since January 1, 2010 which is on the 1<sup>st</sup> place in the world as regards the number of population involved and on the 3<sup>rd</sup> place in the world as regards the cumulated GDP of the participating countries. Another example is the Free Trade Agreement European Union – South Korea in force in a provisory format since July 1, 2011. This agreement is on the 2<sup>nd</sup> place in the world after the North American Free Trade Agreement – NAFTA from the point of view of the cumulated GDP of the participating countries.

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<sup>9</sup> Workshop On Recent Analyses Of The Doha Round, 2 November 2010, Geneva, at [http://www.wto.org/english/news\\_e/news10\\_e/dda\\_brochure\\_nov10\\_e.pdf](http://www.wto.org/english/news_e/news10_e/dda_brochure_nov10_e.pdf)geneva

In 2013 there is an increasing number of negotiations under way regarding free trade agreements. What is of particular importance is that these agreements involve the largest players from the world economy. As result it is expected that the outcomes of such agreements will significantly influence the whole world economy. Among the most important of these agreements currently under negotiation there are:

- \* European Union – USA;
- \* European Union – Japan;
- \* European Union – India;
- \* European Union – MERCOSUR;
- \* Regional Comprehensive Economic Partnership;
- \* Trans - Pacific Partnership.

### **The position of Japan vis-à-vis regional and world wide free trade agreements**

As an important economic player in the world economy Japan granted particular attention to improving the international trade regulations that may influence its export and import performance. This is why Japan has free trade agreements with its economic partners and participate in negotiations for multilateral free trade agreements in its region and world wide.

As of August 2013 Japan had numerous free trade agreements (FTA) and economic partnership agreements (EPA) which can be classified into three categories<sup>10</sup>:

- **Concluded** with Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, Brunei, ASEAN, Philippines, Switzerland, Vietnam, India, Peru,
- **Under negotiations** with Australia, Mongolia, Canada, Columbia, Japan – China – Republic of Korea, European Union, Regional Comprehensive Economic Partnership (RCEP), Trans-Pacific Partnership (TPP), Gulf Cooperation Council (GCC) - suspended.
- **Pre-negotiating** with Turkey.
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The geographical distribution of these free trade agreements (FTA) and economic partnership agreements (EPA) of Japan as of July 2013 is presented in Figure 3.

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<sup>10</sup> Ministry of Foreign Affairs of Japan - Free Trade Agreement (FTA) and Economic Partnership Agreement (EPA), July 2013, at <http://www.mofa.go.jp/policy/economy/fta/index.html>

**Figure 3. Free trade agreements (FTA) and economic partnership agreements (EPA) of Japan**



**Source:** Ministry of Foreign Affairs of Japan, July 2013

### **The importance of Japan – ASEAN free trade agreement**

From the point of view of the concluded free trade agreements of Japan the one with ASEAN is of particular importance due to the current economic significance of ASEAN in the Asia – Pacific context and particularly due to the prospects of further free trade agreements that include ASEAN.

The Association of South East Asian Nations (ASEAN) has been established in 1967 and include a free trade area - **ASEAN Free Trade Area (AFTA)**. ASEAN has now ten member countries: Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam, Laos, Myanmar, Cambodia. Besides economic integration and cooperation ASEAN has other two objectives related to security and socio-cultural integration.

The cummulated population of ASEAN countries in 2012 was of 615.6 million people (8.8 % of world population) while the combined nominal GDP was of about 2400 billion US \$. In 2012 if ASEAN would have been a country, it would be ranked four in the world after USA, China and Japan<sup>11</sup>.

ASEAN has concluded free trade agreements with its main economic partners from the region:

- Japan (in 2008);
- Australia and New Zealand (in 2009);
- China, India, South Korea (in 2010).

Given the high economic dynamism of the countries in the Asia – Pacific area new and more flexible forms of trade related consultations have been established. One of them is the so called **ASEAN Plus Three – APT** forum that reunites ASEAN countries plus China, Japan and South Korea.

<sup>11</sup> Based on data from International Monetary Fund database.

ASEAN Plus Three forum started its activity in December 1997 and has been institutionalized in 1999. The meetings of the Forum are attended by prime ministers, ministers and other officials from the member states that consult each other and aim at coordinating the activities in an ever growing number of fields among which energy, transport, information technology and communications.

In 2012 an even more complex and large free trade agreement initiative has been launched in the Asia – Pacific area. The project that has been launched in December 2012 is called **Regional Comprehensive Economic Partnership (RCEP)** and it is expected to become the largest free trade area in the world. The negotiations involve the 10 ASEAN member states plus the states which already have free trade agreements with ASEAN, namely Japan, Australia, New Zealand, China, India, South Korea. The negotiations started in 2013 and are expected to finish in 2015.

The RCEP project has been launched in 2011 based on two different proposals for regional free trade agreements that existed at that time:

- The **East Asia Free Trade Agreement** that was supported by China and included the ASEAN member countries, China, Japan, South Korea;
- The **Comprehensive Economic Partnership in East Asia** that was supported by Japan and included ASEAN member countries, Japan, India, Australia and New Zealand.

In order to reconcile the two proposals and to start negotiations, ASEAN (which was a member in both proposals) suggested the RCEP and this has been accepted by all parties.

The importance of RCEP is given by a number of economic data:

- The cumulated GDP of the member countries is of about 17000 billion US\$;
- The cumulated population is of about 3 billion people;
- The trade carried out in the area represents 40 % of world trade;

At the same time, the RCEP has a substantial significance for the world economy as it is much more than a free trade agreement. RCEP includes trade with commodities and services, but also investments, technical and economic cooperation, intellectual property competition issues as well as dispute settlement.

At the same time, another characteristic which is very important from an operational point of view is that RCEP provides for a flexible approach which allows members (particularly less developed countries) to avoid or postpone the regulations that are not in their favor.

The role of Japan in the establishment of RCEP is more than its simple presence as a member state or because it is a developed country. The role of Japan is also conceptual in the sense that the first proposal for the establishment of a **Trans-Pacific Free Trade Agreement** was made by the Japanese economist Kiyoshi Kojima in 1966. Although that idea was not accepted at that time, it had a major contribution in the establishment of the **Pacific Trade and Development Conference** in 1980 and then of the **Asia Pacific Economic Cooperation (APEC)** in 1989.

It is interesting to mention that RCEP is not the only initiative for a free trade area and economic cooperation in the Asia – Pacific region. Another current initiative is that of the **Trans – Pacific Partnership - TPP**.

The starting point for the Trans – Pacific Partnership as a project was represented by the **Trans-Pacific Strategic Economic Partnership Agreement** (known also as **TPSEP** or **P4**) which is a free trade area having as members Brunei, Chile, New Zealand and Singapore that started in 2005 and in force since May 2006.

Since 2010 a larger number of countries than the members of TPSEP started negotiations on TPP. The countries involved are: Australia, Brunei, Chile, Canada, Malaysia, Mexico, New Zealand, Peru, Singapore, USA, Vietnam. Japan joined the negotiations since April 2013. Different from RCEP, the TPP has very comprehensive and ambitious goals which lead to the conclusion that this project can not be finalized in the near future.

Because all the countries in the Asia – Pacific are aware that the more comprehensive the proposed agreements are, the more difficult is to finalize them, there is even a third project, besides RCEP and TPP, which is larger as number of countries involved and less ambitious as goals and there easier to be achieved.

This third project is proposed by the Asia – Pacific Cooperation Forum (APEC). The importance of APEC which has started in 1989 and has now 21 member states comes from the fact that it represents 40 % of world population, 56 % of world GDP and 48 % of world trade. The APEC member states are: Australia, Brunei, Canada, Chile, China, Hong Kong, China, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russian Federation, Singapore, Chinese Taipei, Thailand, United States, Vietnam.

This third project is called the **Free Trade Area Asia – Pacific (FTAAP)**. The interest for this project has been determined by the failure of Doha Round but also by the fact that in the Asia – Pacific region there are in force 60 free trade agreements and 117 under negotiation. This huge number of agreements as well as the complex economic interactions generated by transnational corporations and globalization determine many overlapping and contradictions (the so called spaghetti bowl effect) that negatively affect business in the region.

## Conclusions

The free trade agreements, most of them established on a regional basis (that is involving countries located in the same geographical region, even in a broad sense, such as Asia – Pacific area) have increased their importance in the past years.

This trend can be, at least partially explained, by two factors that relates to the importance of international trade for most economies and to the different impact of the economic crisis that started in 2008 on the economies of the world.

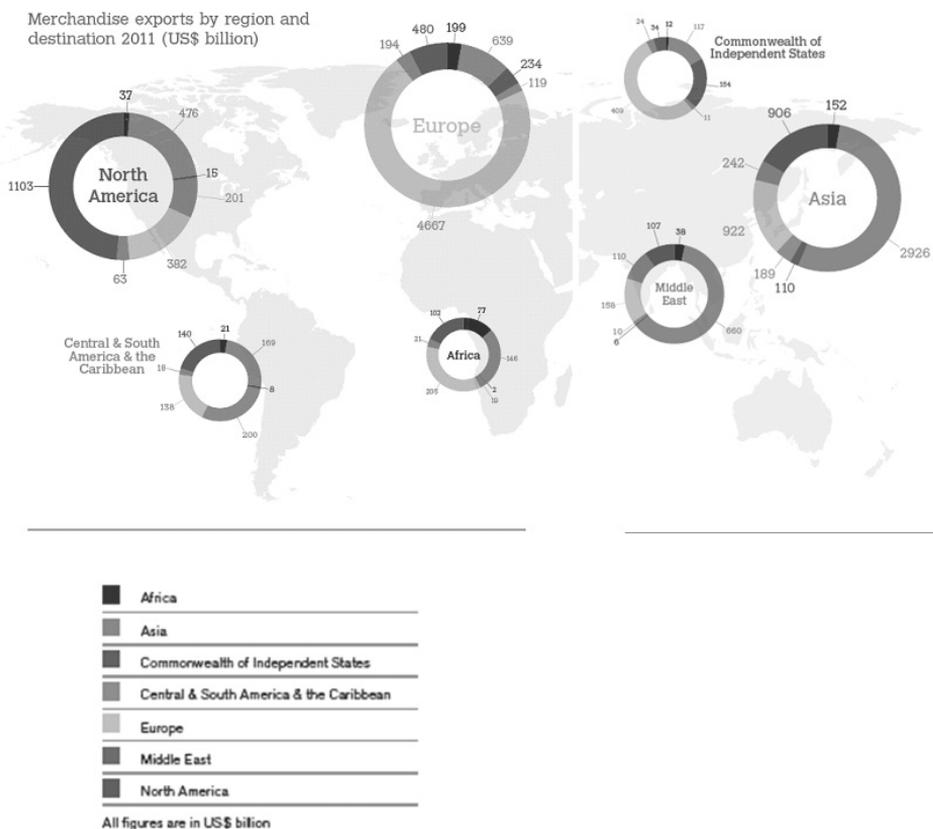
The first factor is represented by the failure of the Doha Round. As world trade is a very intense and large scale economic activity, vital for the well being of the vast majority of economic actors from the world economy, solutions for the support of further development of world trade are continuously searched. For purely pragmatic reasons this activity is carried out both within the framework of World Trade Organization and on a bilateral or multilateral basis, involving either countries located in the same region or countries with intense trade relations. In this respect one can note that the more intense the trade relations among certain economic partners the more likely the establishment of various formats of free trade agreements and economic cooperation agreements. Although some authors<sup>12</sup> present this trend towards free trade agreements as a weakening of the World Trade Organization and multilateral regulation of international trade in our opinion there is no real confrontation between multilateralism and bilateralism in international trade. In our opinion the current trend towards using free trade agreements is just a quick fix for something (that is international trade) too important to be postponed.

The second factor that currently supports free trade agreements is represented by the impact of geographical proximity on the intensity of trade relations. One reason for this is obvious, it refers to distance: it is easier and cheaper to trade on short distances rather than on very long ones. The other reason refers to the (usual) higher economic, political, social compatibility of economies situated in the same region. As region is an ambiguous term we can speak about narrow and large defined regions. Examples of narrow defined regions that led to free trade agreements or even customs unions are: Benelux (involving Belgium, the Netherlands and Luxembourg) or NAFTA (involving Canada, United States and Mexico). Examples of large defined regions that led to free trade areas or customs unions are: ASEAN, European Union, Asia – Pacific free trade agreements such as Japan – India. This significance of the regional dimension of international trade as compared to the extra regional trade has been presented by the World Trade Organization in the International Trade Statistics 2012<sup>13</sup> and it is reflected in Figure 4.

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<sup>12</sup> Corina Berceanu, Why has the unsuccessful Doha round resulted in bilateral and inter-regional FTAs and what are the consequences for global trade?, January 16, 2013, [www.geopolitics.ro](http://www.geopolitics.ro)

<sup>13</sup> International Trade Statistics 2012, World Trade Organization, [www.wto.org](http://www.wto.org)

**Figure 4. Merchandise flows within regions outperform flows between regions**

**Source:** International Trade Statistics 2012, World Trade Organization, [www.wto.org](http://www.wto.org)

From Figure 4 results in a very graphical manner that in North America, Europe and Asia the trade flows within regions are larger than flows between geographical regions. This very factor influences in our opinion the establishment of free trade areas or economic cooperation agreements based on regional economic flows.

In our opinion, gradually globalization will led to the increase of trade flows between regions and that, in its turn, will lead to more free trade agreements between partners located in different regions.

This aspect can be clearly seen in we take the case of European Union. As of August 1, 2013 European Union has been involved in 27 free trade agreements negotiations which are in various stages, among them with USA, Canada, Japan, India, MERCOSUR, Andean Community<sup>14</sup>. A map of the European Union existing and pending free trade agreements is presented in Figure 5.

<sup>14</sup> European Commission, Overview of FTA and other trade negotiations, updated as of August 1, 2013, at <http://ec.europa.eu/trade/policy/countries-and-regions/agreements/>

Figure 5. European Union Free Trade Agreements as of August 1, 2013



**Source:** European Commission, Overview of FTA and other trade negotiations, updated as of August 1, 2013, at <http://ec.europa.eu/trade/policy/countries-and-regions/agreements/>

The interest for free trade agreements is the more so important in the Asia – Pacific region, an area which is particularly dynamic from an economic point of view. The area was much less affected by the economic crisis that started in 2008 and it is regarded as the most important economic area in the world economy for the next 50 years. The fact that the regions include China, India, but also United States and Russian Federation explain why the economic center of gravity of world economy has shifted from the Atlantic to the Pacific area. The Asia – Pacific area will represent a major area for the world economy of the 21<sup>st</sup> century, based on a multi-polar model. This high economic dynamism is also reflected in the number and scope of discussions in the area related to establishment of free trade areas.

In the context of Asia – Pacific area Japan plays an important role both as an economic power (now on the third place in the world) but also as the member and conceptual founder of the existing or under negotiations free trade agreements. Japan has already in force free trade agreements with its economic partners in the region

(ASEAN, India, Philippines, Thailand, Indonesia, Malaysia) and is negotiating agreements with other key player both in the Asia – Pacific area (China, South Korea, Australia) or in the world (with European Union, Canada).

Japan is also part of all free trade and economic cooperation multilateral initiatives in the region: ASEAN Plus Three – APT, the Regional Comprehensive Economic Partnership (RCEP), the Trans – Pacific Partnership – TPP, the Free Trade Area Asia – Pacific (FTAAP).

The numerous and young population in the Asia – Pacific region, the huge reserves of economic growth, the natural resources as well as the geographical proximity make the area and its countries the natural partners for Japan.

Together with Japan an important role for the development of trade and economic cooperation in the Asia – Pacific region is played by ASEAN which has the advantage of being a mature organization (established in 1967), with experience in economic, social, political and cultural cooperation. Due to its experience ASEAN can act as a catalyst for the establishment of the new free trade and cooperation structures, particularly in the case of the Regional Comprehensive Economic Partnership - RCEP.

In our opinion this project is the most likely to succeed in the medium term as compared to the Trans – Pacific Partnership (TPP) or the Free Trade Area Asia – Pacific (FTAAP) because has much less ambitious goals and provides for a flexible approach that can accommodate the different interest of the participants.

The fact that the same countries in the region take part in parallel to similar free trade area and economic cooperation projects is not, in our opinion, a disruptive or inefficient process because the very fact of having some of the same partners allow for “recycling” already agreed upon terms and clauses from one project to another.

At the same time, despite the failure of Doha Round, the proliferation of regional and even global in scope free trade agreements can be seen as an intermediate stage of creation of building blocks for a world wide agreement that will take form at some point in time.

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## THE LESSON OF SURVIVAL OF BALTIC ECONOMIC AND FINANCIAL CRISIS

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### Abstract

*Systematic macroeconomic forecasts and public finance ,the state of convergence and financial markets of EU describe perspectives economies of EU Member States. National economies went through restructuring processes, creating the conditions for further development based on sustainable criteria. Within this study we aimed an analysis of main macroeconomic evolutions in Estonia and Latvia, the causes that have led to deterioration of the economic situation of the two countries as well as measures to counter the real estate crisis, financial and economic crisis lately adopted by the governments of countries.*

**Keywords:** economic increase, gross domestic product, fiscal policy, foreign direct investments

**JEL Classification:** G, G01, G18.

### Introduction

#### **Estonia's main macroeconomic data**

Into a Europe that is in full recession, the Baltic countries make a discordant note. In 2012 Estonia reported an economic increase of 2,5% and Latvia of 4,3%.

From 1 January 2013, Latvia has introduced holding type legislation, becoming the first country in Central and Eastern Europe that makes this step, competing with traditional destinations for setting up off-shore companies and holding companies such as, for example, in Europe, the well known Netherlands, Luxembourg and Cyprus. Practically, from this moment revenues from transfers of social parts and dividends are exempted from tax in Latvia and also there is no limitation in respect of the period of holding those social parts in Latvian entity up to which taxpayers may qualify to such a tax regime.

This is not the first time when a Baltic state simply radically change fiscal policy in our region<sup>2</sup>. In 1994, Estonia became the first country in the world to introduce the flat tax, a concept previously considered to be utopia domain. Within a decade and a half, this tax system proved so easy to administer and so attractive for business and foreign investors that has been copied by almost all Central and Eastern European states.

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<sup>2</sup> Mihaela Mitroi - Consultanță Fiscală, PwC România, Modelul baltic sau cum pot țările mici cu puține resurse să devină competitive prin inovație administrativă

At moment of opening of economic crisis in 2008, the small Baltic economies have been ravaged simply by speculative real estate bubble implosion. But they proceeded immediately to a brutal adjustment of public spending, even with the risk of an explosion of unemployment. The result was that the Baltic states were the only from the region that even registered a crisis in V and economic increase resumed quickly, at relatively high rhythms.

Following the final ECOFIN decision of 13 July 2010 based on the conditions defined in the 'Maastricht' convergence criteria, Estonia adopted the euro on 1 January 2011. As part of the preparations to join the euro area, Estonia was a member of the Exchange Rate Mechanism II (ERM II)<sup>3</sup>.

Since the end of 2009, the economic recession in Latvia has stopped and growth has resumed.<sup>4</sup>

## **2. An overall analysis of the Estonian economy in the current period**

Estonia is among the smaller EU countries, with a dynamic economy in full development that was however very strongly affected by real estate crisis, financial and economic crisis lately, both as a result of decreasing corrections of internal demand and as a result of lower external demand that supported so much the economic increase in previous years. Decrease of internal demand was linked to weak economic activity and on the increase, on global market, of prices of energy and food.

In this context, Estonia has made rapid progress in stabilizing and restructuring the economy, and this is rewarded by the high volume of direct foreign investments in this country, especially visible through indicator of direct foreign investments per inhabitant.

GDP growth rate was 3,1% in 2010 and 7,6% in 2011. For 2012 it realized an increase of 2,5%. Labour productivity has increased in recent years, due to the reduction of wage income. This fact has led to the competitiveness improvement of Estonian companies on international markets. Exports have constitute the engine of economic recovery of Estonia, developing with 22% in 2010 and 25% in 2011, as a result of increasing added value in industry.

### **Causes that have generated the crisis were mainly the following:**

- very small dimensions and opening up the economy to the outside;
- disappearance of many export markets;
- decline in household consumption - previously based on lending.

### **Measures to counteract the economic crisis**

To counteract the negative economic and social effects of the economic crisis, initiated in early 2008 due to real estate crisis already appeared in 2007, was adopted on 9 October 2008 an "Action plan for economic growth and insurance of jobs for

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<sup>3</sup> [http://ec.europa.eu/economy\\_finance/eu/countries/estonia\\_en](http://ec.europa.eu/economy_finance/eu/countries/estonia_en).

<sup>4</sup> Report on Economic Development of Latvia | December | 2012, page 10

2008-2011" based mainly on increasing economic competitiveness. The financial part of this plan is included in the annual budget of the country.

**These objectives are:**

- increasing labor productivity and achieving a threshold of 80% of the EU average;
- increasing research and development costs and reaching a threshold of 2% of GDP;
- increasing the number of jobs by 70.5%;
- change the system of health insurance benefits through greater responsibility of the employee and the employer;
- reduce the number of people receiving special pensions.

From 9 October 2008 entered into force measures to safeguard up to 50,000 euro limit of all bank deposits.

Estonia has not faced with a financial crisis, banks are well capitalized, so no need to take governmental measures of capitalization of thereof. However, it was decided that from February 2009 to be adopted certain deposit guarantee schemes to prevent the transmission of risks to the real economy.

Credit expansion from years preceding the crisis has generated the creation of a large number of unsustainable jobs and with low productivity in the construction industry and commerce.

In evaluation of the situation should be considered, however, spectacular growth rates recorded by Estonia since the second half of the 90s. Thus, the GDP per inhabitant increased from \$ 5,657 in 1993 to 9,200 Euro/person in 2011.

Being a small country with an open economy, Estonia understood from the early 90s that it will not be able to ensure currency stability and capital mobility through an independent monetary policy.

In fiscal policy domain, Estonia has introduced in 1992 a fixed rate income tax of 26%, then decreased to 21%. Since 1999, the reinvested profit is not taxed. In this way, has been simplified tax system and tax collection and were stimulated investments.

Fiscal consolidation measures had cumulated 16% of GDP. Fiscal consolidation works as follows: a reduction of deficit and budgetary expenditures requires in the future lower taxes but leaves more money for current generation consumption in private sector.<sup>5</sup> Two thirds of them looked budgetary expenditures (reduction with 8% of the budget for health insurances, limiting the growth of pensions, reduce administrative costs, those for defense and agricultural subsidies, stop lending to local authorities except co-financing projects with funds EU). The other third of the fiscal consolidation measures has considered the budgetary revenue part (increase contributions for unemployment to 4,2%, increase excise duties on alcohol, tobacco

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<sup>5</sup> <http://florincitu.wordpress.com/2013/03/08/consolidarea-fiscala-nu-influenteaza-negativ-pib-ul/>

and fuel, increase VAT from 18 to 20%, dividends from companies with state capital, sales of their lands, suspension of reduction gradual process of income tax). As a result of these measures, Estonia has managed to reduce public debt at 7% of GDP. The budget deficit was only 1,7% of GDP in 2009 and in 2010 and 2011 Estonia had budget surplus (0,1% in 2010 and 1% in 2011).

During the crisis Estonia did not need the bailout, since reserves created starting from 2001 have covered debts. In 2009 reserves amounted to 11,6% of GDP, and in 2010, 12%. Also, since the major commercial banks in Estonia are with Swedish capital, the answer to the crisis effects has been easier than for countries where state intervention was necessary to save the banking sector.

Besides fiscal consolidation measures, the Estonian government realized public investment projects with structural funds in transport and telecommunications infrastructure and support companies through special programs to create new jobs, stimulation of exports and investments. Moreover, pensions were increased slightly to help the aging population and to stimulate consumption.

Currently privatization process in Estonia is completed, only three major companies in the infrastructure domain remains in state ownership.

Favorable development from Estonian economy continue in 2012, in the third quarter registered a GDP growth rate of 3,4% compared to the corresponding period last year and of 1,7% compared with previous quarter. Activities on internal market constituted the growth engine, the most important areas being construction and IT, and to a lesser extent, transports, commerce and professional or technical services. The European Commission predicted for Estonia growth rates of 2,5% in 2012 (the highest in the EU), 3,1% in 2013 and 4% in 2014. The main factors of growth will be domestic demand and positive developments on the labor force market.

Fiscal reform was carried out in Estonia in the first phase of transition process to economy market. Current tax system came into effect in 1994, being updated, during the time, with a series of new laws.

Flat Tax is a system that applies the same tax rate to every taxpayer regardless of income bracket.<sup>6</sup>

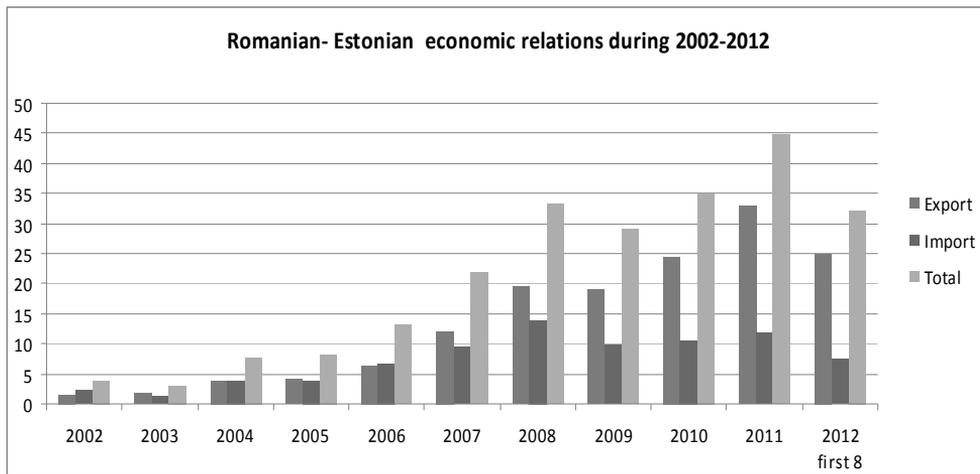
The tax system is net and uniformly (**Flat Tax**), which until 2006 was 23%, being reduced in 2007 to 20%, and at present is **21%**. Reinvested profit is not taxed. The most important taxes are the profit tax which has a share of 21% and a VAT rate of 20%. Social security (social insurance contribution - 20%, State insurance for pension and sickness -13%). Contribution unemployment: 0, 5% employer, 1% employee.

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<sup>6</sup> <http://www.investopedia.com/terms/f/flattax>

**Table no.1 Romanian-Estonian economic relations<sup>7</sup>**

Year	Export	Import	Totals
2002	1.54	2.22	3.76
2003	1.92	1.31	3.07
2004	3.86	3.81	7.67
2005	4.2	3.96	8.16
2006	6.33	6.69	13.02
2007	12.23	9.56	21.79
2008	19.54	13.81	33.36
2009	19.14	9.89	29.03
2010	24.39	10.62	35.01
2011	32.93	11.95	44.88
2012 first eight months	24.89	7.37	32.26



Romanian-Estonian commercial exchanges, although they have an upward evolution, not reflect yet the real possibilities of the economies of the two countries.

**In 2011** the total volume of commercial exchanges between Romania and Estonia was 44,88 million EUR, of which 32,93 million EUR exports (ranked 66th in total Romanian exports) and imports 11,95 million EUR (ranks 74), the balance being surplus of 20,98 million EUR in favor of the Romanian side.

**In the first eight months of 2012**, bilateral trade volume reached a level of 32,26 million EUR (increase of 5,91% compared to the same period of 2011), of which 24,89 million EUR Romanian export (increase of 9,35%, 64th in total Romanian exports) and 7,37 million EUR import from Estonia (decrease of 4,26%,

<sup>7</sup> <http://www.mae.ro/bilateral-relations/1697>

ranks 77). Trade balance remains favorably to Romanian side, with a surplus of 17,52 million EUR

### 3. An overall analysis of the Latvian economy in the current period

#### Exports and imports of goods and services

In 2011, exports of Latvian goods at current prices increased by 28% (14% at constant prices), compared to 2010. Also, in 2012, exports of goods are in continued growth. In January-April 2012, exports increased by 11% in current prices, compared to the four months of 2011.

Like exports, imports of goods increased into a steady rhythm during this period. In 2011, imports of goods in current prices increased by 30% compared to 2010. Also, in early 2012, imports of goods are also increasing. In January-April 2012, imports in current prices exceeded the level in January-April 2011 by 18%.

In the first quarter of 2012, the negative trade balance is less than 10% of foreign trade. In 2007-2008, it was more than 25% of all foreign trade.

Exports to EU countries increased by 29% in 2011, but in January-April 2012 by 10% compared to the four months of 2011. In 2011, the increase in exports of metal products group contributed traditionally the most to this increase, while in the four months of 2012, the group of agricultural products and foodstuffs, have contributed largely to the growth.

Foreign investments in the first quarter of 2012 decreased by 50% compared to the same period last year. In June 2012 the total foreign investment reached 9.497 billion euros.

Latvian **exports** increased in 2011 by 28% compared to 2010. Exports have continued to grow in 2012, in January-April period registering an increase of 11% against the same period of 2011.

In 2011, Latvian **imports** increased by 30% compared to 2010. Import growth continued in 2012, in January-April periods registering a value by +18% against the same period of 2011.

It becomes natural in global economic context that every country to follow the insurance of economic growth, as a source of increasing living standards of the people, and in this sense, the policy of attracting foreign investments becomes a component part of the economic policy of each country<sup>8</sup>.

Flows of foreign direct investments (FDI) resumed to be growing in Latvia in 2010, after it in years of crisis have experienced a setback.

Compared to 2010, FDI volume increased, in 2011 by 43,3% in the Baltic States, at the same time is to be noted that in 2011 FDI was higher with 5,4% than in 2012. It should be noted that in 2011, Latvia has attracted half of all FDI in the Baltic States.

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<sup>8</sup> Rodica BURBULEA, Foreign investment and their role in stabilizing and increasing national economy, page 2

According to the balance of international investments in Latvia, **FDI stock** in Latvian economy reached (6,567 billion LVL) 9,344 billion euros) at the end of the first quarter of 2012, which is higher with 10% than at the end of the first quarter of 2011. The share of FDI in the structure of foreign capital stock was 25,4 percent.

Sweden is the largest investor in the economy of Latvia. At the end of March 2012, investments in Sweden constituted almost 25% of total FDI stock. Mainly, these are investments in financial intermediation (85% of total FDI in the sector). Since the end of first quarter of 2011, the Swedish direct investments nearly tripled, mainly due to mutual transactions between Swedish and Estonian owners in banking sector.

Meanwhile, the stock of direct Estonian investments in Latvia fell by 56% and constituted 5,8% of total FDI stock at the end of March 2012. Major investments were also made by entrepreneurs in Denmark, the Netherlands, Germany, Finland, Russia and Cyprus. The volume of investments in these countries, at the end of March 2012 amounted almost 60% of the total stock of FDI in the economy of Latvia.

FDI is concentrated mainly in the service sectors. By 2008, the growth rates of FDI in services sectors were almost one and half times higher than in manufacturing sectors. However, in 2009 and 2010, FDI grew faster in production sectors (by 6,6% and 10,6%), while the stock of FDI in the services sector remained unchanged in 2009, but in 2010 decreased by 5%.

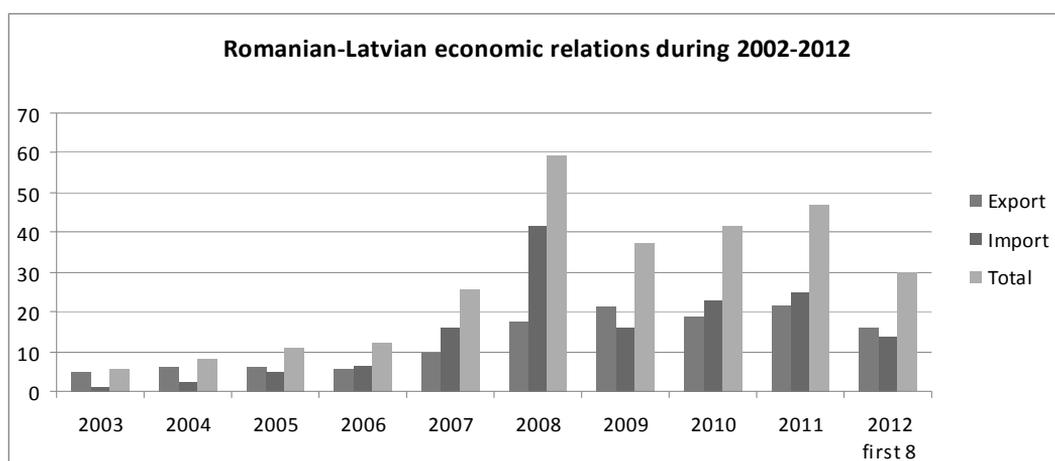
At the end of March 2012, the stock of FDI in services sectors accounted 68,1% of FDI in the economy of Latvia.

The largest investments in the processing industry have been made by investors in Denmark, Finland, Germany, Sweden, Ireland, Estonia, the Netherlands and Cyprus. Investments in the above mentioned countries were 80% of the stock of FDI in manufacturing. Noted that by the end of 2007, none of the countries mentioned has not hold the leading position in the structure of FDI stock in processing industry.

Due to financial crisis, the situation has changed significantly. In late March 2012, the Irish capital was dominant in the structure of FDI, constituting more than one fifth of FDI stock in processing industry. Entrepreneurs in Cyprus and the Netherlands have made, also, major investments in production. Investments in these countries in processing industry increased 3 times compared to the end of 2008. However, the volume of FDI stock from other major countries fell: Germany and Denmark with 7,4% and 8,6%, Finland by 21,6%. Meanwhile, at the end of March 2012, the stock of investments in processing industry increased by 17% in the investments made by businessmen in Russia.

**Table no.2 Romanian-Latvian economic relations<sup>9</sup>**

Year	Export	Import	Totals
2003	4,8	1,1	5,9
2004	6	2.3	8.3
2005	6.1	5	11.21
2006	5.8	6.5	12.3
2007	10	15.8	25.8
2008	17.63	41.72	59.35
2009	21.14	15.92	37.06
2010	18.67	23.12	41.79
2011	21.9	25.16	47.05
2012 first eight months	16.02	13.77	29.79



### The evolution of bilateral trade exchanges:

- In the period 2003-2011, bilateral trade has seen a steady increase, with the exception of the crisis year 2009;
- In 2008, has registered a maximum of almost 60 million euros, 10 times more than in 2003;
- Since 2009, the upward trend was resumed, in 2011 registering a value of bilateral trade of 47 million euros, of which 21,9 million euros Romanian exports (ranked 75 in total Romanian exports) and 25,16 million euros imports (rank 61);
- In the first 8 months of 2012, bilateral trade volume was 29,79 million euros (decrease of 5% compared to the same periods of 2011), of which exports 16,02 million euros (increase of 0,56%, rank 73), and imports 13,77% million

<sup>9</sup> www.dce.gov.ro

euros (decrease of 10,75%, rank 69). Decrease in imports led to obtaining a surplus in bilateral trade balance of 2,25 million euros.

#### **4. Conclusions**

Estonian economy recovered quickly after the crisis, at the moment being, according to experts, more powerful than before the crisis and can do better face of shocks on the international markets. It is the only country in the euro area that has budgetary surplus, public debt being only 6% of GDP, compared with 81% in Germany, the largest European economy, or with 163% in Greece, the country most affected by the crisis.

The global financial crisis has not affected the geopolitical structure of the stock of foreign capital in Latvia. Mainly, these are investments of EU Member States. At the end of March 2012, FDI of EU Member States constituted 71.7% of total FDI, a fifth are investments of new EU member states and nearly half are investments of euro zone countries.

Regarding fiscal policy, in 1992 Estonia introduced a flat rate income tax of 26%, then decreased to 21%. Since 1999, reinvested profit is not taxed. In this way, has been simplified the tax system and tax collection and were stimulated investments.

Since 2010 the Latvian economy recession is over and economic growth started again. In 2011 GDP already has exceeded previous year level by 5.5%. In 2012, growth continued at almost the same level as in 2011, forecast growth being 5%.

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## ROMANIAN HEALTH TOURISM – WHERE TO?

Patrichi Ioana Cristiana  
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### Abstract

*Health tourism has always been the main type of tourism in our country, due to the large number and variety of natural resources. Economic, political and social context in our country after 1990, decreased income, wear and tear reception capabilities and of the equipment used in spa cure, low foreign investment in Romanian tourism, led to a reduction efficiency of health tourism. This was reflected in the tourism statistics for the health tourism. In this paper the authors make a brief description of the Romanian health tourism and some proposals for reviving this type of tourism, once recognized throughout Europe.*

**Keywords:** health tourism, natural resources, tourism statistics, investments.

**JEL Classification:** L83

### 1.Introduction

Romania has a lot of natural resources that can be used for health tourism. Actually, the Romans visited us to use the mineral waters from the west part of the country (Băile Herculane or Sângeorz Băi), and Napoleon III used to send his people to bring to him mineral waters from Călimanești-Căciulata, because he thought that this waters were magical.

There are so many health resorts in our country, but unfortunately many of those were abandoned and there were no investors interested in their restoration. After 1990, the Romanian health tourism entered into a dark period and only a new vision can take it out. We need to adapt to all that is new in the field of health care, need to improve the services and need to reorient to another type of tourist.

In the present paper we describe the evolution of health tourism in the past 20 years and we tried to outline some proposals for reviving this type of tourism, once recognized all over the Europe.

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## **2. Natural resources for health tourism and the development of health tourism**

Mineral and thermal water, salted waters, therapeutic mud or the salt mine are spread all over the country in can be easily access. These resources have the physicochemical properties that meet the needs for prophylactic and health maintenance, building and restoring health, work capacity and individual physical and psychological comfort. Evolution of health tourism started in the 18th century. By the early 20th century were found most sources and tested their healing qualities and began planning major resorts with spa functions, but only after 1880 the development of the health resorts begun. After the World War II, when the Romanian tourism known it's best state of development, there were made 30000 new bed places, which were considered at the time of high comfort.

In this resorts at the beginning there were built single accommodation units and food, and later they were transformed in large complex made according to the concept of "everything under one roof", which allowed the spa cure any season.

There are 160 health resorts in Romania that are holding clean mineral resources, of which 24 are considered of national importance with the recognition in Europe. This 24 health resorts of national importance were ranked based on the classification system of Romania, according to their endowment. The most important health resorts are Baile Felix, Băile Herculane, Călimanești-Căciulata, Eforie Nord, Sovata, Sângeorz Băi, Vatra Dornei, Covasna, Băile Tușnad, Mangalia etc.

Also by 1989 there was a continuous upward trend that started in 1970 in terms of tourist traffic, both for tourism as a whole, but also for the health tourism, particularly. It was a reflection of the increased interest for tourism and for restoration of working capacity and health, which in this decade, 1980-1989, has become a important individual existence, approaching to that stage, a threshold saturation of demand (in the years 1988-1989 about 1/2 of the population used to spend an holiday in a resort, a situation comparable to that of many developed European countries).

Economic, political and social context in our country after '90 decreased income, wear and tear reception capabilities and of the equipment used in spa cure, low foreign investment in Romanian tourism, led to a reduction efficiency of health tourism. This was reflected in the tourism statistics for the health tourism.

Nowadays, because of the lack of investments in specific infrastructure, the offer of the health resorts is no longer a potential attraction for tourists, especially for the foreigners; there are so many valuable therapeutic resources both in terms of quantity and quality, which operated to international standards can generate significant flows of tourists and the development of the areas involved, in economic terms.

In terms of the number of care facilities in health resorts, we find an evolution different from all structures for the country. Because of dwindling revenues recorded by tourism, the funding in this sector has been increasingly lower. Due to a high interest rate on loans and a demand for this type of tourism in decline, the investment decision making for the development of spa offer became a difficult act, as long as their financial resources were insufficient to support current activities and conservation or degradation of existing structures.

**Table no.1 The evolution in number of accommodations and beds**

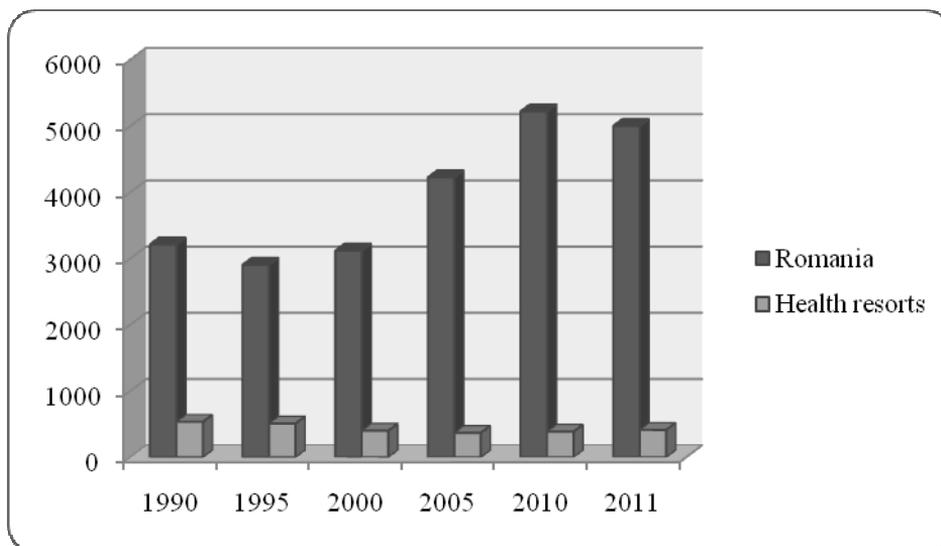
Year	Number of accommodation facilities		Accommodation capacity in operation	
	Romania	Health resorts	Romania	Health resorts
1990	3213	535	79535297	-
1995	2905	510	53539458	-
2000	3121	400	50197142	11326969
2005	4226	369	54978838	10714712
2010	5222	386	63808286	9150435
2011	5003	413	68417259	9621022

Source – INSSE, 1990-2011. [www.insse.ro](http://www.insse.ro)

After an increase in 1991 compared to 1990 the number of tourist facilities, both those across the country, as well as those of health resorts, overall the country has followed a decrease of about 18% in 1995 and a recovery until 2010 when he recorded the highest number of units. On the other hand, the number of units in health resorts declined from 1991 to 2005, and then it begun to slowly increase till 413 in 2011.

In terms of the number of beds, there was a continue decrease at national level, and strong fluctuations in those of health tourism. Although the number of hotel's structure increased, the number of beds continued to decline, reflecting a development of small structures, especially as guesthouses, by private initiative.

At the same time, large units (hotels, motels), came out of the tourist circuit. Receipts increasingly smaller and the increased costs associated with these structures of these large number of them generated closure or difficulty in maintaining standards, the adoption of solutions such as the use of one or two floors of six or ten, in case of the big hotels.



**Figure no.1 The evolution of the number of accommodation facilities**

In health resorts the situation was different. This is due to the closure of some small, old, outdated facilities and non-intervention of private initiative in developing new tourism facilities in the spa field. On the other hand, there were still in function hotels, the spa complex and large bases treatment, old and with a majority of the number of places, which could still provide this form of tourism services. In these circumstances, it was in the interest of those who run the establishments of health tourism to keep running big hotels, spa complex, which also features basic treatment and earn revenue throughout the year, at the expense of reduced capacity, which were removed from the circuit and have been degraded in the absence of investment shares or privatization.

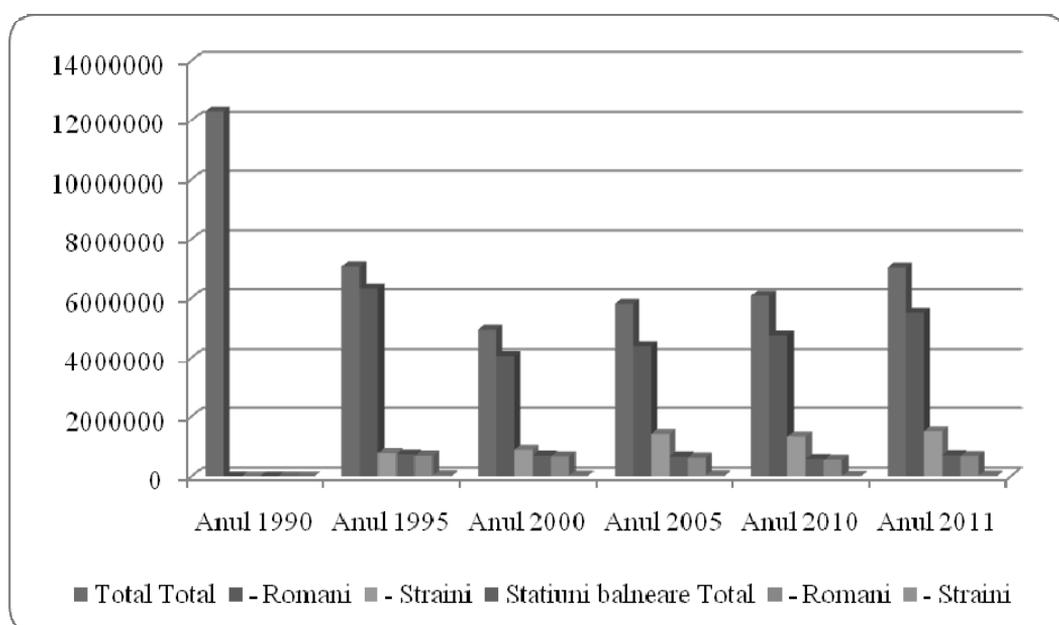
**Table no.2 Number of tourist arrivals in Romania and health resorts**

		1990	1995	2000	2005	2010	2011
<b>Romania</b>	<b>Total</b>	12296552	7070385	4920129	5805096	6072757	7031606
-	<b>Romanian</b>	:	6304570	4053105	4375185	4726414	5514907
-	<b>Foreigners</b>	:	765815	867024	1429911	1346343	1516699
<b>Health resorts</b>	<b>Total</b>	:	718427	677495	650026	568257	689195
-	<b>Romanian</b>	:	680736	651983	613654	546068	662466
-	<b>Foreigners</b>	:	37691	25512	36372	22189	26729

Source – INSSE, 1990-2011. [www.insse.ro](http://www.insse.ro)

In terms of the number of tourist arrivals we can observe from the table above, a strong downward trend, both at the national level and in spas resorts. The decrease was obvious in the period 1990 – 2005, and from 2010 it was observed a gradual increase. Unfortunately this situation has made a point to drop foreign tourist interest for Romanian tourism. Most of the foreign tourists come from neighbouring countries, and the duration of their stay does not exceed 5-7 days. In theory there are so many foreigners who know about the Romanian health tourism, but in practice they do not come in the spa resorts because of the poor conditions they found there.

There are also, good examples of spa resorts where there were made important investments, and they are at the European level. We can mention here Sovata or Baile Felix, two examples of success, especially due to the foreign investments. The hotels were renovated, the treatment facilities were redesigned in order to suit current requirements of spa treatments, and there were developed recreational facilities, especially for young people.



**Figure no.2. The evolution of the number of tourist arrivals in Romania and health resorts**

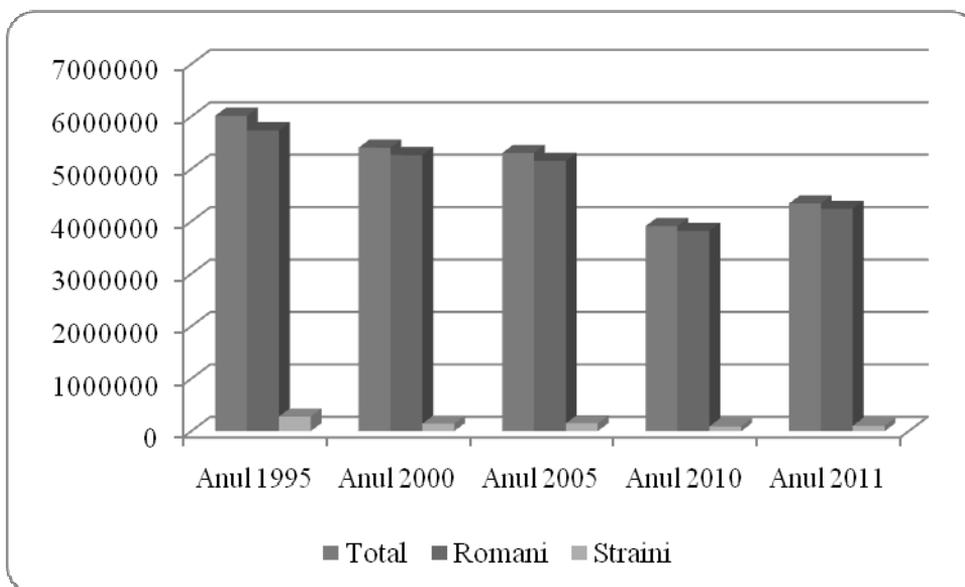
In case of overnight stays in accommodation, we see a clear decrease since 1990. Between 1990 -1995 the number of overnight stays at national level fell by about 45%, mainly due to uncertainty and low purchasing power. Also, the overnights in health resorts represent about 25 % of the total.

**Table no.3 The evolution of tourists overnights between 1990-2011**

		1990	1995	2000	2005	2010	2011
<b>Romania</b>	<b>Total</b>	44551804	24111170	17646675	18372988	16051135	17979439
-	<b>Romanian</b>	:	21730464	15497317	14908854	13284554	14912557
-	<b>Foreigners</b>	:	2380706	2149358	3464134	2766581	3066882
<b>Health resorts</b>	<b>Total</b>	:	6015468	5406773	5303980	3910309	4342157
-	<b>Romanian</b>	:	5737508	5265048	5155731	3820672	4238654
-	<b>Foreigners</b>	:	277960	141725	148249	89637	103503

Source – INSSE, 1990-2011. [www.insse.ro](http://www.insse.ro)

Nutrition, with accommodation, is an important part of the health tourism that contributes greatly to the overall quality and image of the supply. The type and the profile of catering, convenience and services offered, the quality of the preparations have a significant weight in the choice that makes tourists. In resorts and spa towns in our country, feeding takes all its specific forms, from restaurants and restaurants pension in bars, disco-bars, self-service, buffets, bakeries and patisseries. These units includes all categories of classification, but many units are of class II, III and IV, with facilities located well below current travel requirements, but with very good locations in these resorts, which increases the unfavorable image that creates the health supply.

**Figure no. 3 The evolution of tourists overnights between 1990-2011**

### 3. Actions done at the national level and proposals

Diversity and potential importance spa led authorities to pay attention to this sector, so in 2009 tourism was declared as a priority for the ministry, and in 2010 a National Strategy was developed for the health tourism. In 2011 the Master Plan was completed and there was created a “BALNEO ” group, with interdepartmental participation of specialists from the main institutions involved in this activity, which to track and resolve issues in the sector.

Romanian spa tourism strengths are: a loyal clientele and a high confidence of the population in the therapeutic properties of the treatment factors. Among the weaknesses are: a negative image, very close to the hospital and disease image and the absence of research in the field, also the lack of investments in spa amenities and the introduction of modern procedures. More rapid risks are influenced by: the strong dependence of social budgets funded clients in counterpart with extraordinary opportunities created by expanding markets through liberalization in 2013 and people traffic services; the availability of EU funds created for this sector as well as increasing the number of customers in terms of growth potential due to age and the large number of elderly projected for the next 15-20 years; the evolution of international markets, new trends in health tourism in general: anti-aging products, medical tourism private clinics, treatments prescribed care, wellness services.

Diversity and potential importance spa led authorities to pay attention to this sector, so in 2009 tourism was declared as a priority for the ministry, and in 2010 a National Strategy was developed for the health tourism. In 2011 the Master Plan was completed and there was created a “BALNEO ” group, with interdepartmental participation of specialists from the main institutions involved in this activity, which to track and resolve issues in the sector.

The Master Plan for health tourism is developed in phases and short-term, medium and long. It was the result of a strong collaboration between authorities and some local structures, in order to create incentives for investors in spas, respectively, achieving investment grade, according to modern standards and requirements for developing an effective public-private partnership that would stimulate investment.

The Master Plan for health tourism has focused on three principal objectives:

- Objective 1. Choosing one or more marketing positioning.
- Objective 2. Defining the strategy to be applied for each combination market/product.
- Objective 3. Defining financial resources to be allocated and the most optimal method of work.

Privatization has helped many investors to own hotels, with or without the treatment facilities, restaurants, guesthouses, most of them built in the '70 or even older. As a result, there were a large number of employers in spas. It must be appreciated the courage of those who understand the value of an investment in a health resort, many have tried to raise the level of comfort. Even when the clientele

comes from ticket recipients' treatment, they were thinking about the future and have tried to provide a solid, competitive, both internally and externally.

Some of the OPTBR (Organizatia Patronala a Turismului Balnear din Romania) members are investors with a large financial power and small entrepreneurs in almost all resorts, being representative of the whole sector.

#### **4. Conclusion**

Unfortunately, the future of health tourism is not so good. It is necessary to involve more partners and numerous types of investment for this type of tourism, so that it could be at its state of development once know. From our perspective, it is important to align the international trend of development of health tourism, with a focus on the young consumers and strong diversification of recreational structures.

Also, a solution could be the introduction of new technology for maintenance and beautification of the human body, so that the health tourism will not be just a synonymous with aging and illness of the human body. Romania has so many cosmetic products that are extremely popular on the international market, but with very little use in the structures spa treatment in the spas (Gerovital, Ana Aslan, Pell-Amar etc.). This can be transformed in a strength for the spas.

As European countries like Vichy (France), Baden-Baden (Germany), Spa (Belgium) or Karlovy Vary (Czech rep.) were able to maintain and even reinvent themselves, we believe that the Romanian health resorts could be strong competitors on the European health tourism market.

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## THE EFFECT OF PRICING POLICIES AND COST-CONTAINMENT MEASURES IN ALBANIAN HEALTH INSURANCE SCHEME

Enkelejda Avdi<sup>1</sup>

### Abstract

*This paper presents and analyses the evolution of pharmaceutical expenditure, to see the effect of policy measures targeting pharmaceutical expenditure in Health Insurance Scheme in Albania. Quantitative analysis of time series data, comparing and controlled before-after measures are undertaken. In order to answer the research question concerning Albanian pharmaceutical expenditures on HIS are used official data from Health Insurance Institute and other institutions' statistics. Based on this analysis, the appropriate model of regulation in Albanian health scheme, may involve a combination of positive list, restriction on prescribing and reimbursement systems, price control, reference pricing, expenditures drugs control, mark-up scheme and generic substitution. The controlling of health care costs requires a more effective and efficient health care system. The high level of expenditures on pharmaceuticals is likely due to the lack of rules and regulations to control this sector and the lack of a significant policy for using generic drugs as substitutes for expensive products with the same active substances. In the economic and social conditions of Albania, it is important the continual expansion of the list of generic reimbursable drugs, as well as the strengthening the control and monitoring of the financial impact. Is necessary an increasing of accountability of policy makers at all levels of the management health scheme and to strengthen the role of the HII as the sole purchaser of health services in Albania.*

**Key words:** expenditure, pharmaceuticles, reimbursement, reference pricing, quantitative analysis.

**JEL Classification:** I18, H51

### 1. Introduction

In Albanian social health insurance scheme (HIS), the costs of illnesses are considered as a public concern, and also as a protection against the social costs of illnesses. Health Insurance Institute (HII) is a semi-autonomous agency accountable to the Parliament, a third party payer that manages the HIS. HII is in charge of managing the reimbursement list, monitors prescribing behaviors, contracts with pharmacies, administers Primary Health Care service etc. HII has purchased a restricted package of health services and pharmaceuticals. Controlling health care expenditures has been years for several a political objective in Albania. Health scheme functions partly, an informal labor market, lack of incentives for participation in health scheme, weak administration capacity for contributions' collecting and poor

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structure, regulatory and supervisor and all in all it's funding challenges, are the main factors that accompany for years the health care system. Public health care expenditures have reached a threshold that, politically, seems difficult to cross.

A complex mix of factors and risks, both, supply and demand has contributed to the increasing in health care spending. Informal payments are partly a reaction to the health care system, particularly of the managers of health care, the lack of financial resources and patients' response to a system that is unable to provide adequate access to the basic services. HII enrolment varies among the different population groups. The whole population is included in this scheme but there is a categorization of the population such as pensioners, children under one year old, war veterans etc., who receive different level of reimbursement. The majority of the unemployed people, including children and women, who work at home, and the elderly, are automatically covered by the state budget. The state is responsible for covering the non-active population (such as pensioners, veterans and students). Increasing costs constantly for these categories constitutes the internal risk for health scheme. For example, expenses for drugs used to treat the category of "Pensioners" patient's, that comprises about 14% of the population, or about 230 thousand, benefited in 2012 more than 45% of the budget for reimbursement of drugs. Also in the new EU member states, from Central and Eastern Europe, a large share of total expenditures on pharmaceuticals is paid by public means. Different measures have been introduced in an attempt to contain costs, but at the same time these countries have maintained their inherited concern with protecting vulnerable groups and those who are suffering from serious diseases (Mossialos E. et al., 2004).

HII reimburses a defined list of out-patient drugs for the estimated 40-45% of the population that benefit from effective scheme coverage (World Bank, 2006). The Albanian reimbursement scheme is designed to cover a broad range of drugs that are reviewed annually. The current reimbursement scheme was first introduced in 1995. The reimbursed list has been continuously expanded with more innovative drugs and for a broader specter of diseases. A person with a newly diagnosed illness may register with HII and will receive immediate coverage without a waiting period or an exclusion of pre-existing conditions. There is a positive list (in 2013 has 426 generic drugs), which contains a restricted number of pharmaceuticals compared with the total number of drugs under circulation in the country (approximately 4000). Expenditures for drugs, both in the out-patient and in-patient care, are increasing on an annual basis. Decisions regarding inclusion on HII positive list are made by the Reimbursement Commission established by the Ministry of Health (MOH). The Reimbursement Departments at HII manages the list, while the 12 regional HII offices are responsible for issuing the serial coded, prescription forms and for the reimbursing of the contracting pharmacies. A controlling department analyzes prescriptions and investigates cases of alleged abuse or fraud.

Contracting with physicians, pharmacies and wholesalers allows HII to collect data for monitoring prescribing behavior and to catch those who try to play the

system for their own benefits. Reimbursed drugs are dispensed through a network of approximately 80 wholesalers 950 private pharmacies and pharmaceutical agencies across the country (HII, 2013), which have contracts with HII. All the drugs that have received permission from the National Centre of Drugs Control to enter the Albanian market can be included in the Reimbursement Drugs List. Previous to drafting of the list, other criteria are taken in consideration such as: the financial impact on the HII budget, requirements from the patients, lack of alternative therapies and reference price. The hospital services are covered by the special governmental budget. The reimbursement scheme is not applied for pharmaceuticals served at hospitals.

New policies and political decisions in health and pharmaceutical sector are introduced with no corresponding financial impact considered or accounted for the in budget. Increasing effectiveness and efficiency of health care and long-term care are getting more value for money out of the resources allocated to the sector are likely to become one of the most important challenges in the coming years for all actors of health insurance scheme in Albania.

The aim of this paper is to review the existing pharmaceuticals cost-containment policies in Albania in order to illustrate the complexity of the drug policy decision making and to assess the effectiveness of the cost-containment measures introduced so far. The paper will be focused on measures that aim the reducing of the public expenditures on pharmaceutical products. To discuss the possible policy options for better achievement of health policy goals within the context of strained health budgets and to evidence the main risks related to HIS costs; obstacles and factors underlying present and future spending pressures and main challenges in health spending and administer in Albania. The paper will focus and will include a review of pricing related major changes in reimbursement lists, margins, co-payment rates, reference prices system, ceiling or mixed mechanism used by health insurance scheme and highlights the need for polices and interventions for further ill costs reduction in Albania health insurance scheme.

## **2. Research design and methodology**

After a general overview of the evolution of the reimbursement scheme from its beginning in 1995 until now, I have described the policies and measures taken over the years, by analyzing two perspectives supply-side and demand-side cost-containment measures. According to the official data of Health Insurance Institute and other Albanian institutions, I analyzed different data of Health Insurance Scheme, from 1995-2012 and mainly pharmaceutical expenditures data. Via the different methods and quantitative analysis of time series data, comparing and controlled before-after measures and descriptive analysis, drew conclusions and made concrete analysis. I referred to groups of drugs with higher weight in the costs of the scheme (expensive drugs), analysis of new drug, comparison of categories with higher value in drug's expenditures, etc. For a detailed analysis, I was precisely

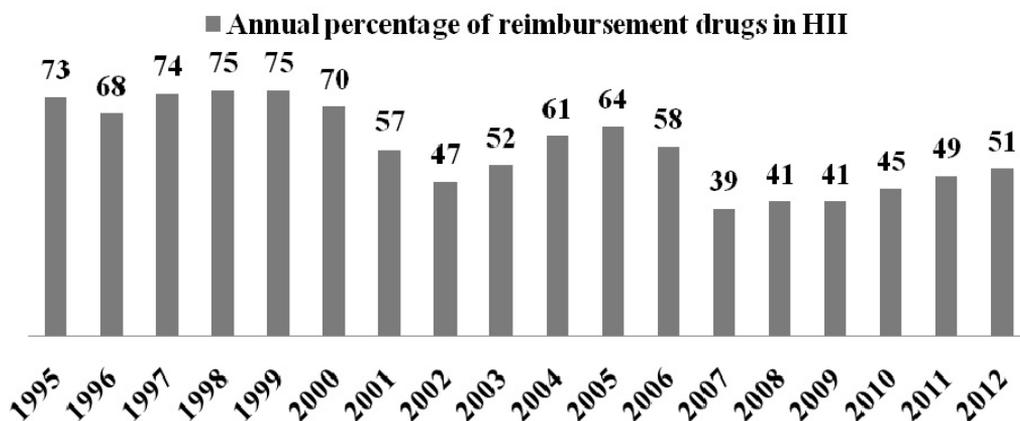
focused in HII data between 2005 and 2012 in Albania. I have chosen to analyze these years, because in the recent years result the major effects of the policies and measures related to pricing and reimbursement.

### 2.1 Reimbursement scheme, funds and drugs reimbursement list

Albanian health services are funded through a mix of taxation and statutory insurance. The State budget revenues remain the main sources, not only for all public health sectors, but also for the HIS. The health scheme revenues in 2011 and 2012 came approximately 23% from health contributions and approximately 77% from State budget.

HII manages a total annual budget of approximately € 200 million. This budget in 2013 is planned approximately 2% of GDP, while for three years, 2010-2012 the rate of 2.1% has not changed (MOF, 2011). Expenditures of reimbursement drugs in 2012 occupy 23% of total health expenditure in Albania (MOH, 2012). The main part of HII expenditures in 2012 (without the hospital's budget) was for pharmaceutical reimbursement 51% (or € 57 million) and primary health care financing 40% (Currency in Albania; 1 € exchange with 140 ALL), (HII, 2013). During the operation of the HIS, the value of the reimbursement costs in the total cost of the scheme has been different, but significant (figure no.1).

**Figure no.1 - Trend of expenditure's drugs as percentage in total HIS's expenditures**



Source: HII, the author's calculation

HII receives annually a certain budget from the Ministry of Finance for the reimbursement of drugs on the positive list. Expenditures for the coverage of the drugs reimbursement have been continuously increased due to different reasons, such as expansion of the health insurance scheme, reimbursement of innovative drugs, the tendency of the physicians to prescribe expensive therapies, etc.

MOH and HII are responsible for pharmaceuticals reimbursement for all the drugs included in the positive list, for some categories of patients and the information concerns pharmaceuticals prices and reimbursement policy. The reimbursement scheme is designed in such manner that covers the most essential drugs and a broad scope of diseases.

The HII reimbursement scheme involves the whole country and the whole population and it covers all the medical services. Medical examinations and pharmaceutical service for out-patient care are reimbursed by HII through contracts with general and specialist practitioners, and pharmacies.

*Table no.1 Trend of Drugs Reimbursement List in Albanian HIS, 1995-2013*

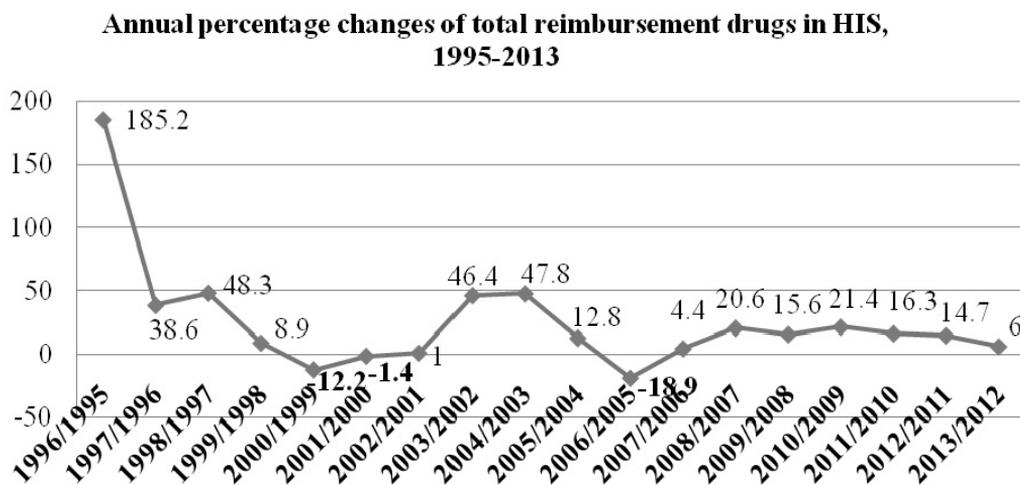
Years	Annual Expenditures of Reimbursement Drugs (in millions ALL)	Annual Percentage Changes of Total Reimbursement Drugs	Number of the First Alternative Drugs	Number of the Active Substances	Number of the Total Alternative Drugs
1995	304		174	174	174
1996	867	185.2	278	174	278
1997	1,202	38.6	278	184	278
1998	1,783	48.3	278	184	278
1999	1,941	8.9	278	197	596
2000	1,705	-12.2	308	175	611
2001	1,681	-1.4	308	181	625
2002	1,697	1	341	213	650
2003	2,484	46.4	346	209	791
2004	3,672	47.8	346	209	724
2005	4,143	12.8	402	238	722
2006	3,361	-18.9	355	207	748
2007	3,510	4.4	362	220	824
2008	4,233	20.6	377	222	865
2009	4,892	15.6	405	233	944
2010	5,941	21.4	409	236	991
2011	6,909	16.3	420	236	1061
2012	7,922	14.7	413	233	1102
2013	8,400	6	426	239	1135

Source: HII

During the years 2005-2013 list of reimbursable drugs has totally increased with 206 new drugs reaching the number of 426 drugs in 2013, 239 current active principles, always keeping within budgets allocated provision for reimbursement of drugs (table no. 1). At the same period the drugs' number in 2013 is increased only with 24 drugs, compared to 2005 (from 402 to 426 drugs or 6%) and active substances are increased only with 1 drug, (in 2005 are 238 and 2013 are 239 active substances). Basing on HII data, a continuous increase of expenditures for reimbursed drugs is evident. If I refer to 1995, the average growth of expenditures of pharmaceutical in drugs' scheme is 25.3%, including the expected value for 2013. The main changes in reimbursement scheme are made by 2005.

From 2005 to 2012, the growth of drug reimbursement expenditures was average 10.9% (figure no. 2). The expenditures for reimbursed drugs from 2005 to 2013 are doubled (€ 29 million in 2005 to € 60 million planned to 2013). One main reason is the expansion of the reimbursement scheme. For example, if referring increase spending by therapeutic groups, expenses for drugs used to treat patients suffering from cardiovascular and hypertension diseases are increased by about 936 million ALL/ € 7 million or about 43% (for the period 2007-2012). This group (C Group) makes up nearly 32% of total drug reimbursement expenditures. The chronic diseases are growing because of different reasons and the risk is greater. For example, diabetes's cost increased by 159% more in 2012, compared to 2007. Policies may also aim directly the controlling expenditures.

**Figure no. 2 – The trend of changing reimbursement of expenditures of reimbursed drugs, from the introduction of health insurance schemes in Albania, 1995-2013**



Pricing and reimbursement policies are always interlinked. Pharmaceutical policies are related to pricing, reimbursement, market entry and expenditure control. A positive list contains the drugs that will receive different levels of reimbursement (Nuijten M. et al., 2001). In 2005 the reimbursable scheme was extended to 72 drugs or 44 active substances, reimbursement, whose has occupied about 14.5-22.2% of total reimbursement of expenditures each year, between 2005 and 2012 (table no. 2).

Expenditures on HII financed prescription drugs are doubled over the past three years, during 2005 have been increased 25% more than in 2004 and 94% more than in 2003. This comes in a HII deficit for the following year. The rapidly increasing spending on prescription drugs over the past these years was largely the result of an imprudent expansion of the positive list of drugs, and of the cancellation of co-payments for most beneficiaries. Pensioners, the main beneficiaries of these new reimbursement rules, from 2005 are now responsible for close from 50% in 2005 to 70% of total HII drug's expenditures in 2010. These policy changes led to a substantial deficit of HII in 2005 and a situation in which HII was no longer in a position to pay suppliers (HII hasn't respected contracts with pharmacies, for payment of refunds for many months. This led to increased interest payment and therefore delay further aggravated the situation in the budget of the health scheme). The Government adopted an amendment to the Budget Law in December of 2005, allowing for an additional transfer from the state budget to HII of 1 billion ALL. In the spring of 2006 the Government reintroduced a flat co-payment per prescription to help stem the rapidly rising drugs expenditure. Additional policy measures, such as the tightening of the positive list of drugs, changes to the reimbursement policy and further revision of the margins to drugs were necessary to curb further cost increases and ensure the sustainability of HII's drugs reimbursement scheme (Avdi. E. 2011).

In order to reduce the costs of reimbursement due to the financial situation of HII, in 2006 were removed 37 drugs with recommendation of the World Bank and WHO, as well as unregistered drugs' entire. Between 2005 and 2013, the policy related to the inclusion or not of new drugs in the list of reimbursable drugs, has been variable depending on the budget allocated to the health insurance scheme. Table no. 2 reflects the performance of all new drugs in the reimbursement scheme in Albania, from the year of their entry in the list of reimbursement up 2012. In 2012 for the first time after 2004, the list was not increased because of budget constraints. I made analysis of 2005, because in this year was increased not only the largest number of drugs (72 drugs), but also with continuing financial effect of expenditures in the health scheme.

**Table no.2 Annual trend in percentage of the reimbursement of new drugs, in relation to the total cost of reimbursement, from the moment of inclusion in the health scheme, from 2005 up to 2012.**

	2005	2006	2007	2008	2009	2010	2011
2005	14.50						
2006	19.19	0.04					
2007	22.23	0.19	4.84				
2008	20.08	0.18	8.44	0.23			
2009	17.99	0.15	8.00	2.38	2.05		
2010	15.99	0.11	7.67	4.44	9.78	0.37	
2011	14.76	0.10	7.08	6.21	12.87	1.64	0.31
2012	15.92	0.07	5.84	6.89	11.08	3.20	1.20
<b>MIN</b>	14.5	0.04	4.84	0.23	2.05	0.37	0.31
<b>MAX</b>	22.23	0.19	8.44	6.89	12.87	3.20	1.20
<b>MEDIAN</b>	16.99	0.11	7.38	4.44	10.43	1.64	0.76
<b>AVERAGE</b>	17.58	0.12	6.98	4.03	8.95	1.74	0.76

Source: HII, the author's calculation

Expressed in value, 13 new drugs included in 2007 and 31 new drugs involved in 2009, continue to have the larger weight of the costs of the HIS until 2012, respectively € 16 million and € 17 million, for each group of new drugs. Studies about benefits and costs of newer drugs in EU countries came to the conclusion that allowing people to use only generic drugs would increase total treatment costs, instead of reducing them, and would lead to worse outcomes (Lichtenberg FR. 2001).

## **2.2 Need to force cost-containment measures in Albanian health insurance scheme**

Being that cost containment provides a support for the review, development and implementation of policies which define the funding and overall allocation of resources to health services, HII is trying to improve the insurance mechanisms in order to contain cost. The cost containment policies show that in many countries, pharmaceuticals markets are heavily regulated, governments are trying to protect population health and to guarantee access to safe and effective medicines, while constraining pharmaceuticals expenditures (Mossialos E. at al., 2005). The price controls certainly can have an impact on either slowing price increases or lowering drug prices. To what extent pharmaceuticals prices can be regulated or what is the reasonable price is still an ongoing debate, as shown by the various methods used in the EU countries.

*Supply-side cost-containment measures* are primarily targeted either directly or indirectly at regulating the prices of pharmaceuticals. Prices of reimbursed drugs are negotiable at the manufacturer level whereas prices of pharmaceuticals not included in the positive list are not negotiable. Prices of non-reimbursed drugs are set on free

bases and are subject to statutory mark-ups. Drugs included in the positive list are selected according to the following criteria: product specific criterion, disease criterion and economic criterion. Pharmacies are supplied by wholesalers with all the types of drugs circulating at the Albanian market.

*Reference prices* in Albanian pharmaceutical scheme are established basing on the cheapest drug with the same active substance and dosage within a group, i.e. on ATC 5 level (application for the first time in 2001). They are changed on annual basis just like the reimbursement drugs list depending on the drugs and the relevant prices offered by pharmaceutical companies. If a more expensive drug is prescribed, the patient has to pay the difference out-of-pocket. There is no mandatory generic substitution in place but the pharmacist is allowed to substitute a drug with its generic of the same substance, strength and form on a voluntary basis.

The patient pays the difference between the reference price and the pharmacy price. Thus, the goal of this measure is to limit the third party expenditure on prescription drugs, not the overall expenditure on medicines.

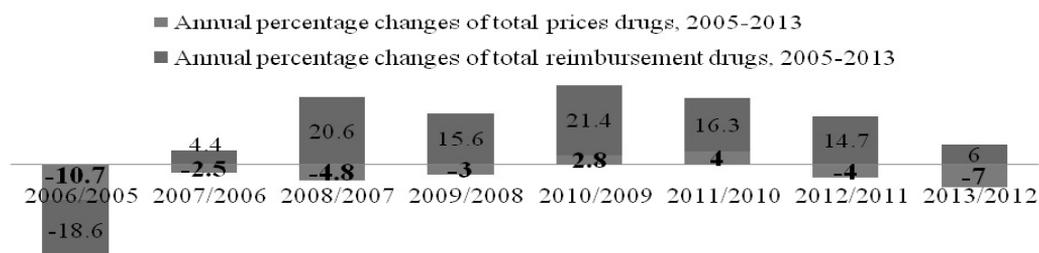
Different versions of internal reference pricing schemes are applied across EU. With the exception of Netherlands and Hungary, who apply therapeutic reference pricing schemes, the other EU countries apply an active substance reference pricing. The use of reference pricing does not always achieve the cost-containment aim and does not result in important long-term savings. (Lopez-Casasnovas G. at. al., 2000).

Various systems of price control can be found across the EU. In most countries, the maximum price of medicines is determined in comparison with the neighboring countries. In Bulgaria, the prices cannot be higher than the retail prices found in nine countries. In Romania, prices have been set as the lowest price from a basket of 12 countries (Ministry of Health, Romania, 2009).

However, not always these types of policies have the expected effect. This policy often fails to have a cost containment effect because the pharmaceutical companies lower their prices to coincide with the reference price (Mossialos E. at. al., 2005).

In Albania the introduction of therapeutic reference pricing between 2005 and 2013 had limited impact on reduction of the pharmaceutical expenditures (figure no.3).

**Figure no. 3 - Reference prices and pharmaceutical expenditures correlation, 2005-2013**



The reduce of the reference prices, not always reflected in the reduction of costs reimbursement. Although between 2006 and 2009 reference prices were reduced, the reimbursement costs continued to increase in 20.6% in 2008 compared to 2007. According to the prevision of the financial effect for the 2013, by lowering of the reference prices in 2013 compared with 2012, benefited a value of 693 million ALL / approximately € 5 million. Half of this amount was benefited by the application of external reference prices.

From 2012, in Albania exist as an official procedure *External Reference Price*, which is a price comparison that was made with a group of other countries. Each state selects which countries will formally compare prices according to his criteria. Countries with low income countries should refer to the same standard. Albania, as all European countries, use external reference price compared with other countries, at least 3 others, Greece, Macedonia and Italia.

In order to reduce expenditures in HIS, other significant politics and cost-containment measures are as follows:

*Different levels of margins* are applied for reimbursable pharmaceuticals in the reimbursement scheme. Pharmaceuticals are divided in six groups according to the percentage of the reimbursement coverage. According to percentages they are divided into groups as follows: 100% drugs that treat cancer, etc., 85-95% insulin for diabetics, etc., 75-85% drugs for chronic conditions, such as coronary heart disease, etc., 65-75% drugs for urinary infections, etc., 55%-65% drugs treating mycosis, rheumatisms, etc. and 50% antibiotics, etc.

It's a regressive margin system for medicines in Albania. The purpose of such a regressive margin is to reduce the incentive for pharmacists to recommend expensive, branded drugs over cheaper generics.

*Margin cuts* or the design of mark-ups for distributors of pharmaceuticals may affect dispensing behavior. Retail mark-ups (wholesale and retail margins) in Albania are annually regulated by the Council of Ministers. Decisions and according to the proposal put forth by the Prices Commission after negotiations with local and foreign producers or their representatives and holders of the registration certificate.

The first mark-up scheme on pharmaceuticals in Albania was introduced in 1995 and was 15% for wholesalers over the CIF prices and, 35% for pharmacies over wholesale prices. In May 1998 a new mark-up percentage of 12% for the wholesalers and 27% for the pharmacies were introduced by the Albanian authorities. In 2005 mark-ups were changed to 18% for the wholesalers and 33% for the pharmacies. For some reimbursable and expensive drugs lower mark-ups were applied (8%, 15%; 10%, 20%; 12%, 24%; and 15%, 30%). This application has increased annual expenditures for drugs approximately € 1.5 million. In 2006 mark-up scheme were changed to 12% for the wholesalers and 29% for the pharmacies for all reimbursable

drugs (lower mark-ups for expensive drugs; 8%, 0%; 8%, 15%; 10%, 20%; and 12%, 24%), affected up to half of 2011 (table no. 3).

The pharmacy mark-up scheme was last modified in 2011 by the Council of Ministers, affected in the drug list of 2012 and is still applying (10% for wholesalers and 26% for pharmacies for all reimbursable drugs).

**Table no.3 Economic effect of appliance of tow last mark-up schemes**

Prescription Average Values (in ALL)	Mark-up scheme 2010-2011			Mark-up scheme 2011-2012		
	Wholesalers	Pharmacies	Profits (in million ALL)	Wholesalers	Pharmacies	Profits (in million ALL)
180.000- 400.000	8%	0%	450	6%	0%	482
40.000- 180.000	8%	15%	17	6%	12%	18
10.000- 40.000	10%	20%	72	6%	15%	123
3.000- 10.000	12%	24%	63	8%	20%	123
Total Profits			602	Total Profits		746

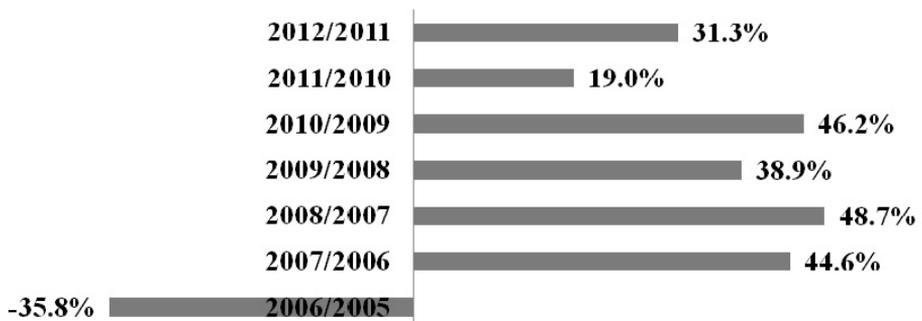
Source: HIS, the author's calculation

Different levels of margins applied for more expensive reimbursable drugs, had an added average effect in health scheme expenditures. Because of the mark-up scheme for expensive drugs, in 2012 were spared 144 million ALL / approximately € 1 million or 24% more than in 2011.

The 24 expensive drugs in 2012 had taken 22% of reimbursable drugs, or 14% more compared to 2005. Their values obviously at figure no. 4 reflect the latest politics and measures to reduce expenditures in HIS from 2005.

There is a reduction of expenditures of the expensive drugs, only in 2006 approximately 35.8% compared to 2005, and a deceleration of the increasing of expenditures in 2011, approximately 19% compared to 2011.

With expensive drugs in 2012 were treated about 1054 patients, with an average prescription value of about 120.500 ALL per month.

**Figure no. 4 – Trend of expensive drugs from 2005 to 2012****■ Annual percentage changes of reimbursement of expensive drugs, 2005-2012**

The introduction of reduced mark-ups for selected expensive reimbursed pharmaceuticals (covering about 20% of the products on the positive list) was a first step to overcome this situation.

The system for *the pricing generic drugs* is basically the same as the pricing for all drugs. Higher priced, innovative products may be reimbursed as long as there is no generic on the market. The HII makes use of the reimbursement ceiling and internal reference pricing to control costs. The reimbursement system stimulates price competition for generic drugs. All generics circulating into the Albanian market have to be registered at the National Center of Drug Control.

In Albania is introduced a *prescribing policies* for monitoring the prescribing budgets and preventing abuse. A list with the name of pharmacies with the highest prescription spending it's published. Prescribing policies are introduced in various countries, especially as an adjuvant tool for monitoring the prescribing budgets. In some countries, the prescribing pattern is monitored more as a way of preventing abuse: Portugal published a list of doctors with the highest prescription spending (Guillén AM. at. al., 2003), while in Romania a list with the name of over-prescribing physicians is published on the Romanian National Health Insurance Fund (NHIF) website.

*Demand side policies* can be seen as a four tiered structure of demand where the physician prescribes, the pharmacist dispenses, the patient consumes and a third party pays. The physicians are the key decision makers on the demand-side and many interventions are targeted at assuring best prescribing patterns. The importance of their role is reflected in the fact that, although within the demand side policies the most efficient in containing costs was proved to be generic prescribing or substitution (Simoens S. at. al., 2006), in order to change prescribing of drugs so that it becomes consistent with medical and cost-effectiveness evidence.

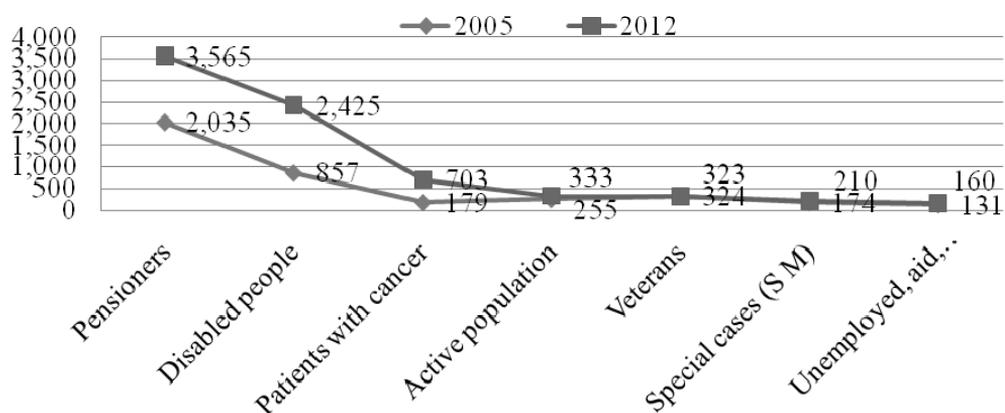
Even if physicians are periodically monitored by HII auditors and since 2004, every general practitioner (GP) has a limited annual budget for the reimbursed drugs

they have to prescribe, continue the cases of wasteful over-prescribing or fraud (collusion with patients and pharmaceuticals) will lead to fines and claims for compensation. Physicians who deviate from the expected prescribing track are being audited by the controllers. If the deviation is based on real medical need, the budget is increased. If the volume of the damage exceeds a certain amount, the contract with the physician is expected to be terminated. But, GP and specialist doctors are prescribing more expensive drugs rather than cheaper generic equivalents. There are not strong mechanisms of control.

*Out-of-pocket payments and percentage co-payments.* While HII reimburses those drugs that are included in its positive list with varying co-payments, an estimated 60% of the population pays for their medicines out-of-pocket (INSTAT, 2008). The whole population, based on their age, health status, income and other criteria, is divided into 20 categories, where 10 of these categories are reimbursed at a 100% rate and 10 others are partially reimbursed. There are two categories of co-payment in Albania. Have two categories of population, where a part of the population receives 100% reimbursement and the rest pays for a part of drugs according to the percentage of their coverage for each separate drug. 0% co-payment is applying to: drugs, that treat cancer, multiply sclerosis, growth hormone, deficiency and to all pensioners, war veterans and disabled people. Partial co-payment is applying to specific patients according to specific pharmaceuticals.

7 by 20 categories had taken 7.720 million ALL / approximately € 55 million in 2012, or approximately 97% of all expenditures of the drug's health scheme (figure no. 5). Expenditure for these 7 categories are approximately 95% increased, compared to 2005.

**Figure no. 5 – Comparison of categories with higher values in annual reimbursement expenditures, 2005-2012 (in million ALL)**



Co-payments are effective when price elasticity is higher - as in the pharmaceutical field - and less effective for other health services like hospital care

(Zweifel P. et al., 2000). Co-payments are the most used cost-control measures on the demand side but their level differs across EU. The majority of EU countries have in place a 100% reimbursement scheme for highly vulnerable groups or for those suffering from very serious diseases. However, there are situations where the concern for vulnerable groups costs more than the public system can afford to pay for.

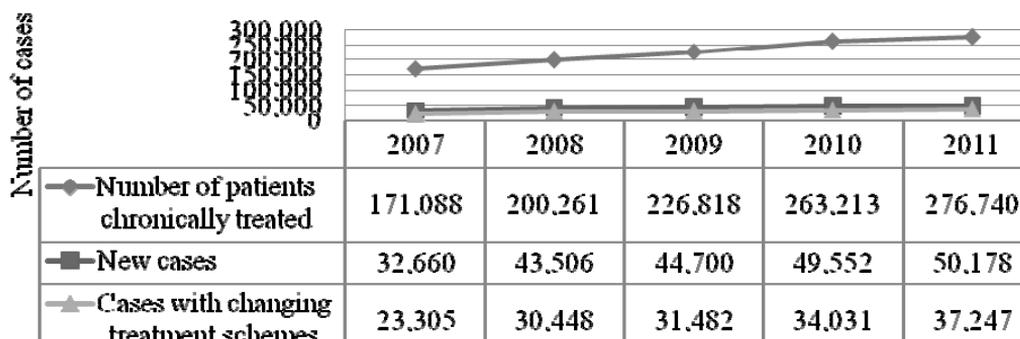
To conclude the analysis of the main facts in the matter of paper, I am giving some figures of the policy health scheme in relation to out-patients (table no. 4).

**Table no. 4 Trend of out-patients data on HIS, from 2005-2012**

<b>Years</b>	<b>The total number of prescriptions</b>	<b>Annual percentage changes of prescriptions</b>	<b>Value reimbursement For prescription (in ALL)</b>	<b>Value reimbursement for inhabitant (in ALL)</b>
<b>2005</b>	2,898,297		1,430	84
<b>2006</b>	2,415,048	-17	1,396	69
<b>2007</b>	2,333,150	-3	1,507	71
<b>2008</b>	2,630,967	13	1,609	87
<b>2009</b>	2,920,648	11	1,675	99
<b>2010</b>	3,245,103	11	1,831	123
<b>2011</b>	3,411,671	5	2,025	139
<b>2012</b>	3,733,744	9	2,122	159

Factors that have contributed to increase the expenditures of reimbursement are related to: 1) Increasing chronic disease, 2) New cases of the patients and 3) Cases with medication changes. The number of patients with prescriptions beneficiary reimbursement, increased from 2007 to 2011 in 76.000 patients or 24.5% more. These patients with highly handle, carrying 218.000 new cases and 153.280 cases of schemes change treatment, depending on the diagnosis of which they suffer. New cases and the total changes in therapy constitute about 3.2% of the total expenditure reimbursement morbidity. The following data (figure no. 6), are the number of chronic patients, new cases and cases with medication changes in five years, 2007-2011.

Figure no. 6 – Trend in the number of cases that have led to increased costs in the reimbursement scheme in HII



Number of patients chronically treated with reimbursement from family physicians in 2011 was 62% more compared to 2007, or 105.652 more cases. New cases in 2007 were 35.531 cases total, in 2011 their number reached a total of 50.178 new cases, or 41% more new cases. Cases with changing treatment schemes in 2011 were 37.247 total cases, or 35% more compared to 2007.

### 3. Final results

Despite the constant ups and downs, expenditures of reimbursement drugs have always had an important weight in the total cost of the health insurance scheme in Albania. The rapidly increasing spending on prescription drugs between 2003-2005 was largely the result of an imprudent expansion of the positive list of drugs, and of the cancellation of co-payments for most beneficiaries. Because of the policy followed and the cost-containment measures taken by the Albanian government in advising foreign factors, in 2006 reimbursement costs were reduced approximately 19% compared to 2005. Also were swept aside 37 drugs with the highest economic effect from the list, included in 2005 and the marketing margins were reduced to wholesalers and pharmacists.

The policy related to inclusion or not of new drugs in the list of reimbursable drugs between 2005 and 2013 is variable depended on the budget allocated to the health insurance scheme. The generic substitution can be considered one of the solutions for cost-containment. From the descriptive analysis of new drugs costs in the HII shows that their use would increase total treatment costs, instead of reducing them, especially in out-patient expenditures. The new drugs involved it in the years 2009 and 2010, still continue to have more weight in reimbursement costs. Only in the case of generic alternatives involvement, in 2011, have a slight decrease in spending of some drugs.

Other factors, influencing total pharmaceutical expenditures, have often occurred simultaneously and make it difficult to isolate specific effects of reference pricing. In Albania the introduction of therapeutic reference pricing between 2005

and 2013 had limited impact on reduction of the pharmaceutical expenditures. The price controls certainly had an impact on slowing price increases, but the results of reference pricing do not show any clear pattern in relationship to the immediate effects. The reduce of the reference prices, not always reflected in the reduction of costs reimbursement.

By the application of external reference price in 2012 was benefited approximately € 2.5 million. Reference drug pricing and external reference price can reduce third party drug expenditures by inducing a shift in drug use towards less expensive drugs.

A regressive margin system for medicines in Albania or the mark-ups schemes for distributors and pharmacists have influenced HIS expenditures. Different levels of margins applied for more expensive reimbursable drugs, had an added average effect in health scheme expenditures. Because of the mark-up scheme for expensive drugs, only in in 2012 was spared approximately 24% more than in 2011. The introduction of reduced mark-ups for selected expensive reimbursed pharmaceuticals was a good step in order to reduce costs for drugs.

To decrease the financial risks for the target population, lower cost sharing policy will usually be followed by over consumption of health services. One of the strategies that should be considered by the policy makers is to analyze the risk level or health status of the target population: lower cost sharing level to those with the higher risk of diseases; higher cost sharing policy for those with lower risk of diseases.

#### **4. Conclusions and further directions**

Based on this analysis, the appropriate model of regulation in Albanian HIS, may involve a combination of positive list, restriction on prescribing and reimbursement systems, price control, reference pricing, expenditures drugs control, mark-up scheme and generic substitution. The majority of the effective measures in containing costs are on the supply-side from the demand-side especially co-payments are used in a systematic way at health insurance scheme in Albania.

Pharmaceutical expenditures is a major area of the health sector in Albania, that needs to be better managed and regulated, if health care expenditure growth shall stay in the budgetary limits. The high level of expenditures on pharmaceuticals is likely due to the lack of rules and regulations controlling this sector and lack of a significant policy for using generic drugs as substitutes for expensive products with the same active substances.

Various problems in Albania, associated with the process of introducing new drugs to the list of drugs and influence of interest groups, such as the service chiefs' intervention, representatives of companies, are increasing. The physician's prescriptions consist in more drugs and of drugs with higher cost. Public health care expenditures have reached a threshold that, economically and politically, seems difficult to overcome. The reimbursed drugs and the cost of reimbursement are not well managed by HII.

In the economic and social conditions of Albania, it is important the continual expansion of the list of generic reimbursable drugs, as well as the strengthening the control and monitoring of the financial impact. Based on different experience CEE countries, in terms of incentives for doctors and pharmacists for the generic description, incentive policies should be strengthened.

It is required a closer collaboration with clinics, HII and MOH for determining the cost-effectiveness of drugs. The accountability of policy makers at all levels of the management scheme should be increased and also the role of the HII as the sole purchaser of health services in Albania should be strengthened.

Health financing reforms aimed at improving the insurance coverage of a wider population group, together with stricter registration requirements for generic drugs, are likely to put additional pressure on drug expenditures. The structure and level of margins for distributors and pharmacists should be further reviewed. There are many small importers and wholesalers in Albania. Drug price negotiations with importers of new drugs could be further strengthened by adopting a more standardized approach to the use of reference prices. A price volume agreement should be taken into consideration for reimbursed drugs. Another element, the delay of price approval after granting of marketing authorization or for obtaining the reimbursement status, can be considered an important impediment in patient access to medicines (Cohen J. et al., 2007), but in the same time a potential measure for cost-containment.

Controlling health care costs requires a more effective and efficient health care system. The most important challenge for the HII is the inclusion of the hospital care in the health insurance scheme. The effects of pharmaceutical policies on patient health associated health care costs and administrative costs which remain to be investigated.

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## CRITICAL SUCCESS FACTORS FOR BUSINESS – IT ALIGNMENT: A REVIEW OF CURRENT RESEARCH

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and Kozeta Sevrani \*

### Abstract

*Business-IT alignment still remains one of the three main research streams in IS literature, and from 1994 it constantly ranks among the top three concerns of CIOs. While a lot of research has been published around business-IT alignment in the last three decades, a number of models have been proposed to structure the concept into various dimensions and levels. However, only a few studies have been made regarding the critical success factors. Moreover, we were unable to find any systematically consolidated evidence in this regard. This is a major gap because research is collaborative venture and each researcher build on what have been found and understood before. After searching some of the most comprehensive science databases such as ScienceDirect, JStore, ACM Digital Library, SpringerLink we could identify only six articles on the matter. Using the model proposed by Schlosser et al. (Schlosser, et al., 2012) to structure the alignment concept, our results show that most of the identified CFSs are related to individual skills and knowledge of IT and business executives.*

**Keywords:** critical success factor, business-IT alignment, literature review, human dimension, social dimension, intellectual dimension.

**JEL Classification:** M10, M15, M16

### 1. Introduction

Business-IT alignment has drawn researchers' attention since the mid '70 (McLean & Soden, 1976). At an early stage, this often meant existence of a linkage between the business plan and the IT plan (Keen & Scott Morton, 1978). Nowadays, business-IT alignment generally refers to applying IT in a proper and timely fashion, harmonized with business needs, goals and strategies (Luftman, et al., 1999). After all these years, it still remains as one of the three main research streams in IS literature (Tanriverdi, et al., 2010) and from 1994 it constantly ranks among the top three concerns of CIOs (Luftman & Kempaiah, 2007; Luftman & Ben-Zvi, 2011). This continuously and increasingly interest in business-IT alignment derives from the fact that it is considered as the basic principle to realize business value from IT

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(Henderson & Venkatraman, 1993; Kearns & Lederer, 2000). Among the most important are; increased IS usage, IS effectiveness and efficiency, higher (business and IT) flexibility, and improved business performance (Chan & Reich, 2007). While a lot of research has been published around business-IT alignment (Walentowitz, 2012; Schlosser, et al., 2012), a number of models have been proposed to structure the concept into various dimensions and levels (Chan, et al., 2006; Luftman & Kempaiah, 2007; Chan & Reich, 2007). Schlosser et al (2012) in their work review the existing conceptualizations of the business-IT alignment construct and present a categorization by making a clear distinguish between the organizational level on the one hand, and the nature of alignment on the other hand. Their model presents three horizontal organizational layers - strategic, cross-domain, operational - and three vertical dimensions regarding the content of alignment: human, social, and intellectual.

Relevant studies, from both academics and practitioners, have pointed out various factors that affect business-IT alignment (Teo & Ang, 1999; Luftman, et al., 1999; Reich & Benbasat, 2000). These limited numbers of areas that management needs to pay special attention to enhance the chances for achieving and improving alignment are known as critical success factors (Rockart, 1979). Luftman, et al. (1999) pointed out that most of CFSs can serve both as enablers and inhibitors of business-IT alignment. Therefore, having a holistic picture on CFSs is an imperative and paramount for organizations aiming for better business-IT alignment. Due to their importance, CSFs are widely researched (Tan, et al., 2007) and applied in many organizations in different perspectives; from a single project to the whole organization strategic direction (Esteves de Sousa, 2004). However in the area of business-IT alignment, few CSFs studies have been undertaken. Despite the fact that some empirical evidence exist on critical success factors for business-IT alignment, still we were unable to find any systematically consolidated evidence in this regard. This is a major gap because research is collaborative venture and each researcher build on what have been found and understood before (Vom Brocke, et al., 2009).

In many research areas results are not considered valid until they have been repeated and independently verified (Landa, et al., 2011). A structured literature review that classifies the results and compiles evidence in a certain domain can be very valuable (Vom Brocke, et al., 2009; Webster & Watson, 2002). First, such a review represents “the state of the field”, and provides a point of reference for others conducting future research on the subject (Webster & Watson, 2002). Second, it adds to the knowledge base of the research subject supporting the progress, as it facilitates theory development, pinpoints heavily researched areas and identifies research gaps (Webster & Watson, 2002). Third, structured reviews usually have a major impact on applied disciplines as they help transferring scientific knowledge into practice more effectively (Fettke, et al., 2010; Goeken & Patas, 2010). And finally, the compilation of empirical evidence can support and inform the design process and its results within the design science paradigm (Fettke, et al., 2010; Hevner, et al., 2004).

These arguments support our research objective to structure and analyze the existing empirical evidence in CFS that need to be considered by top management in their endeavor to achieve and sustain business-IT alignment. We draw on the model presented by Schlosser et al (Schlosser, et al., 2012) to categorize our findings.

By doing so, we will show which CFS are mostly investigated to affect business-IT alignment and which needs to be reconfirmed. To identify the desired empirical evidence, we perform a structured literature review. To our knowledge this is the first attempt to structure the literature on this research subject.

The rest of this paper is structured as follows: the following section gives a brief overview on the key concepts of business-IT alignment and CFSs and their adoption on business-IT alignment. Subsequently we describe the literature selection process and discuss our findings. Finally we offer the concluding remarks and present, some limitations and future directions in the subject.

## 2. Background

### 2.1. Business-IT Alignment dimensions

Alignment focuses on the activities that management performs to achieve interconnected goals throughout the organization. Business-IT alignment as defined by Reich & Benbasat (1996) is “*the degree to which the IT mission, objectives, and plans support and are supported by the business mission, objectives, and plans*”. Business-IT alignment, which is an important goal of IT governance, is one of the three main research streams in IS literature (Tanriverdi, et al., 2010) and also constantly ranks among the top three concerns of CIOs (Luftman & Kempaiah, 2007; Luftman & Ben-Zvi, 2011). Kearns & Lederer (2000) argue that is important to make a distinction between Business-IT and IT-Business alignment. While the first signifies IT management’s understanding of business strategy (Reich & Benbasat, 1996) the later ensures that the business plan reflects the experience and knowledge of the organization utilizing IT based resources, and indicate better top management understanding and commitment (Bensaou & Earl, 1998).

As the research around business-IT alignment has become progressively more mature in the last three decades, slightly different concepts and conceptualizations have emerged (Walentowitz, 2012; Schlosser, et al., 2012). A number of models have been proposed to structure the concept of alignment into various dimensions and levels (Henderson & Venkatraman, 1993; Maes, 1999), including measures to assess alignment maturity (Luftman & Kempaiah, 2007) and examine different outcomes as well as interdependencies to other IT constructs (Chan, et al., 2006). The proposed models and, subsequently their extensions, lay out several dimensions like strategic, structural, intellectual, social, and cultural alignment. Schlosser et al. (2012) revisit the existing conceptualizations of the business-IT alignment construct and present a reconciled categorization by clearly drawing the line between the organizational levels and the nature of alignment. Based on the Strategic Alignment Model (SAM) (Henderson & Venkatraman, 1993), their construct recognizes three horizontal organization layers at which organizational levels alignment can and should be assessed: strategic, cross-domain and operational layer. Next, based on the work of Reich & Benbasat (2000) and Chan & Reich (2007) they enhance their model adding three vertical dimensions regarding the content of alignment: human, social, intellectual dimension.

In essence, the **intellectual dimension** is concerned with artifacts that are purposefully created and most often formally documented and materialized by the business and/or IT personnel. From an IT perspective, it includes the whole area of technology (hardware and software components), closely related to the technology assets (Ross, et al., 1996) and the technological IT resources (Melville, et al., 2004). In addition, the structural elements like committees, meetings, plans, roles and rights, documents, etc... are classified into this dimension as well (Schlosser, et al., 2012).

The core of **social dimension** is concerned about the socially organized human behavior that exists “beyond” a single actor thus encompassing relationships, mutual understanding, but also cultural issues and informal structure. It captures and encapsulates all aspects that affect the work relationship between business and IT. Therefore, soft factors like mutual trust and respect, informal communication, and culture comprise the primary elements in this dimension (Schlosser, et al., 2012).

Contrary to the social collectivism that social dimension refers to, the **human dimension** relate to the distinct attributes of individuals e.g., skills, knowledge, leadership, and behavior. From the alignment point of view it is important that IT employees are equipped with ‘proper’ skills and knowledge to resolve business problems. However, business employees are required to possess the appropriate proficiency in order to effectively use the information systems already deployed. Furthermore, some basic understanding about IT on the business side is valuable to facilitate effective communication and enable business employees to be aware of the opportunities that arise from current and future information systems (Schlosser, et al., 2012).

**Table no. 1: Business-IT alignment dimensions and content as proposed by Schlosser et al. (2012)**

Human Dimension	Social Dimension	Intellectual Dimension
<ul style="list-style-type: none"> <li>• Business skills and knowledge of IT executives/employees</li> <li>• IT skills and knowledge of business executives/employees</li> <li>• Leadership skills of business and IT executives</li> <li>• Managerial capabilities of business and IT executives</li> <li>• Commitment</li> <li>• Behavior and attitudes towards “other side”, respectively</li> <li>• Technical skills and knowledge of IT employees</li> <li>• Managerial skills of business and IT employees</li> </ul>	<ul style="list-style-type: none"> <li>• Shared understanding of business and IT executives/employees</li> <li>• Mutual trust and respect between business and IT executives/employees</li> <li>• Cultural fit between business and IT executives/employees</li> <li>• Work relationships between business and IT executives/employees</li> <li>• Informal structures between business and IT at executive/employee level</li> <li>• Common language</li> </ul>	<ul style="list-style-type: none"> <li>• Alignment of business and IT strategy/goals/plans/...</li> <li>• IT architecture alignment</li> <li>• IT standards and platforms alignment</li> <li>• Alignment of business and IT structures (rights and roles, reporting, committees, formal meetings, (de)centralization, ...)</li> <li>• SIS alignment</li> <li>• IT project portfolio alignment</li> <li>• Shared applications</li> <li>• IT infrastructure alignment</li> <li>• IT project alignment</li> <li>• Alignment of IS and processes</li> <li>• IT services alignment</li> <li>• Procedures/workflow alignment</li> </ul>

## 2.2. CFS for business-IT alignment

Critical Success Factors emerged as a need to simplify (Simon, 1957) and reduce (Hodge & Reid, 1971) the criteria and variables that need to be considered and balanced (Belton & Stewart, 2001) for strategic decisions which typically are not simple, with clear objectives, boundaries and considerations but rather a complex “mess” (Ackoff, 1979). Daniel (1961) was the first to discuss the success factors concept. Based on his work, Rockart (1979) developed the concept of critical success factors and popularize it for determining the executive information needs. According to him (pg.85) they are “*the limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance for the organization*” (Rockart, 1979). He argues that CFS are specific to individual managers on a given time and context, so they are subject to change. In a later work Bullen and Rockart (1981) hinted at the usefulness of the method as a component of strategic planning for information systems or technology. The original concept of CFSs quickly gained acceptance among both academics and practitioners and was used in a variety of industries (Bergeron & Bégin, 1989).

Because of their importance, CSFs are widely researched (Tan, et al., 2007) and applied in many organizations in different perspectives; from a single project to the whole organization strategic direction (Esteves de Sousa, 2004). CSFs are used by organizations to provide constant focus on a limited number of factors that help to define and ensure the success of the business until they are successfully achieved. This helps both the organization and its personnel to understand the key areas in which to invest their resources and time.

However in the area of business-IT alignment, few CSFs studies have been undertaken though its importance for harnessing the power and opportunities of IT to provide long-term benefits for businesses has become critical (Weill & Woodham, 2002). Luftman, et al. (1999) in their work pointed out that most of CFSs can serve both as enablers and inhibitors of business-IT alignment. Therefore having a holistic picture on CFSs is an imperative and paramount for any organization to achieve and improve business-IT alignment.

## 3. Literature Selection

As we previously mentioned there are only few studies concerning critical success factors on business-IT alignment. These studies provide some empirical evidence on CFSs but still none provides any systematically consolidated evidence in this regard. Hence, we couldn't identify any previous all-encompassing CSFs list for successful business-IT alignment and therefore the preparation of the construct considered existing CSF related studies.

Following the recommendation of Webster and Watson (2002), first we conducted a direct search for relevant articles published in journals until June 2012 in the following scientific databases: JStore, ScienceDirect, SpringerLink and ACM Digital Library to identify the key articles. In literature, alignment has been also called fit and linkage (Chan & Reich, 2007) while for critical success factors the terms key

success factors is used (Freund, 1988) as well. Therefore we searched the above databases using search phrases such as: “critical success factors”, “strategic alignment”, “strategic fit”, “success factors”, “key factors”, “strategic linkage” in title, abstract, subject terms or author supplied keywords. Reviewing search results and excluding irrelevant articles (Table no. 3) we could compile a list of 3 articles. Next, we followed by performing a review of the articles cited in our list of key articles. This didn’t provide us any new article to add to the previous list. To complete our literature selection we also performed a forward search using Google Scholar. In this step we searched for articles that cite our previously identified key articles. We could identify 3 more articles to add to our list from this search. Our final list included the following articles (Table 2):

**Table no. 2: List of articles included in the review and the selection process**

Nr	Article	Search type
1	Teo & Ang (1999), Critical success factors in the alignment of IS plans with business plans	Direct
2	Luftman, J. N., Papp, R. & Brier, T (1999), Enablers and Inhibitors of Business-IT Alignment	Forward
3	Reich, B. H. & Benbasat, I (2000), Factors That Influence the Social Dimension of Alignment between Business and Information Technology Objectives	Direct
4	Khandelwal, V. K (2001), An empirical study of misalignment between Australian CEOs and IT managers	Direct
5	Nfuka, E. N. & Rusu (2010), Critical Success Factors for Effective IT Governance in the Public Sector Organisations in a Developing Country: The Case of Tanzania	Forward
6	Aggarwal, H. (2010), Critical Success Factors in IT Alignment in Public Sector Petroleum Industry of India	Forward

The following table presents the queries we run against the databases and the size of result for each query.

**Table no. 3: Results of direct phrase search in journals’ databases as of June 2012**

Search query	Database	Results Size
TITLE-ABSTR-KEY(Critical success factor) and ALL(Strategic Alignment)	ScienceDirect (Journals)	77
TITLE-ABSTR-KEY(Critical success factor) and TITLE-ABSTR-KEY(Strategic Fit)		6
TITLE-ABSTR-KEY(Critical success factor) and TITLE-ABSTR-KEY(Strategic Linkage)		2
TITLE-ABSTR-KEY(success factors) and TITLE-ABSTR-KEY(Strategic Alignment)		11
TITLE-ABSTR-KEY(success factors) and TITLE-ABSTR-KEY(Strategic Fit)		19

Search query	Database	Results Size
TITLE-ABSTR-KEY(success factors) and TITLE-ABSTR-KEY(strategic linkage)		10
TITLE-ABSTR-KEY(Key factors) and TITLE-ABSTR-KEY(Strategic Alignment)		11
TITLE-ABSTR-KEY(Key factors) and TITLE-ABSTR-KEY(Strategic Fit)		13
TITLE-ABSTR-KEY(key factor) and TITLE-ABSTR-KEY(strategic linkage)		14
(ab:(critical success factor) AND (strategic alignment)) AND (cty:(journal) AND ty:(fla))	Jstore (Journals)	1
(ab:(critical success factor) AND (strategic fit)) AND (cty:(journal) AND ty:(fla))		10
(ab:(critical success factor) AND (strategic linkage)) AND (cty:(journal) AND ty:(fla))		2
(ab:(success factor) AND ab:(Strategic Alignment)) AND (cty:(journal) AND ty:(fla))		2
(ab:(success factor) AND ab:(Strategic fit)) AND (cty:(journal) AND ty:(fla))		1
(ab:(success factor) AND ab:(Strategic linkage)) AND (cty:(journal) AND ty:(fla))		0
(ab:(key factor) AND ab:(Strategic Alignment)) AND (cty:(journal) AND ty:(fla))		2
(ab:(Key factor) AND ab:(Strategic fit)) AND (cty:(journal) AND ty:(fla))		0
(ab:(Key factor) AND ab:(Strategic linkage)) AND (cty:(journal) AND ty:(fla))		1
"critical success factor" and "Strategic alignment"		SpringerLink (Journals)
"critical success factor" and "Strategic fit"	2	
"critical success factor" and "Strategic linkage"	0	
"success factor" and "Strategic alignment"	14	
"success factor" and "Strategic fit"	5	
"success factor" and "Strategic linkage"	0	
"key factor" and "Strategic alignment"	9	
"key factor" and "Strategic fit"	5	
"key factor" and "Strategic linkage"	0	
"critical success factor" "Strategic alignment"	ACM (Journal or Proceedings)	22
"critical success factor" "Strategic fit"		4
"critical success factor" "Strategic linkage"		0
"success factor" "Strategic alignment"		52
"success factor" "Strategic fit"		8
"success factor" "Strategic linkage"		0
"key factor" "Strategic alignment"		33
"key factor" "Strategic Fit"		5
"key factor" "Strategic linkage"	0	

## **4. Classifying CFSs**

In this section we discuss the critical success factors identified using the model proposed by Schlosser et al., (2012).

### **A. Human dimension**

#### **4.1. IT skills and knowledge of business executives**

IT skills and knowledge of business executives is identified as critical success factor in most of the selected literature (Teo & Ang, 1999; Luftman, et al., 1999; Burn & Szeto, 2000; Khandelwal, 2001; Nfuka & Rusu, 2010; Aggarwal, 2010). A wide range of organizational processes and activities are top management responsibility (Mintzberg, 1975). Information technology investments for the future is one of the most challenging tasks they are facing (Weill, et al., 2002). While in the past business executives could afford to delegate, ignore or avoid IT decisions (Jarvenpaa & Ives, 1991), nowadays this is not possible in most sectors and industries (Peterson, 2004; Van der Zee & De Jong, 1999; ITGI, 2003; Babcock, et al., 1995).

Being knowledgeable about IT is critical for business executives as the resources in any organization are limited and IT investments are usually not only a costly undertaking but bear also a high degree of risk for failure (The Standish Group, 2009). Such knowledge about IT encompasses the prospective and limitations of organization's IT infrastructure, competitors' usage of IT and the opportunities offered by emerging technologies for the improvement of organization's business (Armstron & Sambamurthy, 1996).

The lack of IT knowledge and culture of business executives makes it rather difficult for them to evaluate IT investments and have more reasonable prospects of what investments in IT can or cannot realize. Business executives have to understand that IT can not be a cure to all organizational problems. Rather, IT should be viewed as a resource to be deployed thoughtfully to support or influence business strategies in terms of streamlining business operations, reengineering business processes, forging electronic links with suppliers and customers, etc... (Teo & Ang, 1999).

#### **4.2. Top management commitment**

Top management commitment has gained a broad consensus in the literature as being critical for success in business-IT alignment (Teo & Ang, 1999; Luftman, et al., 1999; Nfuka & Rusu, 2010; Aggarwal, 2010). Having an executive sponsor who is both sufficiently committed to invest time and effort in guiding information systems development, and has a realistic understanding of the capabilities and limitations of the system is key to success of IS (Poon & Wagner, 2001). Top management commitment will translate into proactive cooperation (Morgan & Hunt, 1994), the provision of resources necessary for IT plan implementation and support for corresponding organizational changes (Ang & Teo, 1997; Luftman, et al., 1999). The level of top management commitment influences the level of support provided by the functional managers (Lucas, et al., 1990; Belassi & Tukel, 1996) and the behavior

of the users as well (Lucas, et al., 1990). People are to be influenced more from top management behavior than their saying. Finally, top management commitment is an important element in managing the change brought about by ICT projects (Milis & Mercken, 2002). Commitment will ensure that business works together with IT, which will be characterized by enthusiasm and positive demonstrations of support for IS efforts (Enns, et al., 2001; Cohen & Toleman, 2006).

#### **4.3. Business skills and knowledge of IT executives**

Business skills and knowledge of IT executives implies that it is no longer sufficient for IT management to be concerned only about the technical aspects of the IT function. (Teo & Ang, 1999; Luftman, et al., 1999; Khandelwal, 2001; Nfuka & Rusu, 2010). The focus of IT managers on the technological issues rather than enterprise-wide business issues is causing misalignment between business and IT (Khandelwal, 2001). According to Teo and Ang (1999) IT management knowledge about business is even more important than top management knowledge about IT and is a key factor in facilitating greater alignment between business and IT planning. The degree of IT deployment in business strategies and value chain activities is significantly influenced by such knowledge as well. Business skills and knowledge cover business strategies, organizational work processes, products and services, industry's recipes for success, and competitors' strengths, weaknesses and potential actions (Armstrong & Sambamurthy, 1996).

In the last decade IT understanding of the business has been crucial to organizations (Luftman, et al., 1999). IT executives risk operating in isolation if their focus is about technology only and risk of becoming excluded, because that is not where the business units reside (Enns, et al., 2001). IT failures can be avoided if IT management has a better understanding on business management's objectives and such knowledge is essential for IT executives to make their contribution to the organization (Lederer & Burky, 1988). They are expected to be knowledgeable about the business and to play an important part in business strategy formulation and implementation. Lack of such knowledge and skills is likely to be a significant inhibitor to the firm's ability to use IT strategically. It may also negatively affect the reputation of the IT function in being only technically-focused rather than business-focused. (Teo & Ang, 1999; Luftman, et al., 1999).

#### **4.4. Leadership skills of IT executives**

IT executives play a critical role in the ability of an organization to derive business value for IT. It is through leadership that they can most significantly influence the impact of IT on organizational performance (Teo & Ang, 1999; Luftman, et al., 1999; Nfuka & Rusu, 2010; Aggarwal, 2010; Preston, et al., 2008). Innovation and creative ideas can often be a source of competitive advantage and can make existing ways of doing things obsolete. By coming out with creative ideas for the strategic use of information technology, IT management demonstrates the strategic relevance of IT to the organization (Teo & Ang, 1999). Frequently the

important leadership role that IT can play is only recognized after a competitor has applied IT innovatively. IT innovation is occurring at an increasing rate across all industries (Luftman, et al., 1999) and as most of organizations are still characterized by relatively lower awareness on available ICT opportunities, IT executives' skills and competencies to bring such understanding and required actions convincingly to top management is critical (Nfuka & Rusu, 2010).

#### **4.5. Technical skills and knowledge of IT employees**

Teo and Ang (1999) argue that the quality of IT personnel is critical for many organizations. IT staff must be sophisticated enough to interact with top management and be able to master the technologies required for the IS development and implementation (Poon & Wagner, 2001). Keeping up the pace with the advances in information technology enable IT employees to put forward better and more appropriate proposals for applications to support business objectives and strategies. Deploying such applications properly may result crucial to the organizations' long term survival. Furthermore, past research has shown that capitalizing on new advances in IT can often give the firm a competitive edge. The sustainability of such competitive advantage relies on many other factors such as whether the organization continues to innovate as well as the strengths and weaknesses of competitors. Failure of IT staff to keep up with advances in IT can adversely affect perception of the IT department and morale of IS staff (Teo & Ang, 1999).

### **B. Social dimension**

#### **4.6. Mutual trust and respect between business and IT executives**

Trust plays a key role on the relationships between individuals and organizational groups. Mutual trust is defined as the expectation shared by the business and IT executives that they will meet their commitments to each other (Dasgupta, 1988). Groups work better together in an atmosphere of mutual trust based on mutual commitment and a stable long-term partnership (Anderson & Weitz, 1992).

Teo and Ang (1999) argue that top management needs to have confidence in the IT department in order to be committed to the strategic use of IT. The lack of trust would result in inappropriate allocation of resources (in terms of funds, personnel, etc.) from top management for the planning and development of strategic IT applications. In addition, those who are respected are more likely to get involved in activities that are well outside their sphere of influence. Those who are not respected tend to get left out, either by not being invited onto senior committees or by not being involved in discussions about important business issues (Reich & Benbasat, 2000). Furthermore, if top management has confidence in the capabilities of the IT department to deliver appropriate systems that are essential for the successful

implementation of organization's strategies, the role of the IT department is more likely to be elevated from a supporting role to a more strategic one (Teo & Ang, 1999).

Finally, all the factors that affect business-IT alignment are important, but none of them matters if there is not an atmosphere of open and honest communications (Luftman, et al., 1999) and no one can mandate meaningful communication between individuals or groups. Thus, it is up to the IT people to earn the right to play a meaningful role in management forums (Reich & Benbasat, 2000).

#### **4.7. Business – IT Partnership**

Past studies have long considered effective working relationship between business and IT executives as critical (Broadbent & Weill, 1993) and a key success factor (Earl & Feeny, 1994; Lepore, 2000). Partnership gauges the relationship between a business and IT organization, including IT's role in defining the business's strategies, the degree of trust between the two organizations, and how each perceives the other's contribution (Luftman & Kempaiah, 2007).

Luftman et al. (1999) argued that both IT and non-IT executives see the need for business – IT partnership in the strategy formulation process as it is easier to achieve alignment when cross-functional teams, including IT, create enterprise strategies. Teo and Ang (1999) note that business management needs to recognize that if business goals and objectives are not made known to IT management, IT management will find it difficult to create IT plans to support business strategies. Past studies have shown evidence for a significant correlation between the quality of communication of strategic business plans and the extent of strategic IS planning (Calhoun & Lederer, 1990). However, having a high quality business plan is not enough. It is crucial for these plans to be communicated and made available to IT management. Business-IT partnership enables joint decision on criteria used to evaluate and prioritize the appropriate IT to be developed and implemented in support of the organization's business goals and objectives (Teo & Ang, 1999). Moreover, Nfuka and Rusu (2010) suggest that business-IT partnership shouldn't be only encouraged but also facilitated and supported among IT and user departments.

#### **4.8. Shared understanding of business and IT executives**

A fundamental premise of information systems in organizations is that they must serve business users' needs. Hence, it is essential to ensure that IT applications are developed according to users' requirements (Teo & Ang, 1999). The process of translating users' business requirements into technical requirement for information systems requires that both parties understand each-others' language. Misunderstandings between IT and the business can lead to inaccuracies in the interpretation of requirements and can create feelings of distance resulting in intergroup conflict (Nelson & Coopridge, 1996).

Shared understanding requires both IT and business executives, at a deep level, to understand and be able to participate in the others' key processes and to respect

each other's unique contribution and challenges (Reich & Benbasat, 2000). Therefore it becomes important to remove barriers and create a collaborative environment between IT and business as well as to increase their ability to work towards attainment of common goals (Nelson & Coopriider, 1996).

Reich and Benbasat (2000) noted that the most important direct predictor of alignment was a high level of communication between IT and business executives. Through frequent communication, business users become more knowledgeable about IT, while IT departments become more knowledgeable about the business. This will greatly facilitate partnership between business and IS management, understand each other's goals, problems and limitations, and consequently improve the use of IT to create business value for the organization (Teo & Ang, 1999). Participants create and share information with each other to reach a mutual understanding, thus over time they converge or diverge from each other in their mutual understanding of a certain topic (Rogers, 1986). Also, field results show that a high level of shared understanding may moderate the expected negative influence of a low level of IT implementation success as both parties understand and respect each other's contribution and trust that each is giving their best effort (Reich & Benbasat, 2000).

### **C. Intellectual dimension**

#### **4.9. Alignment of business and IT strategy/goals/plans/...**

Having a clear and deep understanding of business goals and how IT goals and process support those goals is important for any organization trying to improve its business-IT alignment. Every organization should own clear business goals and a related business strategy, communicated to and adopted by the entire organization. However, data from the field account that in practice this is not always the case (Van Grembergen, et al., 2005; Benson, et al., 2004).

Ideally, the business plan and information systems plan, both products of the corporate planning function, should be linked by mapping IT strategies directly to one or more business strategies in a manner that optimizes the return to the organization (King, 1978; Calhoun & Lederer, 1990). By aligning the business plan and the IT plan, information resources support business objectives and take advantage of opportunities for the strategic use of information systems (McLean & Soden, 1977; McFarlan, 1984; Zviran, 1990; Premkumar & King, 1992).

Nfuka and Rusu (2010) argue that just having the business and IT plans *per se* is not enough. Further improvement to have and align business-IT strategies and cascade them down in an organization is critical for business-IT alignment and can lead to more widespread use of IT (Henderson & Venkatraman, 1993; Nfuka & Rusu, 2010).

#### 4.10. IT Success

The problem of IT's inability to meet its commitments has plagued businesses since the introduction of the modern computer systems. Information systems that fail to satisfy users' needs are frequently underutilized and are a waste of the organizations' valuable resources. Business executives and end-users become increasingly upset that projects are late and over budget. Recent studies suggest that only 32% of IT succeed (finished in time, within budget and satisfying requirements) and this rate gets even lower for bigger projects (The Standish Group, 2009). While most of the problems with projects that fail are not technical, still they have a significant impact on the credibility of IT department and the confidence line managers have in the competence of IT departments (Lucas, 1975). The quality of services provided by the IT personnel play a crucial role in determining business users' working relationships with IT department (Senn, 1978; Brown, 1991). Luftman et. al (1999) noted that failure of IT department to meet its commitment is mostly the result of not adhering to basic project management disciplines, and not having a business-IT relationship that facilitates business participation in all aspects of the project. Hence, if business executives do not have good perceptions of the IT department due to poor track record, it becomes more difficult for them to share and formulate business strategies jointly with the IT department (Teo & Ang, 1999). Reich and Benbasat (2000) argue that IT department success will influence the communication between business and IT executives. Accordingly failed or failing IT projects would result in finger-pointing, reduced levels of communication, and low levels of business-IT alignment (Reich & Benbasat, 2000).

**Table no. 4: Critical Success Factors dimensions and relevance**

Nr.	Human Dimension	Teo & Ang 1999	Luftman et al. 1999	Reich & Benbasat 2000	Khandelwal 2001	Nfuoka & Rusu 2010	Aggarwal 2010
1	IT skills and knowledge of business executives	•	•		•	•	•
2	Top management commitment	•	•			•	•
3	Business skills and knowledge of IT executives	•	•		•	•	
4	Leadership skills of IT executives	•	•			•	•
5	Technical skills and knowledge of IT employees	•					

Nr.	Social Dimension						
1	Shared understanding of business and IT executives	•		•			
2	Mutual trust and respect between business and IT executives	•	•	•			•
3	Business - IT Partnership	•	•			•	
Nr.	Intellectual Dimension						
1	Alignment of business and IT strategy/goals/plans/...					•	•
2	IT Success	•	•	•			

## 5. Conclusion

Business-IT alignment has shown on researchers' agenda since the mid '70 and it still remains as one of the three main research streams in IS literature. In last three decades it constantly ranks among the top three concerns of CIOs (Luftman & Kempaiah, 2007; Luftman & Ben-Zvi, 2011) and it is seen as a basic premise to achieve business value from IT (Henderson & Venkatraman, 1993; Kearns & Lederer, 2000). However, only few studies have investigated the critical success factors that need to be considered by top management in their endeavor to improve and sustain business-IT alignment. Results show that most of the critical success factors identified by researchers are related to the human dimension. This asks for the organizations to put more efforts on developing the individual skills and knowledge of its employee, especially on the IT skills and knowledge of business executives. Business-IT alignment is a collaborative undertaking. Neither business nor IT can achieve any progress without the cooperation and commitment of the other. Accordingly, creating a social environment of mutual trust based on mutual commitment and a stable long-term partnership between them would greatly improve their respective work and collaboration with each other.

## 6. Limitation and future research

Most of articles included in this review are mainly researched through the views of senior managers. Thus the view of managers at tactical and operational level, that reflects the reality people face in day-to-day implementation of the strategies are not considered. While the identified CFSs can serve the strategic level it is important to have a clear view and understanding on the CFSs on the tactical and operational level.

Not all factors are equal and some have a much greater influence on success than others (Pinto & Mantel, 1990). Reich and Benbasat (2000) found that a high level of shared understanding would moderate the expected negative influence of a low level of IT implementation success as both parties understand and respect each other's' contribution and trust that each is giving their best effort. Based on these arguments it would be of great interest to investigate and understand the effect of one dimension's CFSs onto the other dimensions' CFSs and vice versa.

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## EFFECTIVENESS OF REMITTANCES IN IMPROVING THE WELL-BEING OF ALBANIAN FAMILIES

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### **Abstract**

*Massive immigration of the active labor force or “brain” of Albania had its effects following the period of collapse of communism in 1991. Since the first years, net incomes of the immigrants for their families influenced the improvement of miserable economic conditions during that period. In this study, through empirical revision, quantitative analysis of data and theoretical study of literature sources and different authors, we have explored the impact they have on the immigrants’ revenues in reducing poverty and socio-economic challenges among the Albanian families during the global crisis.*

**Keywords:** immigration, effectiveness, remittance, socio-economic development, global crisis.

**JEL Classification:** F24.

### **1. Introduction**

In 2004 the Bank of Albania estimated that the flow of remittances of migrants was 13.5% of GDP of Albania. According to ODA (Official Development Assistance) during that period the remittances of immigrants were three times higher than foreign direct net investments and doubling official development assistance received by Albania (Bank of Albania, 2005)

It is clear that global economic crises had a significant impact in Albania in terms of reduction of remittances. Many studies expressly indicate this finding and the fact that decline of remittance flows may be also due to a natural cycle of migrants’ deliveries, i.e, the larger the number of years of migration, stronger is immigrants detachment from their families of origin due to socialization with the country they live, raising a new family in the country where they have migrated, considering the migration country as a second homeland, regular employment reducing net incomes compared to illegal labor or beginning of studies for younger people etc (Pulaj, 2011). Facts are important; some classify Albania among main countries of the source of remittances, consequently they are deemed as a vital tool for country development and reduction of absolute poverty. On the other hand, reportedly remittances do not reach the poorest individuals as a result of high

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migration costs and so they may have a negative impact on inequality. Even the scale of dependence on remittances at micro and macro level constitutes another concern.

Further, this study will introduce empirical and theoretical data to be collected by surveys with randomly selected interviewees who have become part of our study. Theoretical survey will be realized through the review of literature sources and modern authors, as well as statistical data retrieved until 2010 from other private and public associations and agencies.

By this study we will give a clear overview of influence that remittances have or not on poverty reduction and the way how they will be managed. Similar basic sources are used such as the Albanian legislation on labor market, reports of World Bank, UNDP, ILO and INSTAT, Bank of Albania, IMF and other well known authors. The study will include statistics about the number of migrants and net incomes from their remittances. Further, it will highlight issues related to delivery of incomes from migrants and their management. The study will be finalized with conclusions and recommendations of authors obtained from theoretical and empirical results of the study which will contribute to the field of studies on remittances and their management.

## 2. Literature review

The high level of remittances registered until 2008 has generally reduced poverty effects and high level of unemployment. Although the level of migrants' remittances has significantly decreased, they still have a positive impact and play a crucial role for the macroeconomic stability of our country, maintenance of standards of living and alleviation of poverty. These are at least the findings of statistics and surveys of the Bank of Albania and INSTAT.

Alternatively, remittances in Albania have been instrumental to avoid the high level of unemployment through massive immigration of qualified and unqualified workers, especially to Greece and Italy (IMF, 2008). During the period 1998-2003 remittances constituted 10-22 % of GDP, thus representing the main source of foreign currency in Albania (UNDP, 2005; IMF, 2005). In 2004 they represented about 13.5 % of GDP (AGENDA, 2010) while in 2007 the remittances were at the level of 12-13 % of GDP (Bank of Albania, 2008; UNDP, 2008).

According to AGENDA Institute, the Albanian migrants who are mainly settled in the area of European Union are the main senders of remittances with 90.7 %. To a wider extent, the origin of remittances lies in the neighboring countries such as Greece by 41.9 % and Italy by 38.6 %. About 8.1 % of remittances derive from the United States of America (AGENDA, 2011).

There are different theories on reasons of increase, decrease, positive or negative effects that may be caused by income deliveries of migrants to their countries of origin. Although there are disputes and contradictions between the results of different studies, it is generally believed that remittances have a positive impact on the economy of beneficiary countries. A higher level of demand for goods and services is one of the effects of migrants' remittances (Pang, 2008). Regarding

the effect of remittances on economic growth, many studies have concluded that remittances have a positive impact (Faini, 2003; Ekanayake, 2008). However, other studies question this conclusion or have found a negative impact of remittances on economic growth (Chami, 2005).

At micro level, remittances play a vital role for improving the life of beneficiary families. Cash amounts received from remittances are used to pay the received debts to immigrate or for education and to buy more products, in order to make more investments in business and finance education or health services (Rapoport and Docquer 2006). A study in Guatemala has found that families which receive remittances from abroad spend more for investment goods such as education and houses than for consumables (Adams, 2005). Other studies have reported similar positive effects of remittances as for instance the enlargement of entrepreneurship activity in beneficiary families (Yang 2004; Woodruff and Zenteno 2001). On the other hand it seems that the beneficiaries of deliveries reduce their efforts to look for job due to increased incomes (Frank, 2001).

Studies conducted with data about remittances in Albania provide information about the effects of remittances on different aspects of life within the beneficiary families. The results of (Carletto, 2008) demonstrate that immigration of men may cause the empowerment of women through their wider access to employment or self-employment opportunities. In Albania the remittances are mainly used for primary needs and have a mutual relationship with the level of education of senders and beneficiaries (De Souse, Duval, 2009). However, remittances have positive effects on the level of satisfaction of beneficiaries with the general situation (Duval & Wolff, 2009; AGENDA, 2011).

Extensive research is carried out on the microeconomic motives behind remittances that distinguishes between three basic motives for remittances; pure altruism, pure self-interest and informal agreements with family members left in the home country (Smith, 2003; Solimano, 2004; Rapoport and Docquier, 2006; Adams, 2009; Shahbaz and Aamir, 2007; Alba and Soraya, 2009; Shera, Dosti and Shehaj, 2010). The altruistic model hypothesises that the amount of remittances should increase with the migrant's income, decrease with the domestic income of the family, and decrease over time as the attachment to the family gradually weakens and increase when the home country currency depreciates (Shera, Dosti and Shehaj, 2010).

Jongwanich in 2007 studied the impact of remittances on poverty by decomposing its effect into direct and indirect components, and found that remittances directly reduce poverty through augmenting family incomes, and indirectly through the growth and human capital effects of remittances. He concludes that remittances can generate income even for families who receive no remittances at all mainly through the multiplier effects of expanded spending and such multiplier effect can lead to poverty reduction even for some poor families do not directly get remittances inflows (Jongwanich, 2007). Research suggests that a significant portion of remittances is spent on consumption and a smaller part is saved or invested

(Adams, 2004). Remittances may help families to engage in several investment opportunities including investment in human capital, entrepreneurship and property.

Research on the macroeconomic determinants indicates that remittances respond to changes in the interest and exchange rate differentials between home and host country (Glytsos, 2001; Ratha, 2003; Yang, 2004; Shera, Dosti and Shehaj, 2010). These changes may also affect the timing of remittances for investment, which may indirectly effect poverty reduction (Shera, Dosti and Shehaj, 2010).

Theoretical literature on remittances is mainly focused on three aspects; 1) Motives and determinants of remittances, 2) Use of remittances, 3) Impact of remittances on poverty and inequality. According to the first aspect, the most common and acceptable motive to return money in the family is altruism as the immigrants are concerned about the well being of family members they have left in their home country. (Start and Lukas, 1985).

Regarding the second theoretical aspect on remittances, many researchers argue that the about 2/3 of remittances are used for consumption, mainly for food and the rest for housing (Massey and Parrado, 1994). Various studies about this aspect of remittances have concluded that even in other countries as Greece, remittances are used for food and housing (Glytsos, 1993). A case study in China has reported that remittances go for investments and savings. (Zhu, 2006). A study conducted in Pakistan during 2001-2003 drew the conclusion that remittances are used for investments in physical capital such as agricultural machinery, agricultural land and human capital as education or schooling (Mausuri, 2007).

According to the third aspect on impact of remittances on poverty and inequality, there are different study perspectives and results. A regression analysis on data taken from 40 villages in India, revealed that immigration increases rural inequality within and between villages. Attraction of migration allows the best immigrants to advance with better jobs while the postponement of immigration weakens the poor. The most common senders of incomes from migration work rarely come from poor rural areas. Accordingly, it is less likely that remittances may influence the reduction of rural poverty (Lipton, 1980). However, according to another study in Egypt, international remittances have a minor but positive effect on poverty. Results show that the number of families living in poverty is reduced by 9.8% when the forecasted per capita incomes of families include remittances which are estimated at about 14.7% of the total incomes for poor families. However, when remittances are included in forecasted per capita incomes of families, inequality is increased (Richard, 1991; Adams, 1993). In a study carried out by IMF for 101 countries during the period 1970-2003, there are similar conclusions as the result has suggested a very strong link between poverty and remittances. However, the impact may seem economically insignificant: 2.5% increase in the ratio between remittances/GDP is related to 0.5% reduction of poverty for people who live in poverty. (IMF, 2005)

As regards the case of Albania for distribution of remittances, following the observations it has resulted that remittances from immigrants represent 13 % of

average family incomes while for host families they represent 47 % of family incomes (IMF, 2005). 87% of the total remittances are sent by family members who had left their families since 1990. The rest of 13% is sent by friends or acquaintances (World Bank, 2008). Evidence on impact of remittances on poverty and inequality for Albania vary, depending on areas, migration models and poverty dimensions.

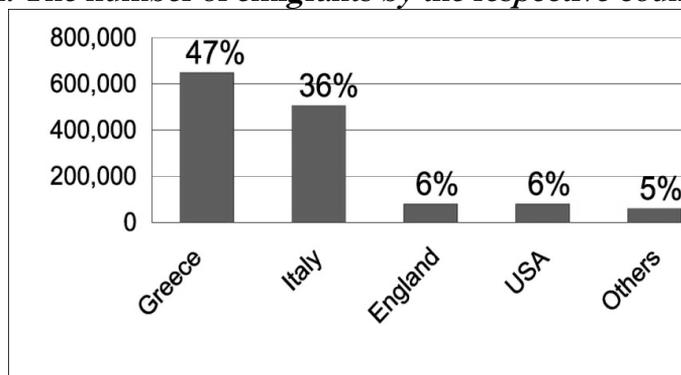
### 3. Research methodology

The research methodology employed is the quantitative one, where data are collected through the conducted surveys and analyzed by the statistical program SPSS. Quantitative research method will be based on numerical data introduced in the form of statistics and collection through the designed questionnaire and define the measurement accuracy. It is based on figures and concise statistics, both objective and deductive. Data will be collected from the surveys carried out through the questionnaires. Assumptions made regarding the study are as follows:

$H_0 \Rightarrow$  Albanian families are not subject to a reduction of poverty due to remittances.

$H_A \Rightarrow$  Remittances reduce poverty of the Albanian families.

***Tab.1: The number of emigrants by the respective country 2010***



The sample population is selected according to the interests of this study, setting some a sample population only persons who: 1) live and work in Greece, Italy, England, USA 2) persons who have travelled by airlines during August 2012, 3) and persons who have arrived in Albania during the timetables 08.00-20.00 (aircrafts landed to “Mother Theresa” Airport after that time have not been taken into consideration for our study). According to the World Bank, the largest percentage of the Albanian migrants as demonstrated by the graph, is focused in countries such as Greece, Italy, England, USA and 5 % in other countries (World Bank, 2010). Therefore, the sample population covers immigrants living and working in those countries. The selected sampling is randomly layered where each individual has equal opportunity to be part of this study falling within the sample characteristics. It is deemed random as the selection of case studies was 1 in 5 migrants crossing the only entry gate of the airport of Albania, who are supposed to live and work in the

countries specified above. Meanwhile, the layering of sample population consists of the fact that people selected for the study are those travelling by the airline to “Mother Theresa” airport, with destination Tirana/Albania, who have arrived only by the airlines Greece-Tirana, Italy- Tirana, England-Tirana and Munich-Tirana (Munich of Germany was selected as it is one of the largest transit lines of the world, where some of the migrants who have come from the USA or Canada to Tirana, have Munich and then Tirana as the first stop). As mentioned above, this layering is caused by the number of migrants in those countries. Based on these percentages it was reached a decision to interview 47 migrants travelling by airlines Greece- Tirana, 36 from Italy-Tirana, 6 from England-Tirana, 11 migrants to be interviewed from the transit airline Munich-Tirana. The total number of persons identified of interest for our study was agreed to be 101 migrants interviewed, where all interviews were conducted during August 2012.

Due to the failure to conduct long interviews and for the purpose of study convenience, the survey used for the interviewing of selected respondents included 19 alternative questions. The questionnaire was structured where the same questions were applied for the whole sample population. The first questions were of demographic character being further expanded with main questions of our study such as: What are the average monthly incomes of relatives living in Albania? What is the average amount of monthly remittances of migrants sent to their relatives living in Albania? Who are the closest relatives living in Albania? Which city or town are they from ...etc.

Indeed, our study has attached proper importance to the principles of study ethics such as: informed consent is the process of explicitly asking the permit of the subject to be participant in the study, based on his full understanding of the interviewing procedures and its purpose (Blanche and Durrheim,1999; Gubrium, 2002). The confidentiality includes an agreement from the applicant to protect the privacy/anonymity of the study participants (Gubrium, 2002). Reporting of results: Study results should be published taking special care of the participants’ rights. At no time the information provided by study participants should be misinterpreted or distorted (Gubrium, 2002). In this study we ensure that the results are fully based on the data obtained from the study participants.

#### **4. Empirical data analysis**

As we already mentioned, we aimed to carry out 101 surveys with the sample population specified above. During the implementation of surveys with 101 subjects selected for our study sample, 87 surveys/interviews were made available for the purpose of analysis. According to a previously reached agreement, a prerequisite for data analysis included only data obtained from the surveys with subjects/persons who do not interrupt the interview until the end of the questionnaire and persons who refuse this survey would definitely not be part of data analysis. Accordingly, out of 101 planned surveys, 12 were not realized due to refusal of the selected subjects in

terms of data collection process. Meanwhile, data obtained from another subject were not taken into consideration due to their low rate of validity.

This person returned to Albania after having served 10 years of his imprisonment sentence in Italy. The respondent in question had lived and worked in Italy for only six months and further he was sentenced by the Italian authorities by a term of 10 years of imprisonment. The data provided by him did not meet the requirements of our study as specified above; therefore they were not taken into account in data analysis. Consequently, it follows that only 87 surveys were taken into consideration for the further data analysis.

All our variables were analyzed through SPSS program, where we will introduce the analysis and relationship between key study variables determining the refusal or not of null hypothesis. Hence, the questions made to the respondents such as age, gender, employment, monthly incomes of their families living in Albania and incomes sent due to work in migration (remittances) etc., are analyzed as shown below in Table 2 and Table 3, to check the frequencies and relationships between them and respectively between the variables of Averagmonth and Monthinc that are respectively the monthly incomes for each family due to work of migrants, and monthly incomes of the Albanian families provided by the employment in Albania of their relatives.

As we will see the table 2 reports that for 35 cases/subjects, the amount of incomes generated from migration, i.e remittances, prove to amount to 20.000-40.000 ALL, where this amount is uniformly distributed for different values of monthly incomes of the Albanian people employed in the country. In this framework, for one case that amount was added to the incomes of less than 10.000 ALL earned from the local employment. In 7 cases, remittances at 20.000-40.000 are added to the value of 10.000-20.000 of incomes from the local employment. In 17 cases which is also the highest frequency, with monthly incomes of 20.000-40.000 ALL, the same amount of remittances per month is added, where it follows that the total of family incomes is doubled. According to table 2, the amounts of incomes from migration work reaching the Albanian families, amount to a maximum of 10.000-20.000 ALL per month with 22 cases and 20.000-40.000 ALL per month with 35 cases.

***Tab.2: (Monthinc \* Averagmonth Crosstabulation)***

	Averagmonth							Total
	Less than 10,000 ALL	10,000 – 20,000 ALL	20,000 - 40,000 ALL	40,000 – 60,000 ALL	60,000 – 80,000 ALL	More than 80,000 ALL	I don't send income	
Less than 10,000 ALL	0	0	1	1	0	0	0	2
10,000 – 20,000 ALL	1	1	7	1	1	0	0	11
20,000 - 40,000 ALL	6	13	17	4	1	1	0	42
40,000 – 60,000 ALL	3	4	7	2	0	0	0	16
60,000 – 90,000 ALL	5	4	3	1	0	0	1	14
More than 90,000 ALL	1	0	0	0	1	0	0	2
<b>Total</b>	<b>16</b>	<b>22</b>	<b>35</b>	<b>9</b>	<b>3</b>	<b>1</b>	<b>1</b>	<b>87</b>

*Tab.3: (Gen \* Averagmonth Crosstabulation)*

	Averagmonth							Total
	Less than 10,000 ALL	10,000 – 20,000 ALL	20,000 – 40,000 ALL	40,000 – 60,000 ALL	60,000 – 80,000 ALL	More than 80,000 ALL	I don't send income	
male	7	15	24	6	3	1	1	57
Gen fema le	9	7	11	3	0	0	0	30
Total	16	22	35	9	3	1	1	87

In the meantime, table 3 identifies the incomes of migrants' work according to gender considerations. This table demonstrates that remittances have higher rates from the migration work of male subjects, where out of 87 respondents, 57 subjects/males bring incomes to their families, where for the most frequent amount of 20.000-40.000 ALL per month, the number of males is 24 compared to 11 females.

Referring to the above table 4 which demonstrates the link between the perception about well being and incomes generated from the migrants, we note that 73 out of 87 interviewees are classified into the group of lowest level of remittances in Albania, i.e 20000-40000 ALL per month. The average remittance of a migrant into the first group of incomes is about 30.000 ALL that is approximate to the monthly salary of an employee in Albania (registered as such). From this perspective we reinforce the above conclusion that the main cause of migration in Albania during recent years is the low economic level.

If we focus on the interviewees of the first group but from the perspective of how they perceive well being, we reach the conclusion that they are moderately optimistic about the increase of well being, since the percentage of interviewees who answer in favor of the increase of well being is a little higher than the one of interviewees who give a negative answer.

We deem that the main part of incomes sent from the migrants is used to meet basic living needs and barely for its improvement. This does not apply to the interviewees of the second group of remittances. Considering that their remittances are higher, their perception about the increase of well being is very optimistic. 100% of interrogated persons have been in favor of the well being. In general terms, the perception about well being which indirectly implies poverty reduction from migrants, is positive.

An analysis of the variable on question for which remittances are spent, clearly explains that they have influenced the upgrading of economic level. However, the cross-tabulation analysis between remittances and the way how they are spent, clearly demonstrates that these incomes are used for minimum living conditions such as food, clothing, medicaments or medical examinations, where tab.5 shows that about 84 % of incomes up to 40.000 ALL from migration are used for living needs or

requirements, 13.8 % are used for house construction or refurbishment or for starting a business and only 1.1 % are saved in bank accounts or they are subject to informal methods.

In the meantime, methods of delivery of remittances basically remain the informal ones, where most of the respondents have admitted that they send them through their relatives or acquaintances or when they come to Albania and about 47 per cent acknowledge they use Western Union or Express Mail.

**Tab.4: Standliving \* Averagmonth Crosstabulation**

			Averagmonth				Total
			20,000 - 40,000 ALL	60,000 – 80.000 ALL	More than 80.000 ALL	I don't send income	
<b>St</b>	Yes, they have influenced	Count	37	12	1	0	50
	to a high degree	% within Averagmonth	50.7%	100.0%	100.0%	0.0%	57.5%
<b>n</b>		Count	36	0	0	1	37
	No, they have not	% within Averagmonth	49.3%	0.0%	0.0%	100.0%	42.5%
<b>ivi</b>		Count	73	12	1	1	87
	influenced to a high degree	% within Averagmonth	100.0%	100.0%	100.0%	100.0%	100.0%
<b>g</b>		Count	73	12	1	1	87
	Total	% within Averagmonth	100.0%	100.0%	100.0%	100.0%	100.0%

**Tab.5: Averagmonth \* Spendincom Crosstabulation**

			Spendincom			Total
			Food / Clothing	Construction/p urchase of a new house	Savings in a bank account	
	20,000 - 40,000 ALL	Count	58	9	6	73
		% within Spendincom	90.6%	69.2%	60.0%	83.9%
<b>Averagmonth</b>	60,000 – 80.000 ALL	Count	5	3	4	12
		% within Spendincom	7.8%	23.1%	40.0%	13.8%
	More than 80.000 ALL	Count	0	1	0	1
		% within Spendincom	0.0%	7.7%	0.0%	1.1%
	I don't send income	Count	1	0	0	1
		% within Spendincom	1.6%	0.0%	0.0%	1.1%
<b>Total</b>		Count	64	13	10	87
		% within Spendincom	100.0%	100.0%	100.0%	100.0%

During the study we were interested to examine or prove the hypothesis whether in Albania the remittances influence poverty reduction. Considering that the perception of migrants about poverty may be more challenging, via the questionnaire we have asked them about the well being and its improvement, therefore the hypotheses we have raised have been as follows: H0: Remittances do not influence the improvement of well being. HA: Remittances influence the improvement of well being. Referring to the above paragraph, the foregoing hypothesis is equal to the following one: H0: Remittances do not influence poverty reduction. HA: Remittances influence poverty reduction.

*Tab. 6: Chi-Square Tests*

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	12.347 <sup>a</sup>	3	.006
Likelihood Ratio	17.472	3	.001
Linear-by-Linear Association	5.506	1	.019
N of Valid Cases	87		

a. 4 cells (50.0%) have expected count less than 5. The minimum expected count is .43.

To verify the hypothesis we have applied the chi –square test (based on cross tabulation) with an importance level of  $\alpha=0.05$ . The results of processed data are given in the following table. On the basis of the foregoing we note that Asymp. Sig=0.006 . Given that A.Sig = 0.006 is smaller than  $\alpha=0.05$ , then the basic hypothesis H0 is rejected and the alternative hypothesis is accepted, arguing that remittances influence poverty reduction.

## 5. Conclusions

Remittances are far from the solution they are supposed to provide. However, they generally have a positive impact on main development aspects, including the creation of human capital, investments, poverty reduction and macroeconomic stability, and even social and political changes.

As a result of the whole analysis of data processed through SPSS-s, it becomes clear that remittances have positive effects on the Albanian reality. Yet, on the other hand, as their consequence women or even men representing active labor force because of additional monthly incomes from remittances, apparently do not develop their competitive skills in the labor market and remittances are used only as a safe means of living.

Firstly, remittances have reduced efforts to find a job. Most of women from families with continuous remittances are unemployed. Secondly, there are reduced efforts for work in agriculture and technology or in other beneficial sectors. The families benefitting remittances generally prefer a more comfortable life. Consequently, the percentages of domestic products are reduced. Thirdly, a real assessment of remittance figures is challenging due to informal deliveries, therefore the effective management and formulation of programs and policies for them has been hard for the Albanian State.

We emphasize that the Albanian Government should encourage investments of remittances in small businesses, to further continue the improvement of subsequent

infrastructures for the development of those businesses. Without these conditions the migrants will find it hard to risk their capital under unsafe business conditions. The government should channel this money to productive and active investments for labor forces. Further, the facilitation of job mobility between the place of source and destination of remittances is probably the most important tool for the increase of inflows of deliveries for developing countries such as Albania and this is realized through the increase of agreements on good migration policies in the host countries of migrants.

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## REGIONAL INTEGRATION AND INTERNATIONAL COOPERATION: BETWEEN WISHES AND REALITIES

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### Abstract

*The first decades of the 21<sup>st</sup> century witnessed the intensification of the regionalisation and globalisation processes as well as the manifestation of an economic crisis without precedent. These specific conditions precipitated the trend towards a multi-polar world characterized by the coexistence and interaction of three type of particular players: nation states, regional and global type organisations with various degrees of integration. These actors are acting in view of providing solutions for food and energy problems as well as for reducing the development gaps between developed and developing countries. A conclusion of the paper is that there is a growing interest for regional integration in all developing areas of the globe: Africa, Asia, Latin America. Specific forms of integration processes are currently taking place in the ex-soviet space. A final conclusion is that all these processes are more complementary in nature than conflicting.*

**Key words:** regional integration, globalization, geo-strategic partnerships, food and energy security

**JEL classification:** F15, F53, F55

### Reflections on the new architecture of international economic relations

A profound analysis on the evolution of international relations in the first decades of the 21<sup>st</sup> century both from the point of view of real elements and of the philosophical implications reveals fast and profound changes at the level of the large geo-economic and strategic spaces of the world economy.

These changes that take place in the context of globalization are correlated with a deepening of the interdependence between all participants in the world economy and led to a number of significant conclusions:

- Globalization as an essential phenomenon in the evolution of humankind and the complementary coexistence of organizations of regional integration. The current characteristics of globalization are given by the technological and information explosions, the increase and liberalization of trade and investment flows, the globalization of capital, the internationalization of production, the increase of the role of transnational corporations, as well as the evolution of the ecological economy from the status of mere alternative to that of fundamental component of sustainable development.

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- Reality of a multipolar world due to the economic and political and diplomatic emergence of China, India, Brazil, South Africa, among some other important economies. According to some scenarios which can be regarded as plausible the world economy of the future will consist of a number of large centers of world power which will determine the rules of the game and around which will gravitate the developing economies and the economies being a state of permanent transition that will lack negotiation and decision power<sup>2</sup>.

We have to notice that nowadays, at the beginning of a new millennium and century the world economy can no longer be regarded as being divided between “first world” (focused on production and marketing of high quality products based on technological development) and the “third world” (traditionally producing and exporting raw materials, with an import substitution industry and a subsistence agriculture).

The superiority of the developed world is based without any doubt on the fact that it owns the main financial levers, such as the International Monetary Fund and the World Bank and, in this way, managing the international financial flows. At the same time, the most performing economies are the ones that integrated faster in the world economy<sup>3</sup>.

- The generalization of the idea that the disfunctionalities from the world economy, the speed and intensity of external shocks, as well as the interests of the great powers make more difficult the solving of the “international files” related to trade, investments, environment and regional security;

- The perception of a “resistance” to mondialisation, fact generated by the attempt of many states of reducing the social protection budget as result of high international competition. The phenomena of unemployment, inequalities in distribution of income, marginalization and disadvantage of certain social categories generate a perception that these negative effects are due to mondialisation.

Professor Thierry de Montbrial stated that according to the market paradigm “structural unemployment cannot be eliminated but by adaptation to labor market to the conditions of current times and observing the supply and demand law<sup>4</sup>.”

### **Food and energy security – priorities of development**

The elimination of poverty continue to remain a major objective of the international community, given the fact that till now efficient solutions for the economic and financial difficulties that exist in numerous countries, particularly in Africa and Asia, could not be found.

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<sup>2</sup> Elizabeth Dickinson, *New Order. How the multipolar world came to be*, Foreign Policy, November/December 2009

<sup>3</sup> A. Globalization of Industry: implication for developing countries beyond 2000. Raport UNIDO, Viena, dec. 1996

<sup>4</sup> Thierry de Montbrial „Acțiunea și sistemul lumii”, Academia Română, Fundația Națională pentru Știință și Artă, Ed. Expert, București, 2003, p. 328

These problems are often generated by the neglect of the agricultural sector as well as the orientation of this sector in some case towards a structure of production that is not adequate from the point of view of internal demand and it is not correlated to external demand.

One of these cases is represented by the Sub-Saharan Africa where agriculture, which is also affected by the climate conditions, does not cover but in a small extent the internal demand and leads to a very high “food invoice”. A great number of countries from Africa and Asia are confronted with major difficulties related to their trade and payment balances and are forced to ask for international assistance, “food assistance” respectively. Unfortunately this food assistance became less relevant given the fact that during 2005 – 2012 the cereal stocks at a global level were drastically reduced.

The solving of these problems has become a major objective and this requires a better correlation of national and international efforts for the reduction of economic gaps between the developed North and the developing South.

Under these circumstances the European Commission proposed the acceleration of the modernization of the agricultural sector in the Community in order to reduce the effects of the increase of international prices for agricultural products and to cover to a larger extent the internal demand from own sources.

It was estimated that in order to cover the whole demand for food the world production would have to increase by 50 % until 2030 and then to double in the next decades in order to cope with the rhythm of world population growth, population expected to reach 9 billion by 2050.

The concept of food security is nowadays accompanied by another dimension, that of world energy security. This concept emerged in the context of the existence of strong disfunctionalities in the fields of energy production and trading as well as disequilibria in the supply – demand for energy in the international market.

The provision of the necessary amounts of energy is conditioned, according to experts, by maintaining a reasonable and constant level of the production of oil, natural gases, nuclear and hydro energy, while maintaining costs at a bearable level.

Starting from the idea that there is no crisis of energy resources at world level we appreciate that the major problems related to energy security and the transfer of efficient technologies for energy exploitation to the countries confronted with major difficulties can be solved by implementing efficient programs for capitalizing the known and potential resources available in a great number of countries. The implementation of these programs is anyway conditioned by the attraction of an important volume of investments.

A fundamental dimension for the development of the world economy is also represented by ecology, that is the viable solutions for the acute problems related to environment degradation. The human civilization is affected both by unforeseen climate conditions, but also by the most important erosion factor for planet Earth that is Man himself who quite often affects the natural equilibrium.

The solving of environment problems needs a collective answer that may be found within the United Nations Organization and in other specialized institutions, having as starting point the World Conference on Environment from Rio de Janeiro (1992) and the Kyoto Protocol (regarding emission of gases that produce the glass house effect).

On the occasion of the Rio de Janeiro Summit the chiefs of state and government stated the “need to redirect investments and adjust economic policies towards the increase in the use of some alternative energy sources, at the same time with increasing energy efficiency in the sectors that use large amounts of energy, such as industry and transport”<sup>5</sup>.

An important role in the evaluation of the causes and mechanisms related to climate changes and also for finding solutions to alleviate the catastrophic effects of natural phenomena is given to the modern telecommunication systems. Experts state that the relation “space technology – geopolitical structures” can be translated in the capacity of technology to offer complex information about planet Earth and disseminate messages without affecting the base of the national sovereignty<sup>6</sup>.

We have to admit the almost general opinion that the surveillance and management of environment as well as the use of space technologies for humanitarian reasons should represent priority fields for international cooperation.

### **Information and technology explosions as supporting factors of globalization**

The impact of the technological and informational explosions on the evolution of the world economy is manifesting in the revival of industrial structures and in the increasing of the intensity of trade and financial flows at a global level.

The internationalization of industrial production offers a favorable framework for the development and implementation of performing technologies both in developed countries and in developing ones from Africa, Asia and Latin America. The resizing of the technological flows reflects, according to professor J.F.Daguzan, the evolution from the military style economy to the civilian style economy, characterized by the gradual transfer of certain prerogatives, in many fields of activity, from the state to the private sector, for financial and efficiency reasons<sup>7</sup>.

The analyses and reflections regarding the ratio between the public and private sectors in a performing economy allows us to say that in the context of globalization the state is losing some prerogatives regarding decision making, but its role continues to remain significant in some strategic fields of economic life (such as infrastructure,

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<sup>5</sup> Florin Bonciu, Gabriela Baicu, „Economia mondială sub lupă”, Ed. Pro Universitară (Universitatea Româno-Americană), București, 2010, pag. 96, 205

<sup>6</sup> Lebeau André, „Tehnologia spațială și mondializarea”, în revista *Observation et Theorie des relations internationales*, Institutul Francez de Relații Internaționale, Paris, 2001

<sup>7</sup> Jean Francois Daguzan, „Technologie et mondialisation”, în *Revue Géoeconomie*, nr. 20/2001-2002, Institut Européen Géoeconomie, Paris, 2002, pag. 9

energy, defense, environment), as well as in the area of technological research and development<sup>8</sup>.

An area of particular interest in the “competition” between the public and private sector refer to space technology, particularly in case of great technological powers such as USA, Russia, China, Japan, Germany, France, Great Britain), but also in some emerging countries with a huge economic potential (Brazil, India, South Africa).

When we analyze the relation “states – regional integration” from the point of view of rethinking the degree of autonomy we have to take into account the new coordinates of the scientific and technical cooperation among states which is needed in order to secure an efficient joint use of the existing resources particularly for very large scale projects and for avoiding duplication of research efforts<sup>9</sup>. In this field, due to globalization and the increase of the size and economic power of some transnational corporations there is a need to better coordinate national policies and regulations with transnational corporations activities.

### **Role and place of transnational corporations and foreign direct investments in the world economy**

Transnational corporations represent main sources of capital and technology and they have an important impact on the localization of economic activities at the global scale, facts that enable them to have a real economic power as well as political influence<sup>10</sup>.

In the analysis of the expansion strategies of transnational corporations we appreciate as relevant the approach of professor Dumitru Miron that states that “globalization is the one that dictates to the corporations the strategic decisions, including the ones referring to internationalization, and the corporations implement such strategies in cooperation with specialized national organizations.” According to his opinion the transnational corporations have in view to appropriate ownership or the control of assets which used to belong to some national economic agents<sup>11</sup>.

A dynamic factor that contributes to economic growth is represented by foreign direct investments which complements the local capital in all countries of the world, with certain differences, function of the economic potential and the absorption capacity of the directly productive sectors, of the qualification level of labor and function of the incentives provided by the host economy.

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<sup>8</sup> Idem.

<sup>9</sup> Erna Hennicot-Schoepges, „Rèperes d'un engagement public” (Sciences et Technologie), Ed. Academiei Române, București, 2008, pag. 44

<sup>10</sup> Robert Gilpin, „Economia mondială în secolul XXI – provocarea capitalismului global”, Ed. Polirom, București, 2004, pag. 132-133

<sup>11</sup> Dumitru Miron, Ovidiu Folcuț, „Mediul internațional de afaceri”, Ed. Universității de Petrol-Gaze din Ploiești, 2005, pag. 71-72

The presence of foreign investors in the priority sectors of the national economies is conditioned by the degree of regional security and by international economic outlook that can influence in the short and medium term the activity of the investors and the efficiency of the investment (by such factors as labor cost, increase of productivity, etc.).

### **Prospects of regional integration: comparative elements**

The deepening of the process of interdependence between globalization and regional integration – with openings towards cooperation and partnerships – represent the fundamental condition for the revival of the world economy, with impact on the reduction of gaps among the countries of the world and on the acceleration of the reform programs and of the democratization of the economic and social activities.

Regional agreements represent – both *de jure* and *de facto* – efficient instruments for the promotion and harmonization of the economic and political national options, provided that they do not contradict the fundamental principles of the liberalization of trade, technology and financial flows. Within the globalization – regionalization equation the fundamental issue remains to evaluate to which extent these two phenomena that mark the evolution of international relations are complementary or contradicting<sup>12</sup>.

This dilemma could be solved if we agree with the reflections of some reputed scientists and culture persons that state that “it is more and more evident that globalization represent the main trend in the evolution of humankind<sup>13</sup> and that regionalization (regional integration cooperation) amplifies the objective efforts of the participants for modernizing and making more efficient the economic activity. Despite the fact that it does not represent a “miracle solution” to the challenges that globalization puts to the state<sup>14</sup>, the institutions established at the level of regional integration organizations can be complementary to national strategies and thus contributing to the acceleration of the processes of reform and macro stabilization.

The regional and sub regional organizations represent an evolutionary process in the framework of the large geo-economical spaces and they reflect a higher degree of integration of the economic and social activities. Given the fact that the international business environment is more and more competitive the dynamic effects of regional integration must lead to more economic performance.

The economic regionalization represent in the opinion of the American professor Robert Gilpin<sup>15</sup> a reaction from the part of the nation – states to the

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<sup>12</sup> Marcel Moldoveanu, “Mersul lumii la cumpăna dintre milenii”, Academia Română, Ed. Expert, București, 2003, pag. 26

<sup>13</sup> Mugur Isărescu, “Reflecții economice”, Academia Română, Ed. Expert, București, 2001, pag. 73

<sup>14</sup> Robert Boyer, „Les mots ex les réalités. Mondialisation au delà des mythe”, Ed. La Decouverte, paris, 1997

<sup>15</sup> Robert Gilpin, Op. Cit. pag 44

common political problems, but also to a global economy with a high degree of interdependence.

The impact of the integration agreements concluded among numerous developing countries from Africa, Asia and partially from Latin America on the third parties is still limited. These limited results are explained also by the fact that the trade incentives received from the part of developed countries as well as the external financial assistance are not enough in order to allow for an “explosive” growth of the trade exchanges and investment flows which have to be oriented primarily to the development of infrastructure and industry.

We appreciate that the “South – South Consulting and Cooperation Group (The Group of 15) may contribute to a large extent to the development of economic and cultural – scientific cooperation at a regional scale as well as to the support of the business environment due to a stronger negotiating power with the developed countries within the Group of 20.

The regional integration and cooperation organizations have as major objectives the consolidation of economic equilibrium and the stability of the political and social life. In this context we appreciate that the following existing institutional approaches to regional and global integration are representative for the present configuration of the world economy:

- The North American Free Trade Agreement – NAFTA that has as objectives:

- The liberalization and stimulation of mutual trade;
- Development of investment opportunities and technological transfer;
- Establishment of efficient dispute settlement procedures;

- Asia – Pacific Economic Cooperation Forum – APEC which concentrates more than half of the world population and represents one of the most dynamic markets of the world. The main objectives of APEC are:

○ The organizational structure of APEC reflects a complex mechanism aiming to facilitate through an “open regionalization” the liberalization of trade and investments;

- the establishment of the framework for a proper business environment;
- and the promotion of economic and technical cooperation.

- In Latin America we outline the presence of MERCOSUR – The South Common Market which has the following objectives:

- The liberalization of mutual trade;
- The harmonization of macroeconomic policies, with an opening to a common political approach with the European Union and NAFTA.

A reference element in the process of integration and cooperation in the Latin American space is ‘the Porto Statement’, a document adopted at the Spanish – American Summit of October 1998 which concentrates the main objectives of economic development within the context of the dynamic evolution of globalization and regional integration.

The process of regional cooperation is also an important stage in the process of integration in the world economy of the Arabian and African countries. The most representative regional economic organizations from Africa are the following:

- The Union of Arabian Maghreb;
- The Economic Community of the West African States;
- The Community for the Development of Austral Africa.

Within the ex-soviet space we can note an accelerated process of economic and political establishment of some organizations of integration and regional cooperation having the more or less explicit objective of creating an alternative or a complementary structure to the European Union.

The strategic options for the ex-soviet space are reflected in the activity of three organizations of economic integration:

- The Community of Independent States (which benefits of a huge material, financial and human potential) which has a pronounced political dimension;
- The Customs Union Between Russia – Belarus – Kazakhstan (entered into force on July 1, 2010);
- The Eurasian Economic Community which would represent a vast cooperation space with the participation of the 3 countries Russia - Belarus – Kazakhstan together with Kirgizstan and Tajikistan and opening for partnerships with Finland, Hungary, Czech Republic, Bulgaria and Mongolia<sup>16</sup>.

Based on an Agreement (signed at the level of state heads on November 18, 2011) the Eurasian Community would enter in force by 2015, having as a model – by means of the Eurasian Commission – the structure of the European Commission. The interest for this project is reflected by the fact that a Treaty for the establishment of the Eurasian Community is intended to be signed in 2013.

## **Conclusions**

At present in the world economy there are some significant regional integration organizations (NAFTA, European Union, ASEAN, MERCOSUR) and some others are under negotiation. Regional integration is a part of a larger globalization process and the objectives of such a process refer to economic development, reduction of gaps between developed and developing countries, solving the food and energy shortages.

Within this process of regional integration and important role is given to economic and cultural – scientific cooperation among states. This role is to be fulfilled through a system of strategic and geo-economic partnerships, some examples of this kind being the Euro-Mediterranean Partnership (EUROMED)<sup>17</sup> and the Trans-Atlantic Partnership.

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<sup>16</sup> [http://www.eurasian-ec.com/index.php?option=com\\_content&task=view&id=2&Itemid=7](http://www.eurasian-ec.com/index.php?option=com_content&task=view&id=2&Itemid=7)

<sup>17</sup> [http://www.ceas.europa.eu/euromed/index\\_en.htm](http://www.ceas.europa.eu/euromed/index_en.htm)

An important conclusion is that in this whole process of regional and global integration the nation states still play an important part and the last 5 years of economic crisis just strengthened this role. Anyway, in our opinion there is no intrinsic contradiction between the two processes of regionalization and globalization and the activity of nation states. The nation states are still key players and the requirements of efficiency and competitiveness made them engage in various integration processes.

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