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EDITORIAL

This issue aimed to gather contributions that focus on understanding the profound changes witnessed after the fall of the Communist regimes. The contributions were expected to study the various paths followed in the attempt to create new political, economic, and social systems in post-Communist societies, both in Eastern Europe and the former USSR. Four out of five articles focus on aspects concerning various aspects of economic reforms while the fifth focus on the evolution of NGOs in this period

Isa Mulaj's article focuses on redefining property rights with specific reference to social ownership in the successor states of former Yugoslavia, from the point of view of economic efficiency. The author analyses the privatization of social ownership, trying to identify the effects of this redefinition. He concludes that from a historical perspective privatization is not the key to economic development, but it depends on how well ownership fits in the economic system and broader environment such as political and institutional stability.

The issue of effectiveness of governmental regulation on human capital development is approached by Igor Dunayev with a data rich single case study on Ukraine. By using qualitative measures obtained from an expert-survey his approach goes beyond macro-quantitative indicators. He portrays the social-and-political

governmental impact on formation and development of productive human ability as the first principle for future economical growth. The core findings of the article underlie that many processes of HCD and innovation regulation would not be successful when there is an imbalance between tactics and strategy, namely that positive dynamics by single constituents (e.g., schooling, applied science) are unable to provide for stable human development through the minor positive changes by other constituents (e.g., life-long studying, fundamental science, modern IT knowledge).

Ioana Mureşan approaches a micro-level the issue of heating systems reform in the case of Romania. The article models and empirically investigates, from a game theoretical and rational choice perspective, the distinction between individual and collective action, and how the former can cause the failure of the latter. Overall, the results show that if enough people cooperate in order to modernize district heating systems, both individual and social costs can be lower than in the case of individual heating systems.

A comparative approach on the evolution of welfare state regimes in transition countries between Romania and Moldova is used by Irina Burlacu in order to contribute to current debates concerning the welfare states classifications and their modifications. Her article provides a strong argument that not all welfare states fit into the traditional welfare state typologies as

that of Gøsta Esping-Andersen's classification. Since the typology refers originally only to Western European state, with the conjuncture of the European Union enlargement and presence of other welfare types with different evolution, the need for reconsideration of the traditional approach appears. Based on secondary data and the use of Hierarchical Cluster Analysis, the analysis shows that according to the social protection expenditure, Romania and Moldova are in the same cluster, even if not forming a clear separate group. Moreover, although separated from clusters formed by EU-25, there are high discrepancies in social protection in terms of GDP expenditure on social protection between these two countries.

Lewis Akenji is interested in the internal problems (shortage of funds, lack of capacity, inefficient management of projects) and external problems (lack of supportive networks, information unavailability, no common perspective on priority issues, and overlap of interests) faced by NGOs from the point of view of the organizational development and sustainability of non-governmental organizations in central and eastern Europe. The author concludes that if NGOs working in sustainability want the message they drum to be heard, they

must start taking themselves seriously in order for their target groups – government, businesses, citizens – to take up the rhythm.

Notes for Contributors

The formal article requirements remain the same and can be found at our web address – [www.ceu.hu/polscijournal]. Articles must consist of 4,000-6,000 words, while any appendixes should not be longer than 5 pages. These requirements apply also to the submissions qualifying as “work in progress,” while the book reviews should not be longer than 1,200 words. Exceptions from these rules might be allowed, but a good justification should be addressed to the members of the Editorial Board, who will consider it only if the reviewers believe that going over the word limit is needed with respect to the content of the article. An additional requirement, which should be met by all submissions, is that any article, work in progress or book review submitted to us for publication should not be under review at other publications or should not have been already accepted for publication elsewhere.

TODOR ARPAD

REDEFINING PROPERTY RIGHTS WITH SPECIFIC REFERENCE TO SOCIAL OWNERSHIP IN THE SUCCESSOR STATES OF THE FORMER YUGOSLAVIA: DID IT MATTER FOR ECONOMIC EFFICIENCY?

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Abstract

High economic growth rates after World War II characterized both socialism and capitalism. There were impressive results in the former socialist block, Western Europe, USA, and Japan. Apart from these models based on private and state ownership, the fastest economic growth for some time was recorded in the former Yugoslavia under social ownership. The issue of property rights despite being subject to comparative analyses pointing to more efficiency of one versus another type of property did not matter much in those growth rates.

Only in mid 1980s when centralist and self-management socialism languished before making their transition to a market economy, scholars began to recognize property rights as a key to economic efficiency. Much attention was paid to how performance is affected when ownership rights are incomplete (e.g. separation of control and residual rights in social property) and/or more complete (like in private property). This article looks at the redefinition or privatization of social

ownership in the successor states of the former Yugoslavia, and identifies the causes of smaller effects than expected of this redefinition.

“The agents of a prince regard the wealth of their master as inexhaustible; are careless at what price they buy; are careless at what price they sell; are careless at what expense they transport his goods from one place to another. Those agents frequently live with the profusion of princes, and sometimes too, in spite of that profusion, and by a proper method of making up their accounts, acquire the fortunes of princes.”¹

1. Introduction

The onset of the transition process in the former Yugoslavia coincided with the economic and political disorganization in Central and Eastern Europe (CEE) and the former Soviet Union. It is argued that its scope, speed, and success depended on initial conditions, policies implemented, and the external environment.² Having

¹ Adam Smith, *An Inquiry into the Nature And Causes of the Wealth of Nations*, Book V, Chapter II, Part I. (Edinburgh, [1776]), ed. Adam Smith Institute (London, 2001), available at:

www.adamsmith.org/smith/won-b5-c2-pt-1.htm

² See among others, Svetozar Pejovich, “Institutions, Nationalism and the Transition Process in Eastern Europe,” in *Liberalism and the Economic Order*, eds. Frankel P.

realized that the economic transition through privatization appeared as inevitable, the question was how to find methods of giving enterprises away from the state into a more efficient use in private hands. On the eve of that transformation in CEE, few managed to comprehensively assess how difficult the road ahead was going to be. The doubt expressed was that the economic reforms and reallocation of resources that were about to occur, perhaps would produce the required gains in the longer run, whereas during the process and in the short run they may hurt a majority of the citizens, which in turn could resist the reforms initiated and undermine democracy. The governments too, were to some extent aware that gains will be preceded by some inevitable pain.³ That the economic reforms during the early transition incur a high social cost, has proved not to be an accident, but those

who mostly benefited in short run were the ones that initiated them. The winners were a small concentrated group who gained at the expense of the rest of the population, the losers. In the longer run, the gains appear to be more dispersed depending on the barriers of the winners' ability to block the gains of the others.⁴

Among many interdependent factors, initial conditions played a significant role in the outcomes of the transition reforms and privatization. For example, the initial conditions of the Yugoslav transition path were characterized by dramatic events and interethnic conflicts that led to the dissolution of the Federation, with political and economic consequences for the republics that became independent states. Such a transition during the 1990s according to Jan Svejnar was more related to turbulent political events and civil wars than economic reforms.⁵

Political disorganization and distorted environment has always been an obstacle to transition and privatization. Policy makers tended to favor the worst scenario during transition rather than continue *status quo* of socialist economy. This then had adverse effects on the restructuring process as a result

Ellen, Fred Miller, and Jeffrey Paul (Cambridge: Cambridge University Press, 1993), 65-78; Michael Ellman, "Transformation, Depression, and Economics: Some Lessons," *Journal of Comparative Economics* 19 (1: 1994): 1-21; Leszek Balcerowicz, "The Interplay Between Economic and Political Transition," in *Lessons from the Economic Transition: Central and Eastern Europe in the 1990s*, ed. Salvatore Zecchini (Norwell: Kluwer Academic Publishers, 1997), 153-167.

³ Such an early assessment was provided by Adam Przeworski, *Democracy and the Market. Political and Economic Reforms in Eastern Europe and Latin America* (Cambridge: Cambridge University Press, 1991), 136.

⁴ Joel S. Hellmann, "Winners Take All: The Politics of Partial Reform in Postcommunist Transitions," *World Politics* 50 (1998).

⁵ Jan Svejnar, "Transition Economies: Performance and Challenges," *Journal of Economic Perspectives* 16 (1:2002): 3-28.

of dramatic economic decline.⁶ While this refers to the early transition period, it should be remembered that privatization has promised more than actually achieved even in a stable country when it was implemented for the first time in large scale – the United Kingdom (UK).⁷

To come out with an assessment on the impact of privatization in the successor states of the former Yugoslavia, the article begins with a brief review of different types of property and their associated incentives with respect to efficiency. Section two outlines the reasons that led to privatization of

public and state ownership. Similarly, the necessity of privatizing social ownership and the methods of privatization implemented are discussed in section three. The section continues with an assessment of the impact of privatization methods on corporate governance and restructuring. Section four summarizes a number of causes leading to smaller privatization results than expected by grouping them as internal and external factors in separate sub-sections. Section five draws conclusions.

2. Different types of property rights as incentives for economic efficiency

In broader terms, property can be understood as a set or system of rules regulating the right to, and control of, material resources.⁸ In this way, the term property rights is used in economics to denote the essence of the property. The enforcement of property rights is made depending on political system of a country and the economic system it wanted to establish through that enforcement. Thus capitalist democracy enforced the right to private property as a foundation of market economy. Centralist socialism enforced the right to state property and planned economy. The self-management socialist regime, as the institution responsible for enforcing the right to social property that was unique to former Yugoslavia, defined the means

⁶ Gérard Roland, “The Role of Political Constraints in Transition Strategies”, *Economics of Transition* 2 (1: 1994): 27-41.

⁷ This may not be a relevant comparison to the privatization in CEE for two reasons: first, the UK (and the West) privatized publicly-owned enterprises as opposed to privatization of commercial enterprises in CEE; and second, privatizations in the public sector in Western countries may be referred to a reform within the existing system. In spite of this, there is one important thing to remember. Privatization in the UK has had smaller effects on overall economic performance and efficiency than the theory of property rights had established. The winners in the short run were the companies that came more efficient from their better position on the eve of privatization, against a larger group of losers with unemployment peaking 11 percent in 1986. For a thorough investigation of the British privatization experience from 1979 to 1997, see Massimo Florio, *The Great Divestiture: Evaluating the Welfare Impact of the British Privatization 1979 – 1997* (Cambridge: MIT Press, 2004).

⁸ Jeremy Waldron, *The Right to Private Property* (Oxford: Clarendon Press, 1991), 31.

of production as socially owned.⁹ That is, the society as a whole was supposed to be the owner of social assets (thus, social ownership). As such, social ownership had both similarities and

differences with state and private ownership.

Social property and social ownership is a relatively new category of property rights, unique to the former Yugoslavia, and the analysis of it is relatively new as well. Since it was introduced in the early 1950s, no significant attention was paid to its analysis until the study by Eirik Furubotn and Svetozar Pejovich who believed that one could not present a satisfactory theory of the Yugoslav firm without an explicit reference to its property rights structure. This was due to some of the specific features of this type of property rights, in particular: (i) enterprises were not allowed to own assets; and (ii) selling and buying of the firm's assets only amounted to a transfer of the right to use but not the right to alienate or destroy those assets.¹⁰ While under capitalism the market signals to producers which goods should be produced, under self-management producers determined what products consumers could buy.

A vast theoretical literature has evolved on comparative performance of different property rights. An article of 1937 laid the basic foundations of allocation and use of property by the firm (its owner or management) and by someone else outside the firm such as

⁹ When Yugoslav ideologists introduced self-management they did not know exactly how the system would operate since there was no theory about it. But even during its operation, the Yugoslav economists have not developed any theory, nor did they make any notable contribution to it. Self-management attracted the attention of Western economists who were the first attempting to create a theory of a Labor-managed Firm (LMF) or the Workers' Management, as the Yugoslav Socially-owned Enterprises (SOEs) were identified. The first article was published by Benjamin N. Ward, "The Firm in Illyria: Market Syndicalism," *American Economic Review* 48 (1958): 556-589. During the 1970s the interest grew among some economists from CEE such as Jaroslav Vanek, *The General Theory of Labor-Managed Market Economies* (New York: Cornell University Press, 1970); Jan Vanek, *The Economics of Workers' Management: A Yugoslav Case Study* (London: George Allen & Unwin Ltd., 1972); Jaroslav Vanek, *The Labor-Managed Economy: Essays* (New York: Cornell University Press, 1977); and Saul Estrin, *Self-management: Economic Theory and Yugoslav Practice* (Cambridge: Cambridge University Press, 1983). Branko Horvat, *The Political Economy of Socialism: A Marxist Social Theory* (Oxford: Martin Robertson, 1982) and Aleksandar Bajt, *Samoupravni Oblik Društvene Svojine* (Self-management Type of Social Ownership) (Zagreb: Globus, 1988) were few exceptions among Yugoslav economists to have contributed to the theory of Workers' Management.

¹⁰ Eirik Furubotn and Svetozar Pejovich, "Property Rights and the Behaviour of the Firm in a Socialist State: The Example of Yugoslavia," *Zeitschrift für Nationalökonomie* 30 (1970): 430-454.

the state.¹¹ Interactions between allocation and use involve a relationship between master and servant or principal and agent of property. The principal (the state or society) may engage the agent (in the former Yugoslavia they were the workers) to perform some actions on behalf of the principal, including full decision making authority delegated to the agent.¹²

The central point of the theory of property rights is that the firm's performance depends on objective function and incentives. State, social and private ownership are different in this respect. Private ownership has incentives to reduce costs and reap more market-based benefits compared to state ownership.¹³ Enterprise profit is allocated by its owners; private owners allocate their profit according to their wishes, state authorities allocate the profit of state enterprises, and the decision of the working collective or members of the company allocated the profit of Socially-Owned Enterprises (SOEs).

Since the pioneering article by Benjamin N. Ward in 1958, the analysis of the behavior of an SOE has been

based on comparing its performance with that of a capitalist firm. Ward who coined the term 'Illyrian firm', considered it a less independent form of capitalist firm, and as such with the failures that makes it less efficient. Ward demonstrated that the SOEs would perform less efficiently than capitalist firms, citing among other reasons, their response to a price increase (or decrease) is the opposite of the capitalist firm's response. He also showed that in these firms investment patterns will be distorted in comparison with capitalist firms due to incentives of the working collective to maximize individual incomes.¹⁴ Such assumptions about the behavior of SOEs were based on competitive self-management for which Jaroslav Vanek created the most noteworthy general theory. Assuming perfect competition and the behavior of the system as a whole, Vanek along the line of Ward argued that a Labor-managed Economy (LME) will respond to aggregate demand by the change in prices rather the change in output and/or employment.¹⁵

For a society, it is more important that economic choices *what, how* and *for whom*, are preceded by techniques, rules or customs which resolve the inefficiencies that arise from the use of scarce resources, i.e. define property

¹¹ Ronald H. Coase, "The Nature of the Firm," *Economica* 4 (1937): 386-405.

¹² Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics* 3 (4:1976): 305-360.

¹³ Andrei Shleifer, "State Versus Private Ownership," *Journal of Economic Perspectives* 12 (4:1988): 133-150.

¹⁴ Benjamin N. Ward, "The Firm in Illyria: Market Syndicalism", *American Economic Review* 48 (1958): 556-589.

¹⁵ Jaroslav Vanek, *The General Theory of Labor-Managed Market Economies* (New York: Cornell University Press, 1970).

rights clearly.¹⁶ In self-management socialism, ownership rights were politically imposed and the residual rights were used by the central authority to monitor managers. The managers' limited incentive to monitor and condemn workers in case of abuse or theft is viewed as an adverse outcome because s/he is elected by the workers who can dismiss him/her.¹⁷ This ambiguous role and actions by the Yugoslav principal (central authority) and agent (management of SOEs) was the underlying reason for some of the inefficiencies of social ownership. In the system of Workers' Management which in its largest part seems to have been operating as a black box, the workers officially were declared and in fact they felt to be the true rulers of SOEs but hardly were; the role of the state and its agents was always significant.¹⁸ In theory, the Yugoslav workers were the agents of the state, though in practice the state played a double role (as principal and agent). Having in mind the labyrinth in which self-management operated, the Yugoslav economy could not be a fully and competitive LME, which various

authors used as an example to establish standard theories.

Due to unclear property rights, resource allocation under social ownership was considered sub-optimal. Regardless the theory, self-management in aggregate terms fared better than capitalism and centralist socialism. At the beginning of its introduction it was lucky to enjoy significant aid from Western countries.¹⁹ Any economic system with such a support would have recorded obvious results. But the fact that the fastest economic growth in the world in absolute terms continued for more than a decade after the aid was received, indicates that there were other determinants. Above all, the workers motivation for work through self-management and the enthusiasm of the Yugoslav communists expressed by the slogan "we" and "they" intimating a comparison of their socialist version with all Eastern block, were the factors of significant impact. Table 1 below summarizes the results of self-management from 1953 to 1965, the period which can be considered as its golden age recording the fastest economic growth in the world.

¹⁶ Armen A. Alchian and Harold Demsetz, "The Property Rights Paradigm", *The Journal of Economic History* 33 (1: 1973): 16-27.

¹⁷ Michael C. Jensen and William H. Meckling, "Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination", *Journal of Business* 52 (4:1979): 469-506.

¹⁸ Harold Lydall, *Yugoslav Socialism: Theory and Practice* (Oxford: Clarendon Press, 1984).

¹⁹ Western aid included capital transfers from the USA, Britain and France amounting to \$425.8 million delivered from 1951 to 1954. See David A. Dyker, *Yugoslavia: Socialism, Development and Debt* (London: Routledge, 1990).

Table 1: Annual rates of growth in different economic systems (from 1953 to 1965)

Systems Indicators	Self-management socialism	Centralist (state) socialism ^{a)}	Capitalism ^{b)}
Output	11.8 (10.3) ^{c)}	8.7 (5.9) ^{d)}	7.1 (3.7) ^{f)}
Capital	7.5 (7.8) ^{c)}	8.1 (10.0) ^{d)}	6.3 (3.2) ^{f)}
Labor	6.7 (4.4) ^{c)}	4.1 (4.8) ^{d)}	2.5 (1.5) ^{f)}
Combined factor productivity	4.7 (4.4) ^{c)}	3.0 (-1.0) ^{d)}	3.3 (1.5) ^{f)}
Basic welfare differences	+5.0	+4.5	-7.0
Gini coefficient	0.25	0.21-0.26 ^{e)}	0.40

a) State socialist countries: Bulgaria, Hungary, Poland, Romania, and Czechoslovakia;

b) Capitalist countries: Greece, Ireland, Norway, and Spain;

c) From 1954 to 1967;

d) From 1940 to 1954, excluding the war years 1941 to 1945;

e) Bulgaria and Poland;

f) From 1911 to 1940, excluding the war years 1914 to 1918.

Source: Branko Horvat, *The Political Economy of Socialism: A Marxist Social Theory* (Oxford: Martin Robertson, 1982): 203-205, tables 7, 8, and 9, *op. cit.*

The Yugoslav self-management was more efficient with output, labor, and combined factor productivity than capitalist and centrally planned economies during the same as well as different comparative periods. One should take the sampling of selective capitalist countries for comparison with a caution. Ireland and Norway of that time (when jokes from the English lampooned the former, and from the Swedes about the latter have been more popular), were not as they are today in the rank of the most developed countries in the world.

Growth rates in self-management socialism should be also attributed to the initial low base. Nevertheless, the fact that the former Yugoslavia performed better than any other socialist country, is undisputed. Centralist socialism was able to mobilize more capital at a lower level of combined factor productivity. Capitalism had higher productivity than centralist socialism but left other resources, especially labor, at the lowest level of use. It was so in capitalism where capital hires labor while in socialism (centralist or self-managed) the opposite was true. High growth rates in the former Yugoslavia continued even after 1965, so for a period of more than two decades (from 1952 to 1973) their annual average growth in percent terms was: 10.6 for

output, 5.3 for labor, and 9.1 for capital.²⁰

The greatest achievement of self-management socialism was that it had quickly transformed the former Yugoslavia from an obsolete and largely agricultural country to an industrialized and more developed economy and society. On the other hand, through the defects in operation, the system was vulnerable to a number of failures. When Saul Estrin and Will Bartlett used a large empirical literature to identify the effects of enterprise self-management on Yugoslav economy, they showed that the efficiency had isolated the general impact of underdevelopment, market imperfections, and government regulation, though the growth performance appeared impressive by international comparisons.²¹ It is worth mentioning that the development gap between federal units that made the country divided as the developed North (Slovenia, Croatia, Vojvodina) and the underdeveloped South (Bosnia and Herzegovina – BiH, Macedonia, Montenegro, and Kosovo). Serbia was at an average level of development of the federation. This division was of

²⁰ Saul Estrin, *Self-management: Economic Theory and Yugoslav Practice* (Cambridge: Cambridge University Press, 1983).

²¹ Saul Estrin and Will Bartlett, "The Effects of Enterprise Self-management in Yugoslavia: An Empirical Evidence" in *Participatory and Self-managed Firm*, eds. Derek C. Jones and Jan Svejnar (Massachusetts Toronto: Lexington Books, 1982): 83-107.

particular concern due to multiethnic composition of the country. The legacy of Yugoslav socialism sought as a top priority to narrow the inherited regional disparities in economic development through the establishment of the Federal Fund for Crediting Economic Development of Less Developed Regions in 1963. Regional development policy narrowed the gap in development in Montenegro and Macedonia, but not in Bosnia and Herzegovina, and Kosovo where the gap actually increased. Therefore, the figures in Table 1 on basic welfare differences begun to decline and Gini coefficient increased over the period from 1965 to 1990. As measured by incomes per capita, this gap between the most developed Slovenia and the least developed Kosovo increased from 1:4 in 1953 to 1:8 by 1990.²²

In any case, for nearly four decades self-management socialism as the "third way" was the most interesting economic system in the world, from which a lot of things may be learned to generate ideas and concepts about different economic systems and their evolution. The Russian economist and Russia's former acting Prime Minister, Yegor Gaidar, upon visiting the former Yugoslavia, would later describe the system of self-management socialism and his personal experience as follows:

"And here [in Yugoslavia] I discover Marxism in its original

²² Diana Pleština, *Regional Development in Communist Yugoslavia: Successes, Failure and Consequences* (San Francisco: Westview Press, Boulder, 1992).

form...I was lucky that I happened to be where I was, because Yugoslavia was the testing ground for worker control and market socialism. As I tried to sort out the ups and downs of the economic reform, I realized how hopelessly my own knowledge of economics was.²³

Former Yugoslavia initiated and was one of the three founders of the Non-Aligned Movement established in 1955 that became the third influential block in the world and remained so until the end of the Cold War. At home, the Titoist ideology sought the doctrine of *brotherhood and unity* between the nations and nationalities as a political stance of appeasement to keep the country together. In the late 1980s, this charade proved impossible and evolved into a bloody civil war.

3. Justifying the transformation of different types of property into private property

It is widely accepted that the firm's efficiency depends on, or is subject to, a number of factors leading to different objectives, incentives and constraints. Theoretical wisdom maintains that private enterprises pursue profit maximization and have strong incentives to reduce costs. On these grounds private property is judged to be more efficient over public and state property. State and public enterprises

are regarded as less efficient for a number of reasons, including among others: i) political interference in enterprise affairs to pursue other objectives that politicians want; ii) involvement of trade unions to lobby for higher wages for the workers; iii) employment of a greater number of employees than actually may be needed; iv) lower quality of management and innovation due to limitations by the principal and absence of bankruptcy threat; and v) less product differentiation and consumer orientation.²⁴

Following theoretical foundations that private ownership does matter for efficiency, privatization was generally supported. With this expectation, the UK embarked on a large scale privatization of public ownership. The British privatization program might have appeared as inevitable to respond to the ongoing decline in efficiency of public corporations, though it was not a carefully planned and controlled program.²⁵ Privatization in CEE arose from similar reasons as in the UK. There were objections against centralist economy and state ownership but privatization was not considered as long

²³ Yegor Gaidar, *Days of Defeat and Victory* (translated by Jane Ann Miller), (Seattle: University of Washington Press, 1999), 14.

²⁴ Stephen Martin and David Parker, *The Impact of Privatisation: Ownership and Corporate Performance in the UK* (London: Routledge, 1997), 5.

²⁵ Ahmad Galal, Leroy Jones, Pankay Tandon and Ingo Vogelsang, *Welfare Consequences of Selling Public Enterprises: An Empirical Analysis* (published for the World Bank by Oxford University Press, 1994).

as the former Soviet Union was able to crush the 1956 Hungarian revolution and 1968 Prague Spring in former Czechoslovakia. Those events, if prevailed, could have given rise to an alternative way of socialism such as self-management, or in a more radical scenario, the privatization of state ownership. Transition and privatization eventually became inevitable by the end of 1980s, following a degeneration of communism from the inside and the decay of socialist economies in CEE.²⁶

It was impossible to maintain state ownership once the communist parties or the principals that monitored enterprises collapsed and pluralist political parties emerged. From thereon the privatization process in CEE preceded by a disorganization of the system that imposed the need for reallocation of resources into a property rights system required by a market economy. More specifically, this was an international promoted requirement within the well-known reform package – the so-called Washington Consensus. For Olivier Blanchard, disorganization is the initial phase of transition that continues with reallocation of resources, and that reallocation involves restructuring and reorganization. Then the relation between property rights clearly defined and incentives becomes

²⁶ Yegor Gaidar, *State and Evolution: Russia's Search for a Free Market* (translated by Jane Ann Miller) (Seattle: University of Washington Press, 2003), 59-62.

obvious.²⁷ Gérard Roland reminded that different ownership *per se* has not played any important role in economic performance from the perspective of general equilibrium theory. He argued that different ownership became central in economics once the theory of incomplete contracts was introduced, which saw their relevance during privatization in transition economies in terms of control rights and residual rights.²⁸

4. The necessity of redefining social ownership in the former Yugoslavia and her successor states

Since its introduction in the early 1950s, the self-management system remained essentially unchanged until the initiation of economic transition in the late 1980s, although it underwent four important changes.²⁹ The 1974

²⁷ Olivier Blanchard, *The Economics of Post-Communist Transition* (Oxford: Clarendon Press, 1997).

²⁸ Gérard Roland, *Transition and Economics: Politics, Markets, and Firms* (Cambridge: MIT Press, 2000).

²⁹ The main institutional changes and phases of the development of Yugoslav self-management were: (i) the period of centrally planned economy (1945-52) that was similar to the Soviet model of socialism; (ii) the introduction of self-management (1952-65), where the process of decision-making was gradually decentralised; (iii) the period of self-managed market socialism (1965-1974) when market mechanisms were utilised in as many areas as possible, focusing on the activities of the SOEs operating in the market; and (iv) the system of 'free associated labour' (1974-1988), or

reform of *contractual socialism* resulted in an increase in the proportion of enterprise revenues that were under the influence and control of state players. SOEs were under constant pressure by the authorities to employ more workers.³⁰ Under diminished autonomy of the workers, outside players used their influence through residual rights and violated the main principle of self-management, which is earning according to work, by redistributing revenues from better performing to under performing enterprises.³¹ The implication of that redistribution as a later analysis would indicate, was that whenever the government policies aimed at increasing the wealth of the society they could result in diminishing the enterprise efficiency over time.³²

The residual rights of the state or government bodies over social ownership should also be seen from another point of view. They can serve as a reason for the government to interfere in the firm's affairs, by which the firm's efficiency is limited because the government may pursue different objectives referred to earlier in this paper. These problems are expected to disappear if social ownership is transformed into private ownership, and LME moves to a full market economy. Any market economy requires the establishment of unambiguously defined, and most importantly, transferable property rights. The challenge is that the process of redefining social ownership will be followed by claims from agents associated with social ownership (especially workers and managers), whose stake is not known. The workers believed that they ran SOEs, financed the investment expenditure, contributed to development and growth of SOE and thus had acquired ownership claims to the assets. On the other hand, when SOEs were not able to pay the minimum incomes of the workers or other claims on their income, they had to either merge with other profitable enterprises which would cover their losses, or accept the intervention by the state or the founding organization who would replace the existing management and restore the firm's financial position (usually by subsidizing it). This formed the basis of ownership claims by the state or the funding organization. In cases the performance of SOEs was very poor, the state assisted them by

'contractual socialism.' See Saul Estrin and Tea Petrin, "Patterns of Entry, Exit and Merger in Yugoslavia," in *Entry and Market Contestability: An International Comparison*, eds. Paul A. Geroski and Joachim Schwalbach (Oxford: Basil Blackwell, 1991): 204-220.

³⁰ Ljubomir R. Madžar, "The Illyrian Firm: An Alternative View", *Economic Analysis and Workers Management* 4 (20:1986): 401-410.

³¹ Milan Vodopivec, "Determination of Earnings in Yugoslav Firms: Can it be Squared with Labor Management?", *Economic Development and Cultural Change* 41 (3:1993): 623-632.

³² Daniel L. Freisner and Robert Rosenman, "A Dynamic Property Rights Theory of the Firm", *International Journal of the Economics and Business* 9 (3:2002): 311-333.

subsidies or rescued them from bankruptcy by writing off their debts, so SOEs in former Yugoslavia enjoyed soft budget constraints like state enterprises in CEE.

During the 1980s the Yugoslav economy was in deep crisis facing hyperinflation, trade deficit, foreign debt, unemployment and inefficiencies at the micro level. The policies aimed at reforming self-management were no longer producing effects as they were introduced as a reaction to correct the previous failures rather than moving towards any planned necessary reform before the crisis appeared.³³ They seemed unlikely to produce substantial changes without changing the property rights regime. It was decided to do so by the end of 1989 when the Federal Executive Council of former Yugoslavia brought in the reform to privatize social ownership and make transition towards a full market economy. Privatization of SOEs was facilitated through the Law on Social Capital, known as the Marković Law, named after Ante Marković, the last President of Federal Executive Council of former Yugoslavia. Very favorable terms were provided to employees; a discount of 30% to buy internal shares, which was enhanced by another 1% for each year of employment – thus the overall discount could be as high as 70% of the nominal value of shares.

³³ Janez Prašnikar and Vesna Prašnikar, "The Yugoslav Self-managed Firm in Historical Perspective," *Economic and Industrial Democracy* 7 (1986): 167-187.

Each worker could buy shares at nominal value up to 3 times his annual personal incomes. The shares were to be paid for within 10 years once the company was registered under a different ownership form.³⁴ The implementation of this privatization program was short lived as in 1991 inter-ethnic conflicts began to give the final stroke to political and economic organization of the former Yugoslavia, and privatization of social ownership remained a challenge for newly established successor states.

4.1 Methods of privatization and implementation of the process: progress, pitfalls and setbacks

Each newly independent republic of former Yugoslavia adopted their own privatization laws and established the relevant institutions – privatization agencies to carry out the process. The successor states, in general, opted for the sale of enterprise assets to insiders on very favorable terms as the main method of privatization, a pattern that, with modification was inherited from the Marković Law. Present and former employees in Croatia and Serbia were entitled to buy shares at a basic discount of 20% plus 1% for each year of employment, to be paid in installments over a period of 5 years. In Montenegro, favorable terms and

³⁴ *Službeni List SFRJ, Zakon o Prometu i Raspolaganju Društvenim Kapitalom*, (Official Gazette of SFRJ, The Law on Circulation and Disposal of Social Capital), no. 84/89, 46/90, Beograd.

conditions to insiders were exactly the same as in the Marković Law.

Provisions of the Slovenian Law on Privatization allocated social ownership to workers and society through the privatization scheme involving: i) the transfer of 40% of the enterprises' shares to the three funds (20% to the Development Fund, 10% to the Pension Fund, 10% to the Restitution Fund); ii) 20% of shares were allocated to employees in exchange for ownership certificates or vouchers; iii) 20% was left at the discretion of the company to be sold to current employees, former employees, and retired workers at a discount of 50%; and iv) the remaining 20% was allocated for mass privatization program (MPP) or free distribution of shares to Slovenian citizens in exchange for ownership certificates.

The Macedonian concept of privatization was based on a number of methods. Social capital was allocated in the following way: (i) 30% to employees as internal shares, involving a discount of 30% plus 1% for each year of employment; (ii) 15% of shares were to be transferred to the Pension Fund; and (iii) 55% of shares were left for sale to domestic and foreign buyers under equal conditions, using a variety of sales methods. Privatization of the renationalized social ownership proceeded under separate programs in the two entities of Bosnia and Herzegovina (BiH), and relied on a decentralized approach. Both programs envisaged mass privatization by

distribution of ownership certificates to the citizens over 18 years of age in the Federation of BiH, and vouchers to all citizens in Republika Srpska. The citizens could use the certificates or vouchers to buy shares in companies to be sold via public offerings, tenders and negotiations.

The last federal unit of former Yugoslavia and the last country in CEE to pass her own law on privatization and embark on the process was Kosovo. Privatization of SOEs did not follow the pattern observed in other Yugoslav successor states, probably because privatization became a specifically shaped problem. The methods of privatization as determined by the regulation passed in June 2002 included: the establishment of subsidiary companies of SOEs (spin-offs) and, voluntary liquidation. Instead of any discount, the employees were entitled to 20% of the proceeds from the sale of SOEs. It was meant to be a compensation for the loss of their self-management rights after privatization, but strangely it could not and still cannot be included as a discount in case the employees buy the SOE. A summary with relevant details of all first privatization laws discussed so far in this section is provided in the Appendix to this paper.

To sum up the legal frameworks on privatization, the characteristics of social ownership related the priority of appropriation to those who were in charge of managing the SOEs. Milica Uvalić identified the appropriation of

those rights or privatization of social ownership synonymously with “converting self-management rights into property rights.”³⁵ The managing role of workers has been described by Karim Medjad as “a source of customary ownership rights.”³⁶ There were exceptions or restrictions to these ownership rights of employees such as, privatization through MPP and direct sales either as primary or secondary method.

Economists generally thought that the privatization of social ownership and the building of a market economy in former Yugoslavia would probably be easier than the privatization of state ownership in centrally planned economies. The Yugoslav system of market socialism was understood as something closer to a market economy and, as Maks Tajnikar put it, “already

market-oriented.”³⁷ Presumably, the longer experience with market-based elements was seen as an advantage in establishing a full market economy.³⁸

Privatization under the Marković Law had started in almost every federal unit but was halted by the outbreak of civil wars and the disintegration of the country. In Slovenia, around 400 SOEs embarked on autonomous privatization by selling shares to insiders.³⁹ Once the Slovenian Law on Privatization was adopted, the process initiated under the Marković Law was stopped and ownership transactions were re-examined. A similar process initiated by some SOEs in Croatia was not recognized and they were required to be privatized by the Croatian law only. The very short deadline for submitting applications for ownership transformation (14 months) meant that most of the 3,619 SOEs remained in the state portfolio. Almost half of them were owned by Croatian Privatization Fund (CPF), creating a large state sector

³⁵ Milica Uvalić, “Privatization in the Yugoslav Successor States: Converting Self-management into Property Rights,” in *Privatization Surprises in Central and Eastern Europe*, eds. Milica Uvalić and Daniel Whitehead-Voughan (Cheltenham: Edward Elgar, 1997), 267-302.

³⁶ Karim Medjad, “Workers Control as a Source of Customary Ownership Rights: Evidence from the Privatization in Former Yugoslav Republics,” (paper presented at the Eleventh Conference of the International Association for the Economics of Participation, Catholic University of Leuven, Brussels, July 4-6, 2002), available at:

<http://ocean.st.usm.edu/~w300388/brussels/MEDJ.pdf>

³⁷ Maks Tajnikar, “From a Labour-Managed Economy to a Market Economy: A Contribution to Economic Transformation,” *Atlantic Economic Journal* 28 (2000): 93-101.

³⁸ Milica Uvalić, *Investment and Property Rights in Yugoslavia: The Long Transition to a Market Economy* (Cambridge: Cambridge University Press, 1992).

³⁹ Uroš Korže, “Decentralized Privatization Strategy: Pitfalls and Benefits – Slovenia,” in *Privatization in Central and Eastern Europe 1991*, eds. Marko Simoneti and Andreja Böhm (Ljubljana: CEEP, 1992), 2 (140-153).

as a substitute for the social sector.⁴⁰ Privatization continued in phases that could not achieve anticipated objectives. After a decade of transition, privatization in Croatia remained incomplete. Among the reasons for slower privatization, was the fact that CPF did not have sufficient operational and professional capacities for the most important sectors of the economy, namely shipbuilding and tourism.⁴¹ As of 2005 privatization in Croatia was still an ongoing process as the CPF continued to hold shares in hundreds of companies.

Even though the Macedonian Law was enacted in 1993, it took 20 months to see the first SOE privatized under its provisions. Until the Agency for Privatization was consolidated, over 400 enterprises (1/3 of the total number of SOEs scheduled for privatization) had been transformed under the Marković Law.⁴² Differently from

Slovenia and Croatia, those transformations and privatizations were recognized. With the remaining SOEs privatized under the new law, the process was declared completed in 2002.

The autonomous privatization that began under the Marković Law proceeded on a larger scale in Serbia than elsewhere in former Yugoslavia. Privatization was further advanced by the Serbian Law of 1991 so that by 1994 the process was completed in 1,785 or in over 53% of total number of enterprises to be privatized. Just in 1994 Serbia saw the biggest retreat in privatization. Privatization was abolished in 1,556 or 87% of privatized enterprises after reviewing the process by the Agency for Privatization.⁴³ Revaluation due to hyperinflation of 1993 had blocked the process and led to the direct state control in enterprises where privatization was abolished and those to be privatized.

Until 1994 when the Montenegrin Law was amended, very little progress had been made. By the end of 1995, only 10 enterprises had been fully privatized to insiders.⁴⁴ Obviously, such a slow

⁴⁰ Nevenka Čučković, "Privatization, Restructuring and Institutional Change: How Far has Croatia Gone?," in *Privatization in Post-Communist Countries*, eds. Barbara Blaszczyk and Richard Woodward (Warsaw: Center for Social and Economic Research, 1996), 1 (53-74).

⁴¹ Nevenka Čučković, "The Privatisation Process and Its Consequences for the Distribution of Welfare: The Case of Croatia," *MOCT-MOST* 5 (1995): 75-90; Damir Ostović, "Privatization in Croatia" in *Privatization in Central & Eastern Europe 1995*, ed. Andreja Böhm (Ljubljana: CEEP, 1996), 6 (106-137).

⁴² European Bank for Reconstruction and Development – EBRD, *Transition Report* 239

1995: *Investment and Enterprise Development* (London: EBRD, 1995).

⁴³ Mladen Lazić and Laslo Sekelj, "Privatisation in Yugoslavia (Serbia and Montenegro)," *Europe-Asia Studies* 49 (6:1997), 1057-1070.

⁴⁴ Institute for Strategic Studies and Prognosis - ISSP, *Montenegro Economic Trends* (Podgorica: ISSP, 2000), available at:

progress left Montenegro with the alternative of MPP, which had been used in Slovenia and Croatia to speed up ownership transformation and privatization. Although it was announced in 1996, MPP did not start until 2001.

Privatization in BiH under the Marković Law from the end of 1989 to 1991 had resulted in 585 SOEs being transformed by distribution and selling of a proportion of shares to employees, but none of them was fully privatized.⁴⁵ The newly elected authorities soon decided to review and halt the process with the reason that the companies were being sold cheaply. The halt followed re-nationalization of social property during the war (from 1992 to 1995) but the share of capital paid by employees was recognized and did not become subject to privatization since then.⁴⁶ In

Kosovo, a dozen of SOEs in the Gjakova region that sold internal shares in the early 1990s remained with unclear ownership status as their shares paid for have not yet been recognized. Privatization of the rest of SOEs started in July 2003 under international administration, was halted in October of the same year and resumed after one year. The Kosovo Trust Agency or the institution in charge to carry out the privatization planned to complete the process by mid-2005, though nearly two years after that deadline it has fully privatized only half of over 500 SOEs, and that with enormous difficulties and controversies. Privatization in Kosovo proved to be the biggest challenge among CEE countries for the following reasons: i) Kosovo's undefined political status; ii) consequences of emergency measures introduced by Serbia during the 1990s and Serbia's attempts to legalize ownership claims made during that time; iii) too many stakeholders involved in managing the process (international administration, Kosovo's institutions, and Serbia); iv) limited management capacities and non-transparency.⁴⁷

<http://www.balkannetwork.org/info/Monet11.pdf>

⁴⁵ Dragoljub Stojanov, "BIH Privatization and Workers Participation: the Case Study of 'Agrokomerc,' Company," (paper presented at the Eleventh Conference of the International Association for the Economics of Participation, Catholic University of Leuven, Brussels, July 4-6, 2002), available at:

<http://ocean.st.usm.edu/%7Eew300388/brussels/stoj.pdf>

⁴⁶ Vesna Bojičić-Dželilović, Fikret Caušević and Rajko Tomaš, "Bosnia and Herzegovina – Understanding Reform," (Global Development Network Southeast Europe and the Vienna Institute for International Economic Studies, Vienna, June 2004), available at:

www.wiiw.ac.at/balkan/files/GDN_UnderstandingReform_BosniaHerzegovina.pdf

⁴⁷ Isa Mulaj, "Delayed Privatization in Kosovo: Causes, Consequences and Implications in the Ongoing Process," in *Path-dependent Development in the Western Balkans: The Impact of Privatization*, ed. Siniša Kušić (Peter Lang: Frankfurt, 2005): 123-163.

4.2 The impact of privatization methods on corporate governance and restructuring

After the difficulties referred to earlier regarding implementation, the completion of the privatization process did not mean the end of challenges. Privatization is not a formal transfer of property rights; it implies a change in enterprise behavior and incentives, management, restructuring, and maybe the change in the environment. Privatized enterprises needed to adopt their activity according to market conditions, something which they could not do within a night given their long operation under different conditions. Adapting to the market conditions depended on corporate governance and restructuring. The type of corporate governance is largely determined by privatization methods.

In companies where the sale of shares on favorable terms to insiders was used the main method of privatization, it resulted in dispersed ownership among many individual shareholders in Employee-owned Firms (EOFs). These group companies have their management largely similar to the past or pre-privatization period. The central decision-making body under self-management – the Workers' Council – has been replaced by the Shareholders' Assembly, now resting on many individual shareholders with the right to vote. A slight difference is the presence of managerial shareholders whose shares account for a little more than those of the average or lower position

employees, derived from the allocation of higher value of shares based on the managers' higher level of salaries.

Dispersed ownership was also an obstacle to restructuring of the companies. Insiders lacked capital to invest while they were no longer enjoying subsidies after privatization. Consequently, EOFs were forced to undergo defensive restructuring through downsizing of enterprise activities such as, reducing costs by closing down unprofitable activities, job cuts, and getting rid of outdated and non-productive technology, to the extent that enabled them to compete in the short run.⁴⁸ The need for greater enterprise restructuring and better corporate governance induces EOFs to sell their shares internally from workers to managers, and externally to the outside investors in the secondary privatization. Such a process happened in Slovenia with the aim to make dispersed ownership that resulted from privatization and MPP more concentrated. An analysis of the changes and shifts in ownership concentration after secondary privatization in 426 companies found that concentration occurred mainly from workers to managers but at a low level, having no major impact on enterprise performance.⁴⁹

⁴⁸ Irene Grosfeld and Gérard Roland, "Defensive and Strategic Restructuring in Central European Enterprises," *Journal of Transforming Economies and Societies* 3 (4:1996): 21-46.

⁴⁹ Simoneti, Marko, Andreja Böhm, Marko Rems, Matija Rojec, Jože P. Damijan and

Corporate governance emerged as a much worse problem for SOEs privatized through MPP, especially in BiH and Montenegro. Too many citizens had no knowledge about the companies in which they became shareholders. In BiH the process neither contributed to economic recovery of the country nor attracted foreign investors as hoped. Many companies in the hands of insiders, unused shares in the portfolio of privatization investment funds, dispersed ownership and the lack of fresh capital for investment neglected enterprise restructuring.⁵⁰

The methods of privatization that favored insiders and the population, left little room for foreign investors to participate. In cases when they participated in privatization of SOEs wholly or partially, corporate governance and enterprise performance was better and more investment oriented. For example, foreign participation in Croatia brought positive changes in corporate governance by filling the gap of well-trained managers and incorporating better organizational practices.⁵¹ The need for fresh capital

was felt during privatization in Serbia and that was why the new law on privatization passed in 2001 and amended in 2003 envisaged cash sales as the main privatization method intending to attract strategic investors.

The answer to the question of privatization performance should be provided in two domains: its impact on national economy and efficiency at micro level. In self-management as already discussed in Section One, aggregate performance was satisfactory despite objections against certain aspects of enterprise behavior. Soft budget constraints, merging loss-making and profitable enterprises explained that aggregate performance. At micro level, there were lazy workers supposed to have been benefiting from those working harder. Given that the workers were decision makers, they found it hard to penalize their colleagues for erosion of the working discipline which was taking place. In practice, this has questioned the theory that self-management enables better evolution of governance as a result of more liberal flow of information than in any other governance system.

After privatization the situation is reversed. Those enterprises that survived competition indeed turned more profitable for existing workers thanks to downsizing and job cuts of

Boris Majcen, "Secondary Privatisation in Slovenia: Evolution of Ownership Structure and Company Performance Following Mass Privatisation," report no. 46 (Warsaw: Center for Social and Economic Research, 2001).

⁵⁰ EBRD, Transition Report 2003: Integration and Regional Cooperation (London, EBRD).

⁵¹ Drago Čengić, "Corporate Governance in Croatia: Present Problems and Measures for

Possible Evolution of Corporate Governance," (First Meeting of the South Eastern Europe Corporate Governance Roundtable, OECD, Romania, September 20-21, 2001), available at:

www.oecd.org/dataoecd/37/22/2393207.pdf

low productivity workers. Looking at a broader picture of privatization reveals that losses in aggregate terms have outstripped gains at micro level, thus raising the social cost as a result of increase in unemployment. This maybe attributed to the theory related to the winners concentration in a small group. One would question if non-privatization could have been a better choice than privatization to insiders that followed deterioration in enterprise performance? Non-privatization could have had higher costs and this has proven in many empirical studies across CEE. Those studies found greater efficiency in privatized enterprises through different methods than non-privatized ones in terms of corporate governance, restructuring, productivity and incomes.⁵² This remark was addressed to the delayed privatization in Serbia, that had SOEs been transformed into EOFs, results could not have been worse.⁵³

5. Causes of smaller effects of privatization

When the use of resources by a certain

⁵² Of course, SOEs in a better position had greater chances of being privatized earlier whereon this sometimes was used as an explanation for post-privatization better performance.

⁵³ Milica Uvalić, "Privatisation and Corporate Governance in Serbia (FR Yugoslavia)" (Global Development Network for Southeast Europe and the Vienna Institute for International Economic Studies, Vienna, 2001), available at: www.wiiw.ac.at/balkan/files/Uvalic.pdf

owner or under a given system of rules of managing property rights appears inefficient, Ronald H. Coase stood for incentives of transferring these rights to someone who will make a better use of them, i.e. achieve greater efficiency.⁵⁴ One of the main requirements for that efficiency is to clearly define property rights and make them fully transferable, so competition would lead to efficient resource allocation. Sometimes it may be so and sometimes it may not. Even in competition circumstances reallocation of resources may be inefficient due to asymmetric information. It is difficult to anticipate a better use of resources if there is insufficient information about their past and current qualities and shortcomings such as social property in the course of privatization and its aftermath.

The limited privatization at the Federal level associated with the monetary stabilization began to produce some positive results which Marković himself had not expected, but he soon realized that the further success above all required the stability in political domain.⁵⁵ But not everything depended on politics; there were also deficiencies within the institutions that carried out the process, in particular after independence of the Yugoslav successor states.

⁵⁴ Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economics* 3 (1960): 1-44.

⁵⁵ Christopher Bennet, *Yugoslavia's Bloody Collapse: Causes, Course and Consequences* (London: Hurst and Company, 1995).

5.1 External causes: the impact of disintegration of former Yugoslavia and thereafter

One of the major factors that undermined prospects and results of privatization in the successor states of the former Yugoslavia (except in Slovenia), is the break-up of the Federation that began in 1991 with the independence of northern republics – Slovenia and Croatia. Disintegration continued with the separation of Macedonia, the war in Bosnia and Herzegovina (1992 to 1995) and, finally, the war in Kosovo (1999), resulting in a complete disintegration of the Yugoslav market into republics and regions. These should be remembered as part of the initial conditions.

The initial conditions in Croatia – the most developed republic after Slovenia, deteriorated severely with the outbreak of war which left a significant adverse impact on the economy in general. Damages were equal to three times the annual GDP of Croatia.⁵⁶ The disadvantageous circumstances became even worse as Croatia redirected considerable and increasing proportion of her diminished resources to defense at the time it was trying to establish state institutions.⁵⁷

⁵⁶ Radimir Buljan, “Industrial Restructuring and its Effect to the Development,” (Proceedings of the Fourth International Conference on Enterprise in Transition, Faculty of Economics, Split, Split-Hvar, May 24-26, 2001): 2386-2403.

⁵⁷ At the height of war, the country with some 4 million inhabitants (excluding the

The civil war in BiH stopped the process at the beginning, which then did not resume until the end of 1997. MPP in BiH did not attract the broad participation of citizens. Ethnically controlled areas prevented minorities to participate in the process and use vouchers through privatization investment funds. The low public confidence in the process, a high level of corruption among the main players, and a lack of interest by foreigners, were some of the characteristics of voucher privatization in BiH.⁵⁸

Slow progress in Serbia and Montenegro during the 1990s was caused by: i) the United Nations sanctions against it; ii) the limited market; iii) the sharp decline in economic activity; iv) poor experience and constraints to implement and control privatization; iv) the low level

Serbs) had an army of 150,000 soldiers. In 1995 the share of military expenditure to GDP reached 9.4%. See Ivo Bićanić, “The Economic Role of the State in Southeast European Economies in Transition” (The Vienna Institute for International Economic Studies, Vienna, 2002), available at: <http://www.wiiw.ac.at/balkan/files/Bicanic.pdf>

⁵⁸ Janez Prašnikar, Polona Domadenik, Aleksandra Gregorič, Bostjan Jazbec, and Mojmir Mrak, “Bosnia and Herzegovina” (Country Study Report Prepared for the Global Development Network, 2001), available at:

www.cergeei.cz/pdf/gdn/grp_final_bosnia.pdf

of information and non-transparent procedures.⁵⁹

Under the impact of external factors such as the bloody collapse of the former Yugoslavia, economic decline would have happened even without privatization. However, what has impacted privatization as a process and enterprise performance afterwards, was the collapse of business networks not only with foreign countries, but also among the Yugoslav successor states. The disruption in the latter case was more costly for enterprises than, say for instance, republics of former Soviet Union, because, the Yugoslav SOEs were organized on the system of associated labor and had their supply network and subsidiaries spread across federal units. In peaceful time many of previous clusters could not be re-established as some enterprises have gone bankrupt and/or reallocated resources dictated by market forces.

5.2 Internal environment: behavior of institutions and enterprises

It is obvious that managers and employees were the biggest beneficiaries of privatization where the sale of shares to insiders at favorable terms and conditions was used. The schema of allocation of social ownership discussed in Section 3.1 and

⁵⁹ Veselin Vukotić, "Privatization in Montenegro" (Global Development Network for Southeast Europe and the Vienna Institute for International Economic Studies, Vienna, 2001), available at: www.wiiw.ac.at/balkan/files/Vukotic.pdf.

presented in the Appendix, often resulted in different ownership proportions after privatization. In Slovenia employees ended up with the same ownership share of 40% as allocated.⁶⁰ In Macedonia they got a much better deal than in Croatia and ended up with a majority ownership stakes in a slightly higher proportion of total number of SOEs than in Slovenia.

Privatization after re-nationalization in Croatia was criticized for unfairness. Well-connected government officials and politicians of the ruling party in power for nearly 10 years, were the main net winners.⁶¹ The political capitalism in Croatia that emerged from this type of privatization caused public dissatisfaction.⁶² The resulting group of

⁶⁰ Marko Simoneti and Aleksandra Gregorić, "Managerial Ownership and Corporate Performance in Slovenian Post-Privatisation Period", *European Journal of Comparative Economics* 1, (2: 2004): 217-241.

⁶¹ A public opinion poll in 1998 assessing the level of satisfaction with the privatisation results showed that around 46.8% of the respondents were completely dissatisfied, 21.6% partially dissatisfied, 13.3% could not assess the results, 16.9% partially satisfied, and only 1.4% completely satisfied. See Nevenka Čučković, "Privatisation in Central and Eastern Europe: Between Intentions and Reality" (Proceedings of the Third International Conference on 'Enterprise in Transition, Faculty of Economics, Split, May 27-29, 1999), 619-635.

⁶² Josip Županov, "Tranzicija i politički kapitalizam (Transition and Political

political shareholders was described as “crony capitalism.”⁶³ Something similar has happened in Serbia. After abolishing autonomous privatization, the state imposed control over enterprises. The newly appointed directors of SOEs, especially of large ones, embarked on running enterprises fraudulently.⁶⁴ The public had suspicions that many of privatized SOEs through direct sale from 2001 onwards, ended up in the hands of those who were believed to have earned their money during the 1990s through corruption and fraud.⁶⁵ A high level of corruption and politicization was the result of privatization in BiH, too.

Inefficiencies and inexperience of institutions and policy makers for carrying out privatization in a consistent way undermined the results significantly. They were able to make good plans, thought they had the needed capacities to complete the process as planned, but underestimated the challenge. The response to unexpected

Capitalism)”, *Hrvatska Gospodarska Revija* 12 (1997): 1399-1407.

⁶³ Bićanić, “The Economic Role of the State”, 9.

⁶⁴ Michael Palairt, “The Economic Consequences of Slobodan Milošević”, *Europe-Asia Studies* 53, 6 (2001): 903-919.

⁶⁵ Livija Maksimović, “Privatisation in Serbia in Conditions of Economic Stagnation” (Proceedings of the Second International Conference on From Transition to Development: Globalisation and Political Economy of Development in Transition Economies, Faculty of Economics, University of Sarajevo, Sarajevo, October 9-11, 2003), 1 (393-404).

difficulties on the road by *ad hoc* and some ambiguous choices delayed completion of the process and made it more costly. It is actually happening in Kosovo as well in spite of a good opportunity to learn very useful lessons.

6. Conclusions

In self-management socialism, two crucial aspects lacked sufficient and careful attention: i) social ownership and social property; and ii) the operation and behavior of SOEs in reality. Depending on the extent to which their insights were blurry, they had implications in ownership claims against SOEs by various players whose stake was not known. I summarize this by maintaining that, although things appear to work well but inside have got some defects that are not properly observed and dealt with in time, then when it comes to the problems accumulated, attempts to further reform the system (as former Yugoslavia did in mid 1980s) are likely to lack perspective. This is why the final role of the state in this respect – to organize privatization and make ownership rights clearly defined, became an uneasy challenge. The blame has been laid mainly on the specific features of social ownership that distinguished it from state ownership and the problem of resolving the national question and the democratic environment.

The experience of privatization involves similarities as well as differences depending on approaches, methods used, and the circumstances in

which the process evolved. The fact that the main method in the first privatization laws of the successor states remained the sale of enterprise assets to insiders on favorable terms, indicates that the Marković Law left a significant impact which lasted long after the disintegration of former Yugoslavia. There were deviations from this course anyway, e.g. when social ownership was re-nationalized (in Croatia, Serbia, and BiH), some SOEs were privatized through other methods (in Macedonia), or when a part was distributed to the population (MPP in Slovenia, Montenegro, and BiH).

Privatization of social ownership was undertaken to improve efficiency and did so for a selective group, so in aggregate terms the losses outweighed gains. No doubt that there has always been a gap between the goals proclaimed and results achieved in privatization elsewhere. It does not imply that the plans were not good or that they were overambitious. The main reason was the limited institutional capacities and management skills necessary to carry out privatization. None of the countries had any experience in privatization and when it ran into difficulties, there was no experience or a ready diagnosis to deal with the problem effectively. Instead, other models were embarked on to cope with the problem and complete the process. This, indeed, accelerated and brought the process to an end, though it left a number of implications behind.

When comparing the management of SOEs in the past and after their

privatization to employees or EOFs, it can be concluded that it is similar with slight differences. During self-management, employees were not the only ones managing SOEs; they had the support and influence of other players outside who acted as a sort of umbrella for employees. After privatization, the role of those players as it was disappeared and employees who were accustomed to that umbrella for a long time, found it difficult to do everything on their own. In cases when they came in joint ownership with the shareholders those who used to exercise their role in managing SOEs, there were difficulties because, in spite of being together again, their relations changed and different objectives emerged. Far more unsatisfactory performance came about when ownership was distributed to society (i.e. citizens) through MPP resulting in diffused ownership that weakened the mechanisms of corporate governance and prospects for restructuring.

The answer to the basic question in this article, (*Did privatization of social ownership matter for economic efficiency?*) is a bit ambiguous. One explanation with respect to the theory of unclear and/or shared ownership rights, like in social ownership, is that they are likely to result in efficiency if an apparatus is to enforce incentive compatibility by minimizing the free riding problem. After privatization, individual or group interests within the firms under better piecemeal incentives for some at the expense of many others prevail in the short run. Was then

privatization necessary? The article showed that privatization was a must, but it took and will take time to produce greater results, perhaps longer than policy makers had anticipated. Henceforth another question arises: which type of ownership matters more in terms of overall economic efficiency? From a historical perspective it depends on how well ownership fits in the economic system and broader environment such as political and institutional stability.

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Appendix I: Privatization in successor states of former Yugoslavia: methods, progress, and post-privatization results

	Slovenia	Croatia	Macedonia	Serbia	Montenegro	BiH	Kosovo
Total number of SOEs slated for privatization	2,500 ^{a)}	3,619 ^{b)}	1,216 ^{c)}	3,486 ^{d)}	354 ^{e)}	2,591 ^{f)}	525 ^{e)}
Year and the month the first privatization law was passed	November 1992	April 1991	June 1993	August 1993	January 1992	December 1997 and June 1998	June 2002
Approaches to privatization	Decentralized	Highly centralized	Decentralized	Centralized	Decentralized	Highly decentralized	Highly centralized
Primary method of privatization	Employee buy-outs	Employee buy-outs	Employee buy-outs	Employee buy-outs	Employee buy-outs	MPP	Direct sales (spin-off)
Secondary method of privatization	MPP	MPP	Direct sales	None	MPP	Direct sales	Liquidation
Transfers to the funds	40% ^{g)}	30% ^{h)}	15% ⁱ⁾	40% ^{j)}	Up to 60% ^{k)}	15% (RS) ^{l)}	None
Discount for insiders	50% ^{g)}	20% ^{h)}	30-50% ⁱ⁾	20% ^{j)}	30% ^{k)}	None	None
Additional discount per each year of employment	None	1% ^{h)}	1% ⁱ⁾	1% ^{j)}	1% ^{k)}	None	None
Maximum discount to insiders	50% ^{g)}	60% ^{h)}	70%-90% ⁱ⁾	60% ^{j)}	70% ^{k)}	None	20% ⁿ⁾
Repayment period	5 years ^{g)}	5 years (20 years in the 2 nd phase) ^{h)}	5 years ⁱ⁾	5 years ^{j)}	10 years ^{k)}	None	None
Limits on sales of internal shares per employee (DM)	None	20,000 ^{h)}	25,000 ⁱ⁾	20,000-30,000 ^{j)}	18,000 ^{k)}	None	None
Progress with large scale privatization during the 1990s	Significant	Moderate	Moderate	fast until 1994; retreat and very slow	Very slow	Very slow or no progress	No progress Slow since 2002
Corporate governance	Moderate	Weak	Poor	Very poor	Very poor	Very poor	n/a
Enterprise restructuring	Moderate	Little	Little	Very little	Very little	Very little or none	n/a
Private sector share to GDP (2002) ^{m)}	65%	60%	60%	45%	n/a	45%	n/a
Privatization revenues as a share of GDP (in 2002) ^{m)}	4.9%	15.8%	n/a	n/a	n/a	2.9%	n/a

Source:

- a) EBRD, *Transition Report 1994* (London: EBRD, 1994);
- b) Nevenka Čučković, "The Privatisation Process and Its Consequences," 76;
- c) Privatization Agency of Macedonia, <http://www.mpa.org.mk/>, accessed on 25 December 2005;
- d) Mladen Lazić and Laslo Sekelj, "Privatisation in Yugoslavia (Serbia and Montenegro)," 1063;
- e) Savezni Zavod za Statistiku, *Statistički Godišnjak Jugoslavije* (Statistical Yearbook of Yugoslavia) (Beograd: Savremena Administracija, 1990), 428;
- f) Privatization Agency of the Federation of BiH and of Republika Srpska, available at: <http://www.apf.com.ba/>, and www.rs.privatizacija.com;
- g) Official Gazette of the Republic of Slovenia, No. 55/92, Articles 22, 23, and 25;
- h) Official Gazette of the Republic of Croatia, No. 84/92, Articles 25 and 31;
- i) Official Gazette of the Republic of Macedonia, No. 38/93, Articles 26 and 28;
- j) Official Gazette of the Republic of Serbia, No. 48/91, Articles 16 and 17;
- k) Official Gazette of the Republic of Montenegro, No. 2/92, Articles 7, 8, 9 and 11;
- l) Official Gazette of the Republika Srpska No. 24/98, Article 26;
- m) EBRD, *Transition Report 2002: Agriculture and Rural Transition* (London: EBRD, 2002);
- n) Not a discount but the share of proceeds from the sale of SOEs going to workers according to provisions of the Regulation No. 2002/2 on the establishment of the KTA (amended by Regulation No. 2005/18); and authors own compilation

EFFECTIVENESS OF GOVERNMENTAL REGULATION ON HUMAN CAPITAL DEVELOPMENT IN UKRAINE

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research with greater confidence of its applicability to their programs.

1. Introduction

Most researchers examine subject-to-object links between human capital and other external institutions, including the Government, in respect to human capital's influence on the subject. There is a broad consensus in the academic literature¹ that human capital is an important determinant of productivity and other economic outcomes, both at the individual and the aggregate level, and that its role is particularly crucial in today's knowledge-driven economy. At the microeconomic level, the following factors show this: (i) the very clear

Abstract

This article aims at appraisal of governmental regulation effectiveness of human capital development in Ukraine. Such a qualitative measurement is necessary for reflecting the social-and-political governmental impact on formation and development of productive human ability as the first principle for future economical growth. The study contains both theoretical and empirical sections. The theoretical section refers to objectivization, data domain definitions and typology. The practical section presents an appraisal of the State's active powers, methods and measures of its impact. Scientific methods employed here are expert survey as well as abstract-and-logical and graphical methods. The relevant forms and methods, both those which are already applied and could be applied in public administrative practice throughout Ukraine, are examined. The next step was the comparison between present and desirable (needed) groups of methods through relevant indices connected with the various groups of methods. The core findings of the article would be valuable to politicians, administrative and municipal officials dealing with the

¹Richard Nelson, Edmond Phelps, *Investment in Humans, Technological Diffusion, and Economic Growth* (Yale: American Economic Review, vol. 56 (2), May, 1966), 69-82; Paul Romer, *Human Capital and Growth: Theory and Evidence* (Cambridge, MA: National Bureau of Economic Research Working Paper No.3173, 1989); Robert J. Barro, *Economic Growth in a Cross Section of Countries* (Cambridge, MA: MIT Press, Quarterly Journal of Economics, vol. 106 (2), 1991), 407-43; Robert J. Barro, *Economic Growth in a Cross Section of Countries* (Cambridge, MA: MIT Press, Quarterly Journal of Economics, vol. 106(2), 1991), 407-43; Theodore W. Schultz, "Economic Growth - an American Problem" in *Investment in Human Capital* (New Jersey: Englewood Cliffs, 1964).

evidence that school attainment is a primary determinant of individual income and labor market status; (ii) the relationship between individual wages and on-the-job training, with some estimates indicating that a year of training increases wages by as much as 5%; (iii) the connection between human capital and productivity at the firm level.² The literature³, also determines that the link between human capital and individual wages becomes stronger in times of rapid technological change and within highly-developed economies.

At the macroeconomic level, it is clear that the contribution of human capital to aggregate national growth is important, although considerable uncertainty is observed in its exact magnitude because of various econometric problems that complicate the interpretation of the empirical results (A. de la Fuente, A. Ciccone (2003)⁴). The most credible

² Catherine Sofer, et.al, *Human capital over the life cycle* (London: Edward Elgar Publ., 2004).

³ OECD, *The new economy: beyond the hype. The OECD growth project* (Paris: Organization for economic co-operation and development, 2001).; Angel de la Fuente, Raphael Domenech, *Human capital in growth regressions: how much difference does data quality make?* (Paris: OECD Economics Department Working Paper No. 262, 2000), 15-16; George Heinrich, Vincent Hildebrand, *Public and Private Returns to Education in the European Union – An appraisal* (Luxembourg: European Investment Bank, 2001).

⁴ Angel de la Fuente, Antonio Ciccone, *Human capital in a global and knowledge-based economy. Final report.*(Luxembourg:

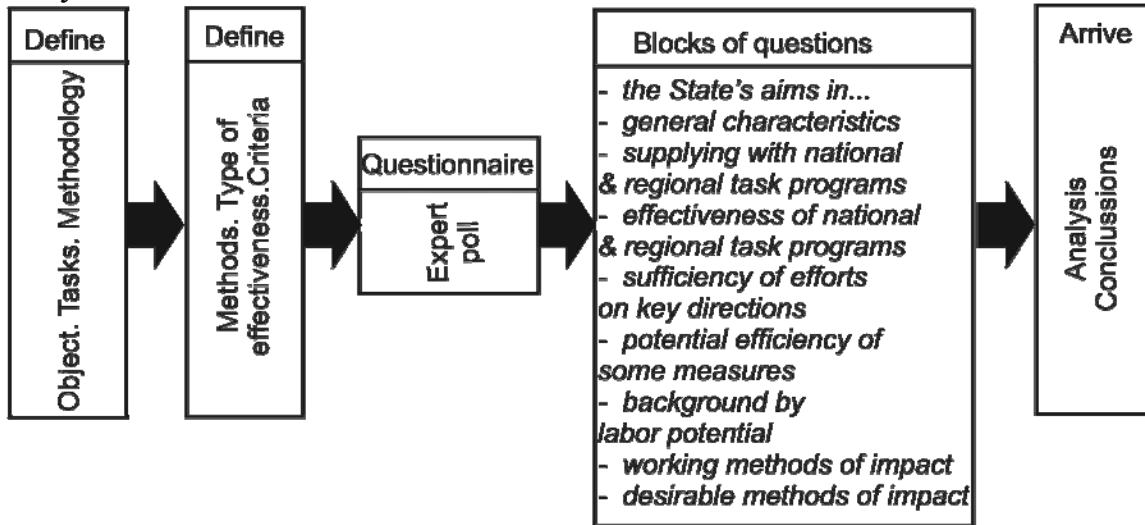
estimates in the literature suggest that, holding other things equal, an additional year of average school achievement increases the level of aggregate productivity by around 5% on impact and by a further 5% in the long run. This second effect reflects the contribution of human capital to technological progress. Some recent research also suggests that the quality of education may be just as important for productivity as its quantity, although further work is needed before reliable estimation of the size of the relevant effect would be available.

There is a lack of complex academic research concerning the state's impact on a human capital development (HCD) at the macro level from the point of efficiency evaluation view. This article more completely develops a complex approach to studying human capital and the state that is non-traditional in academic literature. There was descent from widely accepted analysis of purely economic consequences of companies impact on HCD (micro level, human capital as object (O.)), as well as the human capital's impact on economic growth of the country and the national wealth (macro level, human capital both as subject (S.) and object in "S.-to-S." and "S.-to-O." bands with the state). The present approach is related to "S.→O." form where "S." is governmental authorities and "O." is bearers of human capital institutionalized in forms of educational

Office for Official Publications of the European Communities, 2003), 16, 109.

and scientific establishments. These institutions are considered to be the direct influence of governmental policy. Therefore, the aim of the article is a complex analysis of governmental policy of HCD in Ukraine based both

on theoretical and empirical data obtained from the stakeholders' study. The set aim, determined by a certain research logic based on experts' estimation data, is presented in Graph 1.



Graph 1: Logical scheme of the present appraisal of governmental regulation effectiveness of human capital development.

2. Concept definitions and typology

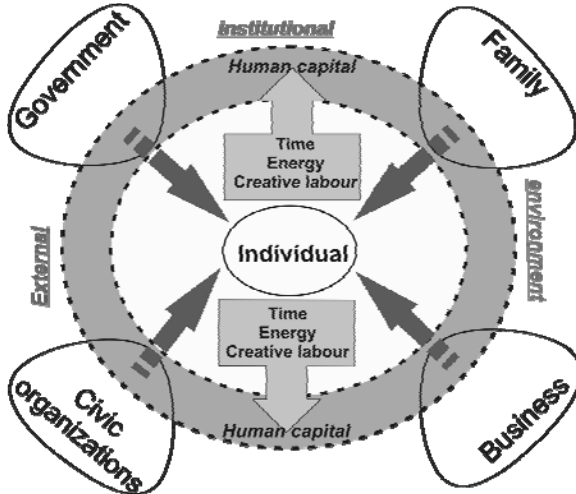
According to D. North¹, the role of institutions is to reduce uncertainty, by means of setting up a stable, though not always effective, interaction between people, and alternative sets restriction which every person has. So, namely the institutional approach to HCD formulation is considered to be pertinent here. It enables deeper research in the field of economic and organizational phenomenon such as institutional administration mechanisms, development strategies,

institutional agreements, etc. Thus, I examine *human capital development as the qualitative change of the human's characteristics within the process of all the social (governmental, business, civil sector and family) institutions' influence on formation and utilization of intellectual resources of mankind in educational and scientific-and-innovation spheres.*² The principal HCD process is presented in Graph 2³.

¹ Douglass C. North, *Empirical Studies in Institutional Change* (Cambridge: Cambridge Univ Press, 1996), 19.

² The sphere of health protection is outside the scope of present and previous research although it surely makes an impact on the process of human capital formation and utilization.

³ Implementation of institutional approach is believed quite appropriate. It is caused by all among acting stakeholders (See: Graph 2), one can see the regular (and irregular)



Graph 2: Principal scheme of human capital development

Such a development should not be defined only in terms of mechanical and extensive increase of its structural elements, including numerical economical factors of its growth. Modern patterns of human development (see Romer⁴, Aulin⁵, World Economic Forum⁶) do demand its achievement to

activity of stakeholders and institutes for arranging and maintaining subject-to-object links shaped in “institutions ↔ mechanisms ↔ human capital bearer” formulae. This activity is respected to “rules of society games” arranging relations between people (See: Douglass C. North, *Institutes, institutional changes and economic development* (Moscow: Nachàla, 1997), 20.

⁴ Paul Romer, *Human Capital and Growth: Theory and Evidence* (Cambridge, MA: National Bureau of Economic Research Working Paper No.3173, 1989).

⁵ Arvid Aulin, *Foundations Economic Development* (N.Y.: Springer, 1992).

⁶ The World Economic Forum, “*Identifying the Key Elements of Sustainable Growth*” in *The Competitiveness Indexe*. (Geneva: The World Economic Forum, The Competitiveness Indexes, Part 1,

be based on mostly endogenous factors, i.e. interaction between national governmental and business, civic institutions, as well as support of corporate sector.

As the practice (See: relevant UNDP⁷, OECD⁸, WEF⁹ reports) proves such effective methods as legislative maintenance, long-term investment into main branches of formation and realization of human capital, generation of national and regional priorities, defining the precise motivation field for the human capital bearers, are constituted as the major forms of the state’s impact on HCD. These are the main types of the state’s impact on formation of “the half-life of knowledge

www.weforum.org/pdf/Global_Competitiveness_Reports/Reports/gcr_2006/chapter_1_1.pdf, 2006).

⁷ Human Development Report 1990. Concept and Measurement of human development // <http://hdr.undp.org/reports/global/1990/en/> 1991; Martin Cooke, Daniel Beavon, Mindy McHardy, *Measuring the Well-Being of Aboriginal People: An Application of the United Nations’ Human Development Index to Registered Indians in Canada* (Toronto: Strategic Research and Analysis Directorate, www.ainc-inac.gc.ca/pr/ra/mwb/mwb_e.pdf, 2004).

⁸ OECD, *Annual report 2006* (Paris: Organization for economic co-operation and development <http://www.oecd.org/dataoecd/37/61/36511265.pdf>, 2006).

⁹ The World Economic Forum, *The Lisbon Review 2004: An Assessment of Policies and Reforms in Europe* (Geneva: The World Economic Forum, 2004), 9, 13.

with long-period”¹⁰, which is about basic and academic education with the long-term economical effect and highly social effect for the state, region and family¹¹.

Public organizations perform functions set by law implementing managerial decisions including a lot of specific actions, mechanisms and procedures approved by social environment and confirmed by certain resources. They are: (a) making decision processes aimed at national programs formation and disposal; (b) public administration technologies in crisis management and information-and-communicative processes; (c) organizational and economic support for education and culture; (d) tax benefits provision; (e) governmental orders and custom provision; etc. Actual public administration experience has worked out a wide managerial kit to provide them according to the objectives and area of economy. The most efficient way that this kit is usually applied into governmental budget and institutional policies and the most prevailing methods and measures for HCD practice are formulated below (See:

¹⁰ Albert Shapiro, *Managing professional people*. (N.Y.: Free Press, 1985), 72.

¹¹ A. Shapiro describes it as “the time after completion of training when, because of new developments, practicing professionals have become roughly half as competent as they were upon graduation to meet the demands of their profession” (See: A source above). E.g., A. Shapiro states that for scientists and engineers this half-life can be as short as five years.

Table 2 in the Appendix), and will be analyzed in this article.

Defining the aim more precisely, one should focus on concordance of “public regulation” essence. One can consider that both “public regulation” and “public administration” are always an ordering, regulating activity¹². It

¹² Quite often there is confusion between “public regulation” and “public administration” in relevant literature. Also there are two different approaches to parity of these notions. On the one hand, one can define that “public regulation” is broader than “public administration” cause of the last one mostly uses administrative methods. It’s appropriate to recollect a comparison of market economy (e.g. Keynesian and neo-Keynesian economic theories) vs administrative-command system. On the other hand, “public administration” is wider cause of classical theory of management proclaims a ‘regulation’ as a function of management (See: Michael H. Mescon, Michael Albert, Franklin Kedouri, *Management* (Glenview: Harpercollins College Div, 1985)). As M. Latynin proves, a ‘regulation’ notion looks more likely when one’s examining a management of subject which are not a state’s property (See: Mykola Latynin, “The essence, components and effectiveness of public regulation mechanism for agrarian sector economy” in *Mechanisms of effective development of agrarian sphere*, ed. Leonid Anichin (Kharkiv: Magister, 2006), 9). Another researcher conducts a difference by the edge of entitled rights: within “public regulation”, a state takes part in market processes entitled with rights of a subject of *market relations* (See: Mykola Koretzkiy, *Formation and development of the system of public regulation of agrarian sector of*

assumed that “public regulation” is less categorical than “public administration” that is supposed to be reflected in subsequent logic. Therefore it deserves consideration that “public regulation” provides the subjects with an opportunity to choose a desirable and suitable way of behavior not foreseen by “public administration”.

Thus, examining transition processes, the state (public regulation provided) often has a few institutions with the stable roles and functions, and even functions autonomously in the economy. Nevertheless it very often follows a liberalization policy enabling other acting subjects to self-realize into economic mechanism. All the private stakeholders of institutional environment direct their investments to those fields where risk is minimized and/or benefits are maximized. It causes excessive financing of certain branches of economy and shortage of such branches, such as education, R&D, high technologies and human capital in general.

Within a market economy, the progressive role of the state is fulfilled due to the maintenance of strategic directions and branches of economy, as well as making favorable economic climate which contributes to the most immediate adaptation of economic system to changeable realities. The regressive role of the state is revealed in the case of non-fulfillment of strategic

economy (Kiev, NAPA [Dissertation], 2003), 140.

tasks, social investment resources are not directed to a real legitimate sector but are accumulated in the “shadow”. Thus the question arises: *Does the state act effectively to meet both the interests of certain social objects and its own engagements?*

There are some approaches to defining governmental regulation (GR) effectiveness and criteria of effectiveness which can be looked at from different angles (See: Table 1). Most of them describe different theoretical and practical aspects of effectiveness of both governmental regulation and public organizations' activity (D.Beeton and F.Terry¹³, N.Carter¹⁴, M.Cave¹⁵, M.Holtzer and K.Callahan¹⁶, P.Smith¹⁷, V.Dzundzyuk¹⁸ etc.). The OECD 1993 Annual Report highlighted a direct connection between

¹³ Danny Beeton, Francis Terry, *Evaluating public service performance* (London: Public Finance Foundation, 1989).

¹⁴ Nail Carter, et al., *How organisations measure success – the use of performance indicators in government* (London: Taylor & Francis, 1992).

¹⁵ Martin Cave, Maurice Kogan, et al., *Output and performance measurement in government. The State of the Art* (London: Jessica Kingsley Publ., 1990), 112-118, 131-140.

¹⁶ Mark L. Holzer, Kathe Callahan, *Government at work – best practice and model programs* (N.Y.: Sage, 1997).

¹⁷ Peter Smith, *Measuring outcome in the public sector* (London: Taylor & Francis, 1996).

¹⁸ Vyacheslav Dzundzyuk, *Effectiveness of activity of public organizations* (Kharkiv: Magister, 2003).

effectiveness of public sector and effectiveness of national economy on the whole. It is reported that there is a need for permanent improvement of service quality and clients' satisfaction in public sector¹⁹.

Nevertheless what does public effectiveness mean and how can it be reached? According to N. Carter²⁰, J. Child²¹, Ch. Talbot²², public organizations and public sector effectiveness are linked with: (a) the ratio between consumed resources and received final results (goods and services); (b) the decrease in quantity of consumed resources or their costs reduction; (c) process duration restriction; (d) ratio between final product and final result. On a nationwide and society scale, some international organizations (UNDP, OECD, UNCTAD, Institute of Management Development etc.) it is indicated by: (a) the level of real GDP per capita; (b) the level of GDP growth per capita; (c) the rate of costs

utilization (human and material resources); (d) the ability for consuming generated goods and services; (e) the competition level; (f) the adequacy and precision of strategic planning. Some modern Ukrainian and Russian authors (see G.Atamanchuk²³ and officials of Ministry of education and science of Russia²⁴, V.Tsvetkov, edtd.²⁵) came to the conclusion that the main criteria of modern state regulation effectiveness in the social political area are: (a) most complete correspondence of administrative activity to society's vital interests; (b) widening and deepening democracy; (c) securing the citizens' rights and liberties, its realization in practice; (d) fulfillment of tactical and strategic political and social aims as to reforming society; (e) taking the economy out of crisis and turning Ukraine into a developed country. In this respect, one can summarize some approaches and criteria of effectiveness which have been considered (See: Table 2). The correct definition of effectiveness will assist us to carry out

¹⁹ OECD, *Annual Report 1993* (Paris: Organization for economic co-operation and development, 1994).

²⁰ Nail Carter, et al., *How organisations measure success – the use of performance indicators in government*. (London: Taylor & Francis, 1992), 17-20, 29.

²¹ John Child, *Organizational Structure, Environment and Performance: The Role of Strategic Choice*. (American Journal of Sociology, vol.6, 1972), 2-21.

²² Charles Talbo, *Public Performance - towards a new model?* (London: Public Policy and Administration, vol.14, <http://ppa.sagepub.com/cgi/reprint/14/3/15>, 1999).

²³ Grigoriy Atamanchuk, *Criteria and procedures of measuring for social activity of public administration*. (Moscow: Nasha Vlast review: www.nashavlast.ru/archive/2006/11/08.htm, 2006).

²⁴ *On enhancement of effectiveness of public sector in sciences*. (Moscow: Ministry of education and science of the Russian Federation, www.mon.gov.ru/science-politic/gossektor/doc180505/doc180505.doc, 2005).

²⁵ Vladimir Tsvetkov, *Reforming of public administration in Ukraine: problems and prospects*. (Kiev: Oriyany, 1998), 131.

proper research and to meet assigned goals.

The need for establishing a set of goal criteria for a public (governmental) regulation (G.R.)²⁶ system is determined as carrying out the State's functions for assigned goal achieving or social effect attaining. Acting on behalf of the nation and the State, public organizations rarely assume the direct economic (commercial) effectiveness criteria, although the economic criteria (one of the cheapest variants, as a rule) always stand during decision making. Mostly showing preference for the social effectiveness rather than economic one, governmental organizations run with low or very low economic effectiveness in their activities. The socially significant effect usually appears in medium- & long-term prospect, and at the same time *optionally having a precise value form or expression*. In this present research, one would appeal to study *the way how governmental and some public bodies reach the goals for creating HCD conditions* that have been exactly input into goal effectiveness of public administration. Considering the

effectiveness of administration as an effect (result) confronted with the costs (efforts) for its achievement, in the case of HCD target effectiveness it is more appropriate *to analyze through the goal of regulation*. It dynamically compares the object's status at the output (the final one as ideal) with the planned or desirable status (result). Taking into consideration that it's rather difficult to highlight a clear dependence on a certain factor's impact due to lack of relevant statistics, the impact of some factors on HCD have been estimated based on expert responses²⁷.

All the experts were selected from the biggest Ukrainian cities like Kharkiv (41,6% or 26 people), Kyiv (38,3% or 23 persons), Donetsk (6,6% or 4 people) and other cities (13,2% or 8 people). Within the period from October to November 2006, this survey was conducted among a 60-person expert target audience:

1) scholars and scientists who represented universities and research institutes;

²⁶ Modern European and American academic literature on Public administration & Political science does not emphasize the differences between "public regulation" and "governmental regulation" notions very much, providing them virtually the same matter. The "governmental regulation" is widely used to be mentioned in relevant literature. And I would apply namely it and primarily identifying it with "public regulation" during the ensuing research.

²⁷ As V. Dzundzyuk proves, clashing certain complication in determination the objective indicators of effectiveness in public organizations, there is an approach of experts' opinion to be implemented. The external effectiveness is measured with a single integral indicator as clients' satisfaction of activity (See: Vyacheslav Dzundzyuk, *Effectiveness of activity of public organizations* (Kharkiv: Magister, 2003), 79).

Table 1: Classification of present approaches to defining of public administration effectiveness

Approach		Main criteria	Essence of approach
Economic effectiveness		Effectiveness is an indicator of profit	Linked with ensuring intakes to budget; bringing in and off-budget funds development; market cost increase of organization where the State is a key shareholder (e.g., natural monopolies, national sectoral holdings)
Goal effectiveness		Goal achievement	Co-ordination results with a goal; succeeded by correct set aims and by scientifically grounded fulcrums.
Functional effectiveness		Activities of functions	Linked with public functions performance, realization of the state's strategic priorities, ensuring positive structural reforms, output capital goods.
Social effectiveness	- general	Prosperity of population; quality of life; safety for life activity and labor; growth rates of national wealth etc.	Performs as partial criteria of social labor effectiveness. Characterized by "human-to-human" attitude as well as effectiveness of public organizations' activity. Defined by social contents of labor, including managerial one.
	- special	Rationality and effectiveness of organization and functioning of public administration subject.	
	- specific	Activity effectiveness of separate official body, administrative decision.	
Organizational effectiveness		Effective functional links between elements of organization	Defined by optimal organizational interaction form that works it out more effectively in a goal achievement. Conditioned by certain extent of voluntary cooperation that lies out of any constraint.

- 2) public servants (the chiefs of structural departments related with education, science and employment);
- 3) chiefs and leading experts of non-governmental analytical centers;
- 4) journalists who professionally deal with topics of social and innovative politics.

In this case, the following are taken as the field research matters being studied (a) all the organizations directed to formation and use of intellectual human resources in education and R&D spheres, as well as (b) social relations arisen after the state impact and can't be solved without the interference.

3. Active powers for the state

Analysis of expert surveys concerning a G.R. effectiveness of HCD enabled certain conclusions. Some of them are considered *to be rather unexpected* as well. Nevertheless, on the whole they are able to give a picture highlighting the main problems in present public policy.

1) The lack of really modern and widespread national priorities for HCD. Public policy is characterized by:

(a) divergence between political declarations and authorities actions, between necessary and realizable events; (b) existing bureaucratic limitations, but at the same time (c) there are qualitative successive improving reforms.

According to the most complete compliance with society's vital interests as the main criteria of modern public administration (after V. Tsvetkov), our experts note that Ukraine is rather weakly (15%) following the path of maintenance and development of the national priorities (Graph 3 in Appendix). According to 16% of experts' opinion, Ukraine's priority-oriented movement could be intensified by parties' election pledges. But within young Ukrainian parliamentary-and-presidential republic (since January 2006) it doesn't look like "one & indivisible team" game with common rules. Also it proves the facts of: (i) imbalance between the main political and economical groups' interests around the realization of economic

growth as a mission; (ii) present debility of public institutes. Besides, an effective use of all available resources as the goal of the state's activity, is rather low (11%). But experts' appraisal concerning aimlessness activity of in HCD is believed appreciable (16%) now. It means that governmental bodies so far make decisions based on situations, and/or they don't have any interest in productive activity on this aspect of social-and-economic development.

The last statement is confirmed with the experts' responses but in slightly different dimension (See: Graph 4). Almost half of the respondents characterized the modern GR of HCD status as contradictory, and almost a quarter of them stated it to be "neglected". No expert said that the present policy is "weighed and emphasized", although every second respondent marked that qualitative reforms have started for the better.

Also 20% experts observe excessive regulatory influence from the government which comes along with prohibitions and limitations. It just intensifies the opinion of (a) imperfection and interior divergence in HCD public policy and (b) low goal effectiveness of the government.

2) Current national and regional task programs in educational and scientific sphere are outdated, they demand some modifications. Their effectiveness is rather low as well; some of the main reasons are lack of budget financing

and the national local authorities' carelessness in fulfillment.

As positive experience of Japan, Sweden, the US, etc demonstrates, exact program-targeted approach plays the major role in maintenance of the state's priority directions. The first governmental task programs (GTP) were launched in 1992 in Ukraine. With reference to Ministry of Economics of Ukraine, in 1992 there were only seven GTP (See: Table 3) and their number was supposed to grow annually (up to 323 programs in 2004).

Ukrainian GTPs are believed to be one of the main mechanisms of budget funds' investment into social-and-economic development. Therefore some experts were asked about the level of supply with GTPs in spheres of education and scientific-and-technical policy scaled on Ukraine's national and some regional (Kharkiv, Kiev, Donetsk and a little other cities) levels. Also separate attention was called to GTPs' effectiveness (See: Graphs 5 and 6).

Analyzing national educational programs provision, 22% of respondents noted that all the directions are defined clearly and 12% of experts stated that present programs are actual and appropriate. Almost the same summarized quantity of experts (38%) think that present GTPs are outdated and they demand corrections both in budget expense item as the matter of fact, and the amount of financing. Some 11% of respondents consider that there are no such programs at all.

The same situation is observed in the provision of regional educational programs. There is a balance between relevance and lack of relevance for making correction into present GTPs. But there is a more prevailing thought about both subsistence of such regional programs (16%), and subsistence of national programs (11%) on the whole. The response distribution in favor of its obsolescence and correction the R&D programs, is rather evident (45%). Moreover totally 22% of respondents do positively estimate the provision of them. Some more 15% of experts think that such the programs do not subsist. Besides some of the experts didn't determined their position, and it actually seems to be quite essential, and their opinions vary from 13% to 20% for all four pointed positions.

The experts' survey has given the following results concerning appraisal of educational and scientific-and-technical GTPs effectiveness (See: Graph 6). Respondents set quite low rates for amount of necessary financing for those programs reflecting low final result in practice. Also a lot of remarks were made with the reference to fulfillment of these programs and ranked them from 19% for national educational programs to 26% for regional R&D ones. One can observe some actual usefulness of them due to both 12% (national educational programs) to 18% (regional educational ones) appraisals. Responses as for mistakes in strategic HCD planning range from 7% for regional R&D programs to 12% at the same sphere

statewide. It suggests that as a whole Ukraine has a sufficient quality level of strategic and macroeconomic forecasting and planning, and one couldn't refer to the highest-level's inadvertencies and failures at the present situation.

3) Governmental efforts for secondary education services are appraised very positively. But one can see a gap between rates of financing education and science on the one hand, and necessary and desirable level on the other hand. Also there is a shortage of organizational efforts for stimulation lifelong education.

The survey also showed the appraisal of adequacy of the focused governmental efforts on the certain HCD directions which are believed to be universally decisive for formation and development of creative human ability (See: Graph 7). The highest experts' appraisal is credited to efforts for secondary education granted for population (summed-up positive 65% vs. bad estimate with 5% only). Also the work for education of brainpower (summed-up positive 42%) seemed to be rather successful. But on the other hand, it is balanced with skeptical rates (almost 40% for the weak level of the governmental efforts).

At the same time, one can estimate the efforts for stimulating lifelong studying as totally insufficient: more than a quarter of experts could not appraise it positively, and almost as many experts estimate it rather negatively. Judging on

estimation of the sufficiency of the state's budget expenses, there is a dangerous situation for education and science. A mere 10% of experts appraised volumes of public expenditures positively. And the reverse 67% of experts saw insufficient efforts that are used to be valued in absolute monetary characteristics. Also summarized 19% of respondents marked the government's efforts for popularization of modern IT among Ukrainian nation as "sufficient". A third (33%) of responses asserts that little efforts were made in this sphere, and 20% consider the efforts as unsatisfactory.

4. Methods and measures of impact

4) Within present situation, normative and economic methods of G.R. of HCD prevail greatly, moreover desirable methods insignificantly vary from presently acting kits.

In compliance with impact facility, the methods of GR of HCD are classified according to Table 1 (on normative, economic-and-financial, administrative, organizational, scientific-and-methodical, and informational-and-educational ones). All these methods, being implemented in the budget, monetary politics and institutional practices, are believed the most commonly used and finally effective. The experts' poll stresses a fact that transition period in Ukraine is accompanied by using mainly normative (22%) and economical (33%) methods of G.R. of HCD (Table 4).

5) *Desirable measures for effectiveness increase in scientific-and-innovative sphere are also in legal plane, e.g. further improvement and permanent keeping to law, and determining the strategic development priorities for Ukraine.*

At the same time, the idea of desirable methods differs from reality. Thus, normative methods are to be intensified a little. This fact just extrapolates a prevailing experts' view on cause requirement for national strategic move determination. Also as experts supposed, it's more desirable to implement more informational-and-educational methods. Survey's results prove that experts felt the need for little liberalization in administrative and even economic methods of regulation.

Respondents' answer concerning some methods and measures to improve the science-and-innovation sphere (Graph 8), testify for legislative establishment of "rule of game" (63%), the national priorities identification (59%) and intellectual property (I.P.) protection (45%). There are normative and legal methods as well.

Let's note that alternatives for (a) National Academy of Science of Ukraine reformation, 35%, (b) consulting centers administration, 31%, (c) governmental works, 29%, and (d) direct permanent loans, grants etc., 28%, are believed to be the most doubtful ("being in lost to reply" responses) here. In addition, experts are rather cautious in regard to both "not

enough covered the media's measures" response, and appropriateness of the state's disinterested charity.

6) *As a whole, one can observe a low level of administrative implementation the legislation which points to and combines the main forces in certain HCD direction.*

In order to estimate how labor potential grounds and serves for further formation of more complicated "human capital" economic category in Ukraine, there has been a relevant case study (See: Table 5). It was dedicated to analysis of the government's work referring to the Decree of the President of Ukraine which has fixed the main directions of labor potential development in Ukraine till 2010.¹

Suggested measures ranged according to relative coefficient of trust balance (c_{tb}) which has been calculated as a quotient between summary positive estimates and summary negative estimates. After this result one can make a conclusion that some forms of the Presidential statute are "not been held" or "rather not been held" in sphere of educational base development and sphere of the population extensive reproduction. Namely they are: (a) integration on vocational, higher and after-graduate education into international educational system, and

²⁸ Decree of the President of Ukraine, *On general directions of labour potential development in Ukraine for the period till 2010* (Kiev: Official bulletin of Ukraine, Sept.20, No.31, 1999).

(b) development of a reasonably-priced housing market. Besides one should note some high indicators in (a) conditions of vocational and higher education accessibility for the population; (b) further creation of educational service market. The first (“a”) sentence is rather considered to be gained since the time of the Soviet Union.

7) *The least effective current measures are labor incentives for educational and science employees, I.P. rights protection, and quality of procedures for innovative projects appraisal.*

Appraisal of economic impact effectiveness measures for HCD (See: Table 6) presented that experts give preference to (a) governmental order for education of brainpower; (b) governmental order for manufacturing of science intensive output; (c) financing the GTP in R&D sphere. None of the 7 suggested impact measures have relative coefficient of trust balance (C_{tb}) higher than 1. Thus, looking at the experts’ subjective estimate, one could realize the rather low effectiveness of selected economic instruments.

Between all the seven suggested normative and administrative instruments of Governmental impact (See: Table 7), the most effective ones are: (i) drawing civic consulting bodies to making decision process ($C_{tb}=1,03$), and (ii) starting educational reforms ($C_{tb}=0,71$). Expert examination and

appraisal of innovative projects ($C_{tb}=0,19$) and I.P. protection ($C_{tb}=0,18$) are marked with unsatisfactory effectiveness. The totally low effectiveness is also observed in this group of impact measures.

5. Conclusion

The research aims at an expert-survey basing analysis of governmental regulation effectiveness of the main human capital constituents in Ukraine. This is still a weakly developed direction in economic and political sciences, which could allow the finding and synchronizing of some macroeconomic development reserves lying in the plane of public policy and public administration. Examining the main weak and problematic spots in governmental regulation of human development process, in particular educational and scientific spheres, there is a large number of gaps and problems, arisen from insufficient performance in public organizations. Looking at the Ukrainian case, it can be seen as a problem of not high final effectiveness and sometimes even a detachment of performing measures both from Ukrainian economic realities and from effective realization stimulation of available labor potential.

The Ukrainian experience testifies that many processes of HCD and innovation regulation would not be successful when there is an imbalance between tactics and strategy. Annually some institutional changes come and certain innovative infrastructure elements

appear, but there is no national strategy or purposeful policy under fragmented management. In Ukraine, innovative favorable environment has been shaped visa versa, from the construction of separate parts of its infrastructure under the weak governmental institutional support.

Concerning the main substantial human capital constituents, Ukraine has become in a situation when positive dynamics by single constituents (e.g., schooling, applied science) are unable to provide for stable human development through the minor positive changes by other constituents (e.g., life-long studying, fundamental science, modern IT knowledge). In this respect, unless one assumes urgent managerial measures to stabilize a situation, hereafter it could lead to the lack of prospects in human capital utilization for national wealth formation in Ukraine. The prospects for the solution of the main difficulties are considered to be in more severe governmental participation, particularly, in more intensive use of the normative and economic measure complexes, which have the strongest positive effect today. I hope to be able to attract more undivided attention to the subject of human capital development while I was successively answering several questions: Are the existing governmental impact methods still applicable in the Ukrainian case? What measures can the state apply in order to function more effectively? How does the Ukrainian government follow society's vital interests?

Finally, the present research conveys my imagination. It lies on the verge of public administration, law and macroeconomics sciences, and contains much potential for further research. Being aggregated, the research is of theoretical, methodological, and practical nature, and can be used in practical performance of governmental bodies and local authorities for purposes of improving the human development regulation processes both on the macro level and locally.

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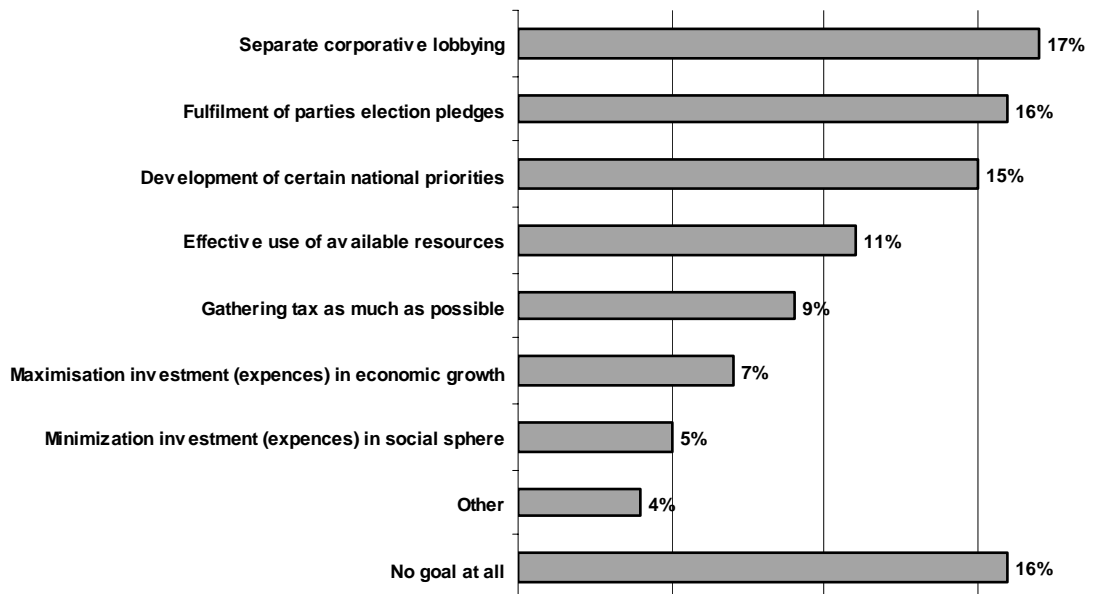
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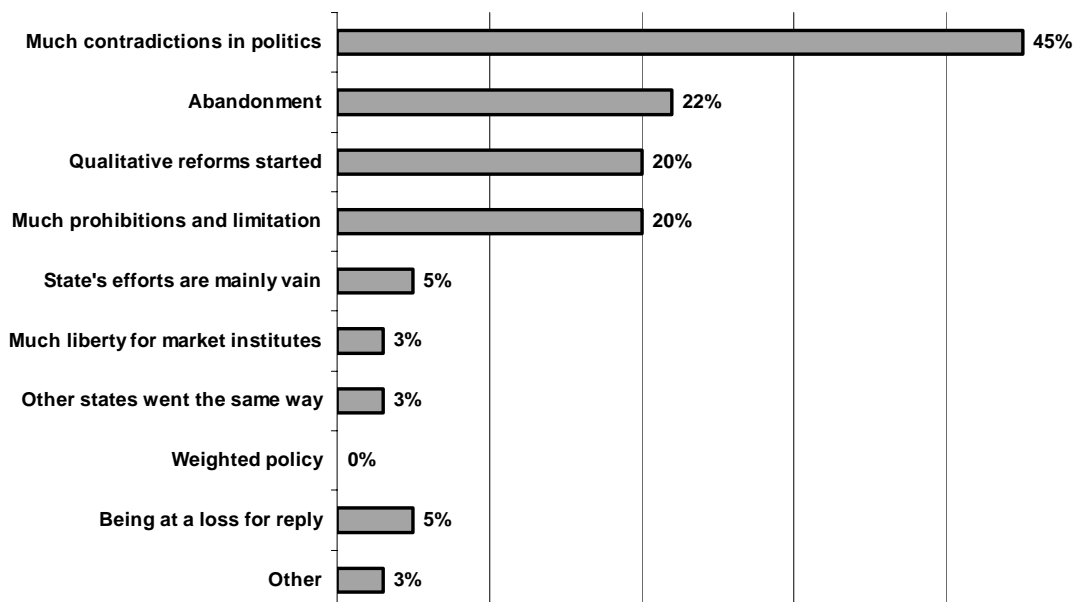
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APPENDIX

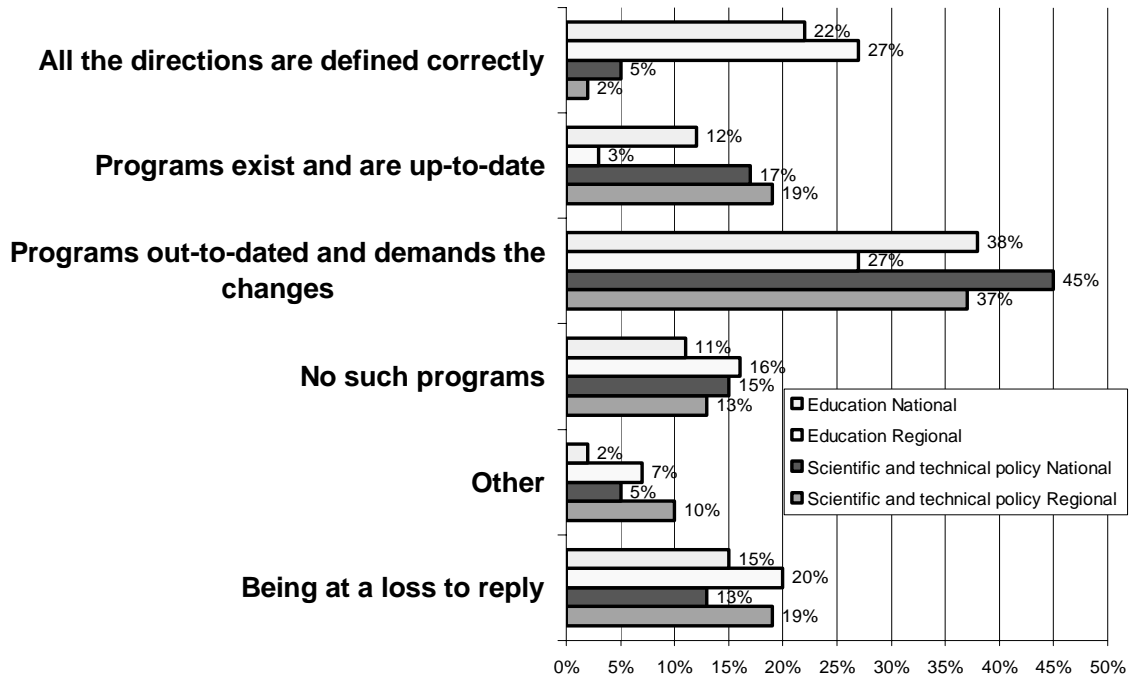
Graph 3: Government’s object in human capital development processes (*% of expert responses*)



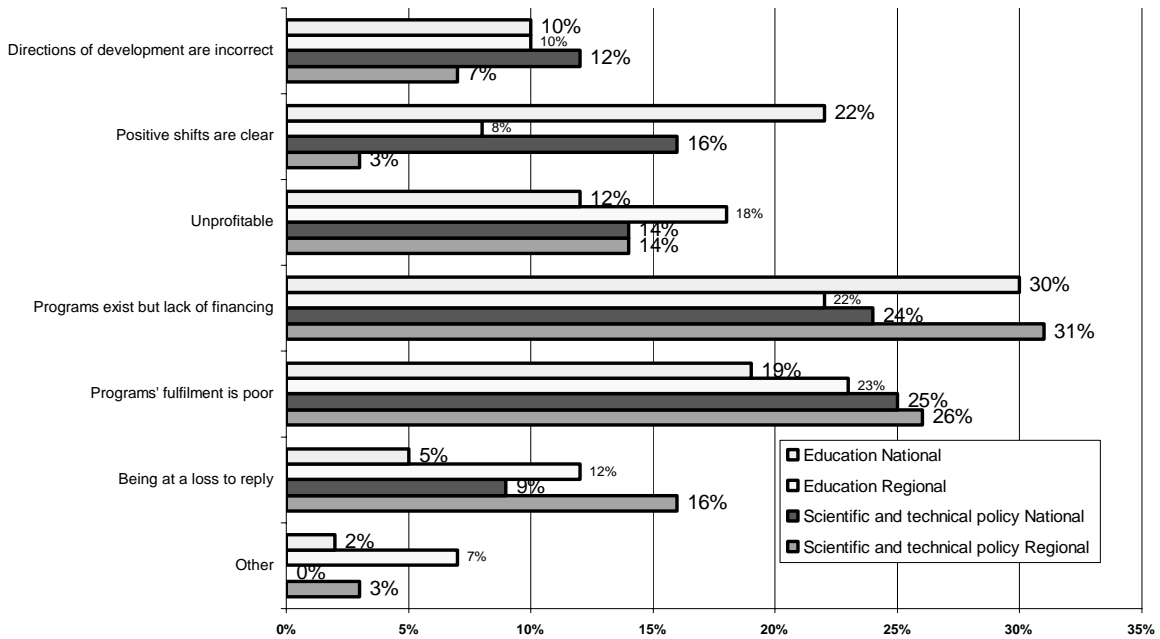
Graph 4: General characteristics of present governmental regulation of HCD in Ukraine (*% of expert responses*)



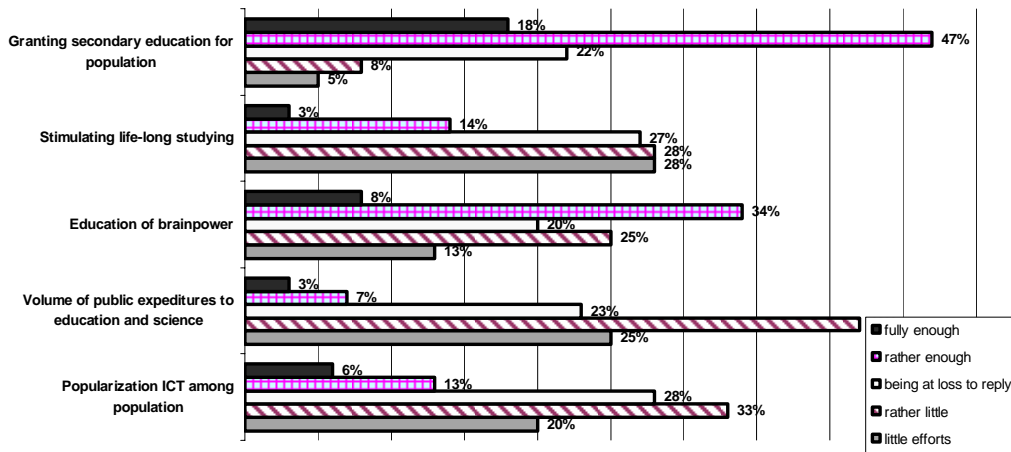
Graph 5: Appraisal of supplying with regional and national GTPs in spheres of education and scientific-and-technical policy (% of expert responses)



Graph 6: Appraisal of effectiveness of regional and national GTPs in spheres of education and scientific-and-technical policy (% of expert responses).



Graph 7: Sufficiency/insufficiency of Government efforts in such educational constituent directions... (% of expert responses).



Graph 8: The most efficient measures for regulating science and innovations sphere in Ukraine (% of expert responses).

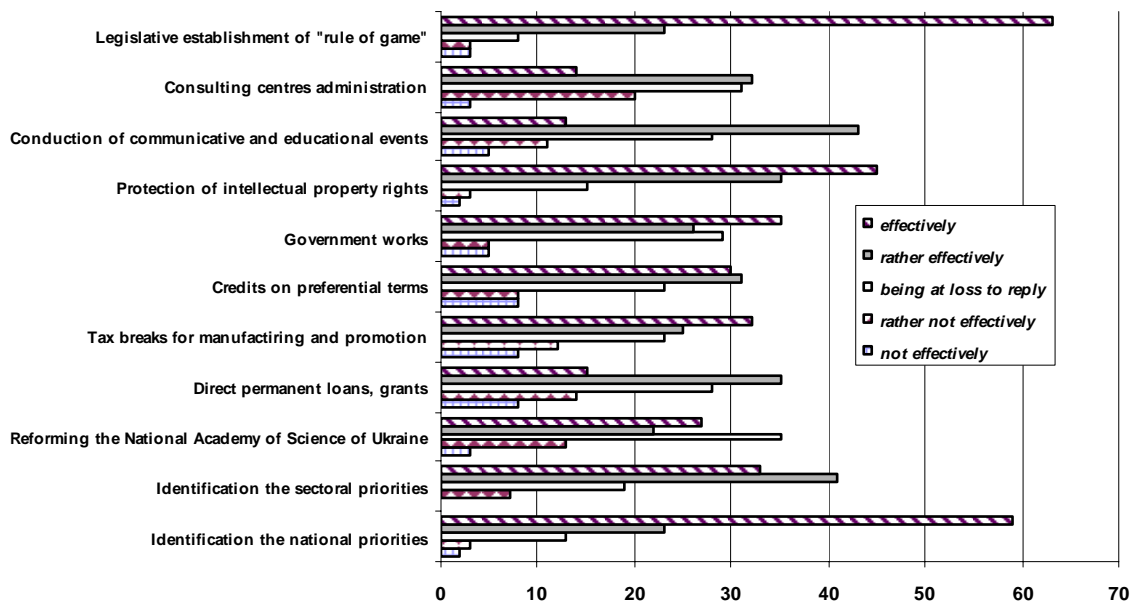


Table 2: Classification of methods and measures applied in public regulation of HCD.

Title of method	Essence of method	Resorts	Measures and actions of regulation
1) Normative	Arrangement the obligatory legal conduct regulation.	Working out and adoption of statutes (“games rules”) by public organizations. Social standards.	Constitution, laws, decrees, resolutions, decrees, acts, fiats, court decisions etc. Minimal wages (pension), level of subsistence wage, working day duration, requirement for safe working conditions etc.
2) Economic-and-financial	Based on economical calculations, conscious use of the whole economic laws system and market economy categories, e.g. planning, financing, pricing, economic stimulation.	Budget and off-budget financing of target programs; crediting; financial support for licensing of public research institutes and universities; financial support for producers; depreciation policy	Direct irrevocable subsidy, grants; loans; shareholding; tax bonanza (tax credit, tax deferral, tax zero rate); alternative loan; accelerated depreciation; interest relief for labor remuneration; funding for individual housing construction; financing the governmental education and training programs; governmental work etc.
3) Administrative	Based on authority supremacy, subordination of the object to subject volition; they include means of interdiction, permission and compulsion.	Patenting the intellectual property objects; licensing; registering and liquidation of companies, control of their activity; reforming of actual institutions etc.	
4) Organizational	Providing arrangements of certain actions and institutional infrastructure formation.	Adoption of normative acts. Establishing of new regulatory foundations.	Consulting offices; participating in civic unions, expert councils; governmental laboratories, institutes; regional-and-cluster facility management etc.
5) Scientific-and-methodical	Based on analytical accompaniment for subject management activity.	Working out of messages, strategies, plans, programs and forecasts of social-and-economic development; grants and publications for researchers.	

Title of method	Essence of method	Resorts	Measures and actions of regulation
6) Informational- and-educational	Based on educational measures increasing educational level and public awareness.	Organization of communicative campaign.	Conferences, seminars, trainings, discussions, forums; working out published materials, preprints, Internet sites; sociological research.

Table 3.
Dynamics of governmental task programs launch in Ukraine

Year	GTP launched	GTP in realization
1992	7	7
1993	17	...
1994	17	...
1995	21	...
1996	20	...
1997	87	...
1998	203	...
2001	251	208
2004	323	267

** Source: Ministry of Economics of Ukraine*

Table 4: Distribution of expert answers concerning working and desirable methods of G.R. of human capital development...

Methods	Unit weight of expert appraisal		Variation, Δ („3” – „2”)
	Methods working the most today, %	Desirable and needed methods, %	
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
Normative	22	24	+2
Economic-and-financial	33	28	-5
Administrative	9	5	-4
Organizational	13	15	+2
Scientific-and-methodical	11	14	+3
Informational-and-educational	8	12	+4
Others	1	0	-
Being in lost to reply	3	2	-

Table 5: Estimation of the current status of adhering to Decree of the President of Ukraine “On general directions of labor potential development in Ukraine for the period till 2010” by the Government

Measure of impact	Appraisal ¹					C_{tb} („4” + „5”) / („1” + „2”)
	„1”	„2”	„3”	„4”	„5”	
	Unit weight of expert appraisal, %					
1. Arrangement of the conditions for accessibility of vocational and higher education for all the population	3	5	43	32	17	6,13
2. Formation of educational service market	13	20	23	32	12	1,33
3. Fostering of professional self-determination of the youth	14	21	30	27	8	1
4. Integration of vocational, higher and post-graduate education into international education system	5	32	38	17	8	0,67
5. Development of reasonable priced housing market	13	40	27	12	8	0,37

¹ Here and further along the text: “1” – unambiguously goalless, “2” – „rather goalless”, “3” – “being at a loss”, “4” – „rather resulting”, “5” – unambiguously resulting”.

Table 6: Appraisal of economic impact measures for HCD effectiveness

Measure of impact	Appraisal					C _{tb}
	„1”	„2”	„3”	„4”	„5”	
	Unit weight of expert appraisal, %					
1. Governmental order for education of brainpower	7	29	33	26	5	0,86
2. Order for science intensive output manufacturing	11	24	40	16	9	0,77
3. Financing of the GTP in R&D sphere	12	22	42	13	11	0,70
4. Financing of the GTP in education sphere	12	26	38	16	8	0,63
5. Arrangement of the tax remissions for subjects of innovative activity	18	32	29	16	5	0,42
6. Availability of credit resources for subjects of innovative activity	21	29	28	15	7	0,40
7. Labor incentive for education and science employees	18	42	29	9	2	0,18

Table 7: Appraisal of normative and administrative impact measures for HCD effectiveness

Measure of impact	Appraisal					C _{tb}
	„1”	„2”	„3”	„4”	„5”	
	Unit weight of expert appraisal, %					
1. Drawing of civic consulting bodies to making decision process	11	19	40	21	9	1,03
2. Continuation of further educational reforms	18	24	28	20	10	0,71
3. Expediency of financial aid for innovative projects	20	24	28	18	10	0,63
4. Stimulating of non-governmental investment in R&D	14	35	28	16	7	0,46
5. Observance of contest principal during the projects financing	10	33	37	17	3	0,46
6. Expert examination and innovative projects appraisal	22	39	27	10	2	0,19
7. I.P. protection	20	38	30	11	0	0,18

PLAYING THE GAME OF HEATING SYSTEMS. THE CASE OF ROMANIA

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Abstract

Although theoretically the individual decision of buying heating systems is expected to be an efficient choice, the problem of social sub-optimality must be considered. This article models and empirically investigates, from the point of view of game theory and rational choice perspective, the distinction between individual and collective action, how the former can cause the failure of the latter. Individuals still choose to buy individual heating systems without being aware that a better solution is the investment in the modernization of centralized heating systems. Although it has a lot of beneficial aspects, as comfort or efficiency, the choice of individual boilers has important social negative externalities, such as neighborhood pollution. Therefore, the main inquiry is how public authorities can contribute by setting incentives to transpose individual rationality to the social level. The formal and game theoretical results show that if enough people cooperate in order to modernize district heating systems, both individual and social costs can be lower than in the case of individual heating boilers.

1. Introduction

One of the main challenges of technological development in countries that use centralized heating systems is the increased number of individuals that decide to purchase individual heating systems. Thus, they have become responsible for the way common-pool resources, as gas, water, electricity and even clean air, are managed.

This article focuses on the Romanian case. While in most Central and Eastern European countries, as for instance Hungary, disconnection from the central system is associated with high costs¹, in Romania, over the last few years, there has been a steady increase in the number of individual purchases of heating systems due to low costs of disconnection. People have decided to give up the old and inefficient system and become independent in their heating, water and gas consumption. As the next table shows, the number of households connected to centralized heating systems decreases almost continually every year.

Based on the above described situation, the main question that this article tries to explicitly answer is the following:

¹ Katalin Pallai (ed.), *The Budapest Model. A Liberal Urban Policy Experiment*, World Bank Institute and Local Government and Public Service Reform Initiative, Budapest 2003, 261.

which alternative – purchasing an individual heating system or investing

Table 1: The number of households connected to the centralized heating systems in Romania in the last four years

Year	The number of households connected to the centralized heating systems at the end of the year
2004	1,190,635
2005	1,113,093
2006	1,088,074
2007	1,082,628

Source: National Authority of Public Service Settlement for Communal Households²

in the modernization of a district heating system, induces a more effective management of common-pool resources and thus provides greater benefit at both the individual and social level? The two problems present in this question – the management of common-pool resources and the individual and social benefit, are interdependent and imply a single answer. The efficiency of the way common-pool resources are managed influences both the level of

individual and social benefit. A secondary question this article addresses is: How can public or political institutions intervene in the problem of heating systems in order to effectively manage common-pool resources? Considering these questions, the hypothesis of the article is that *the modernization of district heating system is a more beneficial alternative to individual boilers at both individual and social levels.*

From the methodological point of view, the article aims to apply a formal and a game theoretical perspective. I will develop formal functions and I will apply a game theoretical perspective in order to find the desired equilibrium of the game of heating systems.

2. Conceptual framework

This part of the article aims to offer the conceptual tools needed in order to better understand and to clearly describe the issue of heating systems. Therefore, the main concepts that are going to be used are management of common-pool resources and collective action.

Development, broadly understood as demographic growth, growing demand for natural resources, integration of resources into the market, and technological innovations, increases the impact of human behavior on natural resources. Edwards and N. A. Steins argue that this development leads to “overexploitation, alienation of traditional users groups and conflict

² National Authority of Public Service Settlement for Communal Households (Autoritatea Nationala de Reglementare pentru Serviciile Publice de Gospodarie Comunală), Available at http://www.anrsc.ro/index/servicii_energetice/ARHIVA/arhiva_2007.htm, (accessed 15 May 2007).

among different stakeholders”.³ Before entering the issue of resources management, a definition of “*the common-pool resource*” concept is required. Contrary to private goods owned by a single person, common-pool resources are those resources that do not exclude anyone from using them, but that do not permit multiple consumers to use the same good for unlimited time.⁴ In other words, as Heikkila claims, common-pool resources present the difficulty in excluding users and sub-tractability of supplies (which can lead to problems of free-riding or insufficient maintenance of supplies), where each resource user reduces the supply available to others (which can lead to problems of over-appropriation or congestion).⁵

³ V. M Edwards and N. A. Steins, “Developing an Analytical Framework for Multiple-Use Commons”, *Journal of Theoretical Politics*, no.10 (3), 1998, pp. 347-383, in Steins, Nathalie A and Victoria M. Edwards “Synthesis: Platforms for Collective Action in Multiple-Use Common-Pool Resources”, *Agriculture and Human Values* no.16, 1999, Kluwer Academic Publishers, 309.

⁴ Elinor Ostrom, Roy Gardner, and James Walker, “*Rule, Games, and Common-Pool Resources*”, (Michigan: The University of Michigan Press, 1994), 4.

⁵ Tanya Heikkila, “Institutional Boundaries and Common-Pool Resources Management: A Comparative Analysis of Water Management Programs in California”, *Journal of Policy Analysis and Management*, Vol. 23, No.1, 2004, Published by Wiley Periodicals, 100.

Therefore, the “tragedy of commons”⁶, as Hardin named it, may arise mainly because “human behavior is driven by the maximization of individual payoffs and not by the desire to achieve a socially optimal solution”.⁷

The literature has tried to find the proper solution to the problem of common-pool resources and to give further public policy significance to the issue. The most viable solutions for the tragedy of commons, found in the literature, are central authority management, market or private property management, and self-management. However, due to the fact that the issue of heating systems is a large community’s issue, the only plausible solution seems to be the state intervention.

This solution is related to the extent to which a central authority or public institutions can create incentives to induce rational behavior at the social level in order to maximize general welfare. Thus, in the case of common pool resources, the state may have an important role in shaping the ways in which users of such goods “coordinate their actions to solve supply and demand dilemmas”.⁸ Institutions are

⁶ Garrett Hardin, “The Tragedy of the Commons”, *Science* (162, 1968):1243-1248.

⁷ Maria-Elisabeth Fischer, Bernd Irlenbusch and Abdolkarim Sadrieh, “An Intergenerational Common Pool Resource Experiment”, *Journal of Environmental Economics and Management*, No. 48 (2004): 811.

⁸ Tanya Heikkila, op. cit., pp. 97-117.

able to formulate norms, rules or laws to regulate behavior, in a formal or informal manner. Thus, coercion might be the instrument that regulates individuals' behavior in such a manner that, through punishment, leads to social consciousness. Olson claims that in the absence of coercion, the collective action of the members in a group managing common pool resources will not lead to an efficient social outcome and rational self-interested individuals will not maximize their common economic interests.⁹ In the same manner, Ophuls refers to the same solution of coercion, sustaining that only public control over common pool resources will efficiently align members' behavior.¹⁰ However, Hardin recommends only "mutual coercion", agreed by the majority of people.¹¹

Jeff Dayton-Johnson and Pranab Bardhan consider that the management of common-pool resources is a "collective-action dilemma: a situation in which mutual cooperation is collectively rational for the group as a whole, but individual cooperation is not necessarily rational for each member".¹²

⁹ Antonio Nicita, "Incomplete Contracts and the Commons: Valuing the Strategic Role of Existing Costs", *Italian Antitrust Authority and University of Siena*, 1999, 2.

¹⁰ W. Ophuls, "*Leviathan or Oblivion*" quoted in Antonio Nicita, op. cit., p. 3.

¹¹ Garrett Hardin, *Ibid*, 1247.

¹² Jeff Dayton-Johnson and Pranab Bardhan, "Inequality and Conservation on the Local Commons: A Theoretical Exercise", *The Economic Journal*, 112 July, pp.577-602, 283

One of the multiple definitions of collective action presented in the literature is given by Holzinger. She claims that collective action refers to "the joint actions of a number of individuals that aim to achieve and distribute some gain through coordination or co-operation"¹³. Thus, it is generally accepted that collective action implies cooperation and collaboration between the members of a community.

Furthermore, the issue of cost within a collective decision must be considered. While first there are costs related to the fact that collective decision might not correspond to individual preferences, second there are costs related to the decision-making process, as time and effort of bargaining in order to reach a consensus.¹⁴ Collective action is not described as meaning that every single individual within a community is engaged in the process, but that enough people that have similar interests are connected.¹⁵

Royal Economic Society 2002, Published by Blackwell Publishers, p.577.

¹³ Katharina Holzinger, "*The Problems of Collective Action: A New Approach*", *Gemeinschaftsgüter: Recht, Politik und Ökonomie*, Bonn, (January 2003): 2.

¹⁴ Mark Sproule-Jones, "Toward a Dynamic Analysis of Collective Action", *The Western Political Quarterly*, Vol.26, No.3, (September. 1973): 414.

¹⁵ E Schlager, and Bloomquist, V. M., "A Comparison of Three Emerging Theories of the Policy Process", *Political Research Quarterly*, 49 (3), (September 1996):.651-672 in Naidu, C. Sirisha, "*Heterogeneity and Common Pool Resources: Collective Management of Forest in Himachal*

In sum, in order to avoid the issue of free riding, the state seems to be the best solution for properly managing common-pool resources at the social level. The main common-pool resources this article refers to are gas, water and clean air, all of them being goods used by heating systems.

3. A formal approach to heating systems

In Romania, district heating constitutes approximately 31% of the supplies of the heating market.¹⁶ Although it is believed that individual heating systems offer a large number of advantages, the specialized literature claims that district heating systems are more reliable than individual boilers, at least in the case of Romania.¹⁷ Some cities in Romania have even experienced explosions caused by the improper use or construction of individual heating systems. While the costs of maintaining district heating are included in the monthly price, it is admitted that

individual heating systems need extra maintenance due to the risks coming from inadequate installing or lack of annual control.¹⁸ Furthermore, although there are measures in order to protect the environment and to save energy¹⁹, there is a large amount of pollution produced by individual boiler systems. Thus, the risk implied is believed to be even higher mainly because many people demand less and less services from the centralized heating offices, due to poor quality or high prices, and switch from district heating to other forms of heating, such as the individual boiler.²⁰

Based on the theoretical framework and on the *status quo* description, this part of the article explicitly and formally makes the distinction between three types of heating systems - old district heating, individual heating system, and modernized district heating. The figure below graphically represents the main issue.

The main argument is the following. Heating systems use gas and water in order to produce warmth. Therefore, the way these two common-pool resources are managed should not be indifferent, in terms of efficiency. Thus, reality shows that, in the present, there are at least two main possibilities of using gas and water within the

Pradesh, India”, Department of Resource Economics, University of Massachusetts Amherst, 6.

¹⁶ Madalina Anastasiu, Institute for Studies and Power Engineering, The case of Romania, in “*District Heat in Europe. Country by Country/ 2003 Survey*”, Published by EUROHEAT & POWER, The International Association for Combined Heat and Power, District Heating and District Cooling, Belgium 2003, 301-302.

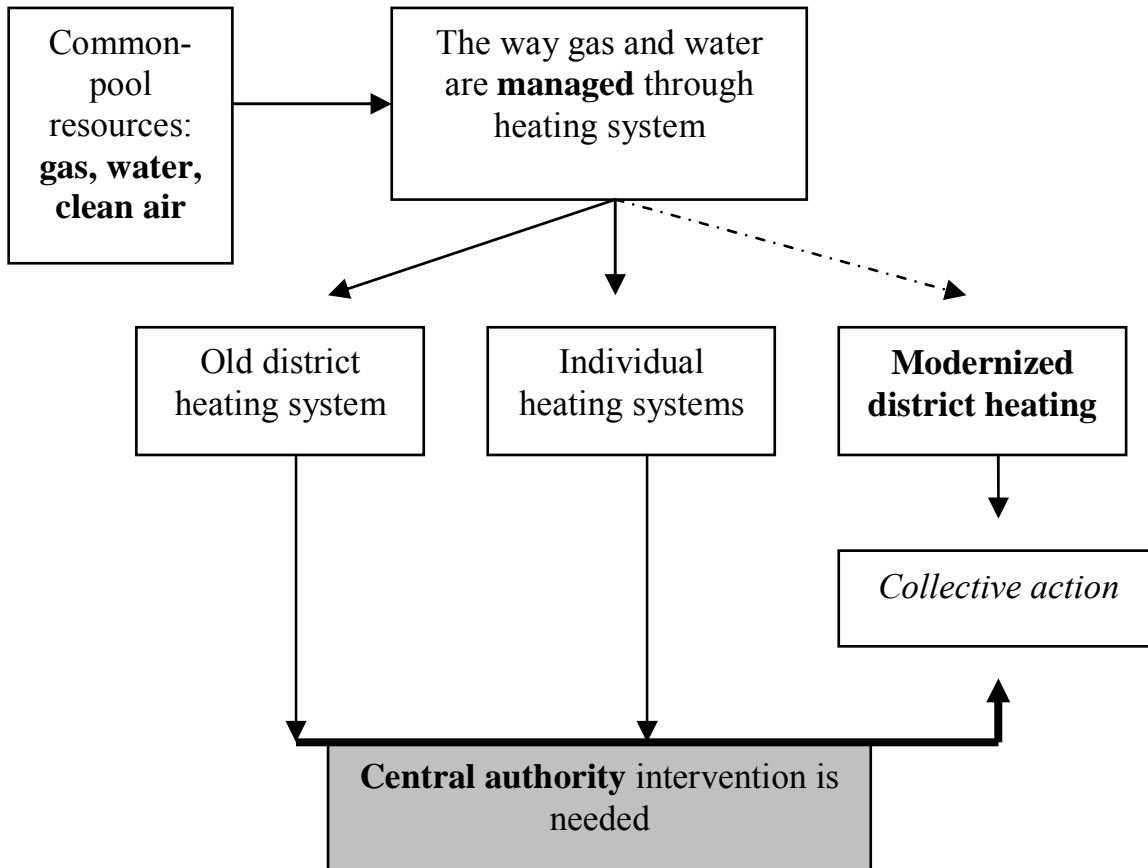
¹⁷ International Energy Agency, “*Coming in from the Cold. Improving District Heating Policy in Transition Economies*”, OECD/IEA, 2004, 39-40.

¹⁸ *Ibid*, pp.132-133.

¹⁹ Madalina Anastasiu, *ibid.*, 303.

²⁰ International Energy Agency, “*Coming in from the Cold. Improving District Heating Policy in Transition Economies*”, OECD/IEA, 2004, 51-52.

Figure 1: Summary of heating system issue



with a small number of consumers and from the point of view of pollution generated by mechanisms of producing

heating systems framework: the old district heating systems and individual heating systems. However, the main focus of this article is on the third alternative, namely the modernization of district heating. Although sooner or later this alternative is going to be put in practice, the questions that can be raised are when and how, or under what conditions.

In the case of Romania, the issue of disconnection from the district heating seems to become a very risky action, both from the point of view of heating agencies that cannot afford to survive

heat (as, for instance, individual boilers). In addition, the modernization of district heating systems is not an inexpensive investment. On the contrary, it implies significant costs, which are almost entirely supported by heating agencies. However, based on the formal description that will be presented, this article offers a solution to the aforementioned issues, namely, the contribution of all consumers to the modernization of district heating systems.

The transposition of reality into a game relies on mathematical computations of benefits for both choosing to purchase

an individual heating system and for choosing to remain connected to and to invest in district heating systems.

4. The functions of the game

Considering the background, this part of the article aims to mathematically evaluate the hypothesis by constructing functions for each of the three analyzed heating situations: old district heating system (ODHS), individual heating system (IHS) and modernized district heating system (MDHS). The formal modeling aims both to simplify the heating system issue by putting it in a mathematical format and to comprehensively understand the differences between different types of heating systems.

It can be logically deduced that if individuals have to choose among different types of heating systems and if they make rational decisions, they opt for the alternative that has the lowest cost and the highest quality. In the case of heating systems, although there is rational choice at the individual level, this article tries to test whether the aggregated decision is optimal at the social level. In this respect, I aim to formally test if individual heating systems are more costly than the modernization of old heating systems. The role of the state in all this game is that of becoming conscious of the heating system issue, of informing people about the alternatives and payoffs and of creating incentives to persuade individuals to opt for the socially optimal solution.

As the heating system issue is a very complex one, the function for each case is going to contain variables, as *comfort* (Com), *control of the temperature* (Cont), the amount of *externalities* (E) and *efficiency* (Ef) of the system that cannot be quantified without specialized mechanisms. However, they are going to be part of the functions due to their importance and they are going to be interpreted only from the point of view of their formal sign (positive or negative) as a cost or a benefit. In addition, these variables will reach a meaning and a theoretical value based on specialized literature described above.

Besides the four aforementioned parameters, the main quantifiable variables that are going to make an empirical difference between the three heating systems and that are going to be the main values within the game theoretical perspective are: the *investment* (I) in the heating system, if it is the case, and an average of a *monthly maintenance costs* (Mc). In the case of modernized heating system, another variable will be introduced, namely the number of the subjects (N) that are likely to invest in the modernization.

It is important to note that all the variables will be considered at the household level. Furthermore, as it is not feasible to use information about the characteristics of all types of households, an average number will be considered for each variable. Thus, the

general function of *heating systems* (HS) looks as it follows:

$$f(HS_net_benefit) = benefit - cost$$

$$\Rightarrow f(HS_net_benefit) = Com + Cont + Ef - (I + MC + E)$$

The following parts of this article are going to separately consider each case of heating system, by computing individual net benefits in all the three heating situations. Based on the formal modeling and on the available data, I try to give values for every heating system case in order to shape proper comparisons.

5. Old district heating system

In the case of the Romanian old district heating system, the costs for the heating depends on the dimensions of house and not on personal characteristics as income or comfort needed. For instance, a certain dimension of dwelling or a certain number of rooms corresponds to a certain quantity of gas and water provided, regardless of the amount of warmth needed. Therefore, there might be cases in which, although the members of the household do not need it, the level of warmth is very high due to the lack of control over the consumption. As a consequence, a large number of people, at least in the case of Romania, might pay for certain amount of goods - gas and water - they do not need and that can create even physical discomfort.

The function for the old heating system comprises all the above-mentioned variables. The exception is the investment cost, which is zero in this

case. I will consider the value of “control” variable as null because individuals do not have instruments in order to control the amount of warmth they receive. There might be cases in which there is lack of comfort due to being too cold or too warm. The efficiency of consumption might be under question both due to the lack of comfort and to the wasted energy related to transportation, and thus, can be considered as a cost or as a null variable. In this case, specialized literature claims that the efficiency of centralized systems does not go beyond 70% because both of the annual revisions – when there are accidental cuts in the water and warmth provision – and of the wastes in the system due to its age– more than 50 years of functioning without radical improvements.²¹ In addition, centralized system is characterized by a dependence on neighbors. Thus, if the payments that are not done on time might affect all the households in the building due to temporary breaking offs of the water and warmth provided.²²

²¹APICT – The Association of Producer and Importers of Heating System (Asociatia producatorilor si importatorilor de centrale termice), Individual Heating System – Study Case, Available at: www.apict.info/statistici.htm, (accessed 6 May 2007);

²² Ibid.

This article only takes into account externalities as negative effects. The net benefit in the case of old district heating systems is the following:

$$f(ODHS_net_benefit) = -(MC_1 + E_1)$$

Due to the fact that there are no exact official data on the present monthly costs of a household that is connected to an old district heating, I will use estimates. Therefore, as unofficial data demonstrate, for an average number of family members and for an average household, a family connected to the centralized system paid in 2004 around 1.200 RON per year, which means around 100 RON monthly.²³ It means approximately 30.19 Euro.²⁴

The net benefit in the case of old district, although it is more of a cost, is the following:

$$f(ODHS_net_benefit) = -(30,19 + E_1)$$

Although the monthly financial cost per household seems not to be that high, the benefit of the system is minimal due to the lack of comfort, control and efficiency. However, the situation of old district heating systems is not an

alternative anymore due to further modernization plans that already exist at the Romanian level.

6. Individual heating system

The case of individual heating systems is the case in which the state allows individual boilers' market to develop. This situation is a marginal propensity case in which people pay exactly the amount of resources they have consumed. In this case, there are no fixed costs involved beside the investment costs in the heating system. Unlike the above described case, individual characteristics, as the comfort needed in terms of temperature and control, are more valued. However, as with every heating mechanism, this system has its shortcoming: interdependence - due to the fact that within a building, common pipes are usually cut in the process of installing boilers, some householders might give in to the pressure of the neighbors and have to disconnect from the old system although they cannot afford to invest in an individual heating system, and pollution mainly due to an improper installation and lack of maintenance.

In the case of individual heating, consumers have control over the system and are independent of the neighborhood energy losses. Therefore, comfort and efficiency may be quantified as positive variables. Thus, the net benefit for the case of individual heating system is described in the following equation:

²³ "Installations Technique" Magazine, (Revista "Tehnica Instalatiilor"), Available at

http://www.tehnicainstalatiilor.ro/articole/images/nr_13/82_84.pdf, (accessed 15 May 2005).

²⁴ The currency used is from Romanian National Bank, from 7 May 2007, 1 Euro = 3,3118 RON, Available at <http://www.bnr.ro/>, (accessed 7 May, 2007).

$$f(IHS_net_benefit) = Com_2 + Cont_2 + Ef_2 - (I_2 + MC_2 + E_2)$$

(1)

$$f(IHS_net_benefit) = Com_2 + Cont_2 + Ef_2 - (766,36 + 18,9 + E_2)$$

$$\Rightarrow f(IHS_net_benefit) = Com_2 + Cont_2 + Ef_2 - (785,26 + E_2)$$

An estimated average of an investment on an individual heating system is around 766,36 Euros. In addition, if the monthly cost is computed only for the consumption, without the investment, the estimated costs are around 62,6 RON²⁵, which means 18,9 Euros²⁶. Based on these data, the equation is the following (see 1)

In contrast with the minimum comfort and maximum prices, the individual system provides the possibility of controlling the amount of gas and water consumed and of self-managing them.²⁷

However, although the two above described systems have their benefits, the main emphasis of this article is on

testing if a third system is more efficient. Thus, the next part of the chapter formally describes the modernized heating systems.

7. Modernized district heating system

Given the above discussion, although, at least in the case of Romania, heating agencies are the ones investing in the modernization of their equipment, this paper, proposes a hypothetical perspective in which the consumers who are connected to the centralized system are the ones that must invest in the improvement of the district heating systems. This approach might serve as a policy application in the future that refers to both cost reduction of heating agencies and, thus, increased efficiency in the entire improvement of the system, and to a minimum investment of individuals in the renovation process. The main debate of this article is related to the difference between individual and modernized district heating systems. I claim that, in the long run, the latter is more beneficial than the former. Although it seems to be more effective to have an individual boiler, in most of the cases, this is because the real costs and benefits are

²⁵ ASA Holding Romania – “Centralized Heating or Individual Heating System?”, Available at:

www.euroheat.org/workgroup4/ASAPublicFolder_rom.pdf, (accessed 6 May 2007);

²⁶ The currency used is from Romanian National Bank, from 7 May 2007, 1 Euro = 3,3118 RON, available at <http://www.bnr.ro/>, (accessed 7 May, 2007);

²⁷ APICT – The Association of Producer and Importers of Heating Systems (Asociatia producatorilor si importatorilor de centrale termice), Individual Heating System – Study Case, Available at:

www.apict.info/statistici.htm, (accessed 6 May 2007).

not actually quantified. The main arguments that people might think about in favor of the individual heating system are the following: the negative experience with the old and inefficient centralized system, a better comfort and control of the temperature, and the belief that boilers are a cheaper option. Therefore, a wider analysis that involves all possible important factors is needed. The modernized district heating system resembles the old district heating system in terms of the centralized idea of functioning. However, the former can differ in a large number of respects from the latter, as for instance, the efficiency it provides, comfort and control individuals can have within this system.

$$f(\text{MDHS_net_benefit}) = \text{Com}_s + \text{Cont}_s + Ef_s - \left(\frac{I_s}{N} + MC_s + E_s\right)$$

Although the transition from the old heating systems to the modernized ones seems to be the initiative of the heating agencies, and although the cost of modernization is part of their contribution, a different perspective can be raised. As mentioned before, I argue that the individual monthly cost, including the investment in the modernization of the district heating, is lower than in the case of individual boilers. Since the net benefit in the modernization case depends on the number of households that invest, the previous statement seems to be valid in the situation in which a large number of people contribute to the renovation

One of the most important variables that comes into discussion and that is different from the above two mentioned cases is the number of people investing in the modernization.

In this case, total cost, including the investment and the total monthly payments, depends on the number of people that contribute to the modernization. Thus, the more people cooperate in the game of modernization, the less money each of the individual has to pay. Furthermore, it is more likely to have social optimality and not under-investment. The net benefit in the case of modernized district heating is described by the following equation:

process.²⁸ The perspective of individual contribution is a rational alternative from at least two points of view. First, each individual pays a minimum amount of money for a maximum efficiency and comfort. Second, heating agencies can afford to offer best quality in a shorter period of time and to a larger number of consumers.

²⁸The International Association for District Heating, District Cooling and Combined Heat and Power, "The Case for District Heating: 1000 Cities Can't be Wrong! A Guide for Policy and Decision Makers", p.17, Available at: www.euroheat.org/ecoheatcool/project_3.htm, (accessed 7 May, 2007).

Within this framework, the aspect of who is going to invest must be further discussed. Specifically, it is the issue of those consumers that have already invested in individual boilers or of those that have never been connected to a centralized system. The former ones are highly unlikely to give up on this investment and on the comfort they have and invest again in a system that did not provide them any benefit in the past and that is uncertain for them. They are even less likely to reconnect themselves to the modernized district heating system due to the fact that negative externalities of individual boilers not necessarily have a direct effect on them. In the latter situation, there are people connected to other types of heating systems, as, for instance, stoves with solid or liquid fuel or electric systems²⁹, who might be skeptical in approaching a new and unsure type of investment that implies interdependence on the system. However, although these situations are improbable, they are not impossible and some people that are not connected to the centralized systems might decide to invest in its modernization. Although it would be easy from the point of view of rational choice to predict individuals' action, it is not feasible to say that all consumers are going to choose the highest utility at the lowest price. Thus,

²⁹ APICT – The Association of Producer and Importers of Heating System (Asociatia producatorilor si importatorilor de centrale termice), Individual Heating System – Study Case, Available at: www.apict.info/statistici.htm, (accessed 6 May 2007).

the number of people that is expected to invest represents mainly the individuals that are still connected to the old district system.

In 2007, considering that the number of households connected to the centralized systems in 1992 was 2,921,368³⁰, and that the number of households connected in 2007 is 1,082,628³¹, we may estimate the percentage of households that are still connected to the centralized systems. Based on formal computation, 37% of the total number of households is nowadays still connected to district heating systems.

Due to the fact that data regarding the number of district heating systems is officially available only for Cluj county case – 107 systems³² we need to estimate the number of district heating at the national level. Thus, if 107 systems function for approximately 60 000³³ of connected household in Cluj,

³⁰ Census Report 1992, Romania, Available at <http://www.recensamant.ro/>, (accessed 15 May 2007).

³¹ National Authority of Public Service Settlement for Communal Households and Public Utility (Autoritatea Nationala de Reglementare pentru Serviciile Comunitare de Utilitate Publica), Available at http://www.anrsc.ro/index/servicii_energetice/starea_servicii_energetice_interes_local.htm, (accessed 15 May 2007).

³² “Termoficare Heating Agency”, Cluj-Napoca, Romania, information provided by the Manager Director of the company, 2006.

³³ “Termoficare Heating Agency”, Cluj-Napoca, Romania, Available at www.ratcj.ro, (accessed 12 May 2007).

and considering that the number of connected households at the national level is 1,082,628, we may say that the number of district heating systems at the national level is approximately 1930. Thus, while the investment in the modernization in one district heating system is estimated to be around 750,000 Euro, the value of the total investment in modernization is estimated to be around 1,447,500,000 Euro.

Having 1,082,628 households connected to the centralized system in 2007 and 1930 district heating systems,

$$\begin{aligned}
 f(MDHS_net_benefit) &= Com_s + Cont_s + Ef_s - \left(\frac{1.447.500.000}{1.082.628} + 30,19 + E_s \right) \\
 \Rightarrow f(MDHS_net_benefit) &= Com_s + Cont_s + Ef_s - (1337,02 + 30,19 + E_s) \\
 \Rightarrow f(MDHS_net_benefit) &= Com_s + Cont_s + Ef_s - (1367,21 + E_s)
 \end{aligned}$$

Although the modernized heating systems seem to offer higher benefits for a larger number of people, in contrast with individual systems, the main shortcoming that still remains is the interdependence on the entire system.³⁴ By using meters, an important part of this problem seems to be solved. However, a centralized system, although offering the efficiency and comfort needed, is very likely to remain a system that confronts itself with permanent technical problems related to the dimensions of the system.

³⁴ “Termoficare Heating Agency”, Cluj-Napoca, Romania, information provided by the Manager Director of the company, 2006.

each system’s modernization costing around 750,000 Euro, the estimated investment cost per household in the modernization of district heating is around 1337.02 Euro. The monthly maintenance bill is estimated to be the same as in the case of old district heating system, namely 30,19 Euro. However, although there are no data available yet, this cost can significantly decrease after the modernization process and after the heating systems become more efficient. The net benefit in 2007 situation is described in the following equations:

8. A game theoretical approach to heating systems

Considering the above formal approach, this part of the article transposes the households’ results, computed by using a cost-benefit formula, into an aggregate situation or a game in order to find the social equilibrium. If the transition from old district heating and maybe from individual heating systems to the modernized systems seems to be a desirable situation, the issues of collective action and of management of commons come into the picture. Thus, state or local authorities may be the main actors that can intervene in order to inform about the new heating option, to establish the communication network between consumers and between

consumers and heating agencies, and to regulate the market by adopting a specialized legal framework.

Although collective action is mainly associated with moral rather than logical concept, as Rapoport³⁵ claims, this article analyzes the issue of collective action from the latter point of view. By using a game theoretical perspective of heating systems the analysis is going to focus on the way people from large communities can be determined to cooperate and to collectively act in order to improve both individual and social living conditions, from both financial and non-financial points of view.

It is claimed that the biggest payoffs come not from maintaining a game that is not proper anymore, but from changing the game and the rules of the game in a more beneficial way.³⁶ The present real game of heating system is a non-cooperative one, in which each individual aims to satisfy his/her own needs without taking into account his/her actions' effects on the entire society. As the case of Romania is emphasizing, there are both individual and social issues that need to be solved

by adopting a new game. Thus, the modernization of heating system can be a beneficial alternative both at individual and social levels. At the individual level, the amount of money paid monthly per household in the case of modernization can be lower than the in the case of the old district heating system and than in the case of individual boilers, mainly if enough individuals contribute to the investment. At the social level, besides the fact that there is social equality, meaning that all those that invest need to pay exactly the amount of money associated to the amount of resources consumed, the system seems to promise a higher degree of efficiency in terms of the rapidity of the modernization process - if enough people invest, and a lower quantity of pollution.

Thus, the elements that can make the difference between an old district heating system or an individual boiler and a modernized heating system, if the above condition is fulfilled, are the lower monthly costs in general, a higher efficiency for everybody regardless of the level of income, and a reduced amount of pollution. Furthermore, one of the possible civic benefits of the modernized alternative is the lesson of cooperation, of collective involvement for the case of the entire society. Although the state or local authorities are the main constraining actors in order to make people play the new game of cooperation, the main players that can decide the further development of the game are individuals.

³⁵ Anatol Rapoport, "Prisoner's Dilemma – Recollections and Observations" in Brian Barry and Russell Hardin (Eds.), *Rational Man and Irrational Society? An Introduction and Sourcebook*, (Beverly Hills/ London/ New Delhi: Sage Publications, 1982), 72-73.

³⁶ Adam M. Brandenburger and Barry J. Nalebuff, *Co-opetition*, (New York: Currency and Doubleday Publishing Group, 1996), 69.

9. The game of heating systems

The entire perspective on heating systems described above will be developed within this part of the chapter as a Prisoner's Dilemma game, in which the equilibrium of the game is defection-defection. Prisoner's Dilemma shows that individually rational strategies do not necessarily lead to social optimality. A one shot game will be developed, in which a

decision already taken cannot be changed. Once one has invested in the modernization of district heating, one cannot disconnect oneself during the game. It is the same situation regarding the choice of purchasing individual boilers. The table below represents the game of heating systems with the payoffs included.

Table 2: The Prisoner's Dilemma Game - the case of heating system issue (2007 data)

Table no. 2- The Prisoner's Dilemma Game - the case of heating system issue (2007 data)

		Player 2	
		Individual heating systems	Modernized district heating
Player 1	Individual heating systems	$Com_2 + Cont_2 + Ef_2 - (785,26 + E_2)$ $Com_2 + Cont_2 + Ef_2 - (785,26 + E_2)$	$Com_2 + Cont_2 + Ef_2 - (785,26 + E_2)$ $Com_3 + Cont_3 + Ef_3 - (1367,21 + E_3)$
	Modernized district heating	$Com_3 + Cont_3 + Ef_3 - (1367,21 + E_3)$ $Com_2 + Cont_2 + Ef_2 - (785,26 + E_2)$	$Com_3 + Cont_3 + Ef_3 - (1367,21 + E_3)$ $Com_3 + Cont_3 + Ef_3 - (1367,21 + E_3)$

Due to the fact that the modernization of district heating seems to be an irreversible issue, which will happen in any circumstances sooner or later, the game is only taking into account the perspectives of modernized heating and of individual boilers. As the graphical form of a game does not permit a more than two players game, I have reduced the entire society to the above game. However, after discussing the implications of this game, a discussion for the case of the entire community is needed.

There are two players that usually find themselves in the situation of not knowing what the other one is doing. However, this is not a classical Prisoner's dilemma situation in which the players cannot communicate.

Individuals who know each other or who live in neighborhood might have

the chance to communicate among themselves. The main possible strategies are either investing in individual heating systems or investing in the modernization of old district heating. As the players can communicate, the decision is not necessarily a simultaneous one, but a decision that must be taken in a limited time.

As it can be observed in the above table and as the idea of game stresses, three situations can be illustrated. First, if none of the players invest in the modernization of the district heating but in the individual boilers, both players and the entire society have negative benefits from that. The aim of the game is that of establishing Nash equilibrium,

a situation in which nobody has any incentive to change their state or the chosen strategy. Thus, as long as the state does not provide incentives in order to induce the decision of choosing the alternative that is both individually and socially desirable, this equilibrium cannot be reached.

Second, if one of the players chooses to purchase an individual boiler and the other one chooses to invest in the modernization of district heating, which is the most probable situation that can happen in the real life, the costs of the latter individual depends on the decision of the former. In an n-player game, the amount of the investment in the modernization of the district system constantly depends on the number of the people who choose the individual alternative. As stated before, as the number of people investing in the modernization increases, the individual cost decreases.

Finally, in a two-person game, if both actors choose to invest in the modernization of the system, they can reach a Nash equilibrium that is Pareto optimal as well. Although in large communities this is not a possible situation, a desirable situation is that the majority of people play the modernized alternative.

Regarding the efficiency of the systems, for which we have statistical data, the following comparison can be made. On the one hand, based on the specialized literature, while an old centralized heating system has efficiency close to

35% but not higher than 70%³⁷, a modernized one can increase its efficiency up to 80-90%.³⁸ On the other hand, in the case of high technology that can be reached in the case of developed countries, the efficiency of individual boilers is evaluated to be around 86-90%.³⁹ However, studies that compare different types of individual boilers conclude that the level of efficiency may vary between 55% and 88%, depending on the technological characteristics.⁴⁰

Thus, the game shows that at almost equal comfort, control and efficiency, the optimal solution for both players is choosing not to cooperate, meaning to

³⁷ APICT – The Association of Producer and Importers of Heating System (Asociatia producatorilor si importatorilor de centrale termice), Individual Heating System – Study Case, Available at: www.apict.info/statistici.htm, (accessed 6 May 2007).

³⁸ Dimtcho Gueorguiev Linkov, “Energy Efficiency of Space Heating in District Heated Buildings in Bulgaria”, MA Thesis submitted to the Department of Environmental Studies, Central European University, Budapest, August 1998, 7.

³⁹ The A to Z of Building, “Boiler Efficiency – The Legislation and Compliance”, 29 September 2005, Available at: www.azobuild.com/news.asp?newsID=1627 (accessed 30 May, 2007).

⁴⁰ DEFRA – Department for Environmental Food and Rural Affairs – Boiler Efficiency Database, Available at: www.sedbuk.com/cgi-local/dynamicv.cgi?page=boiler8, (accessed 30 May 2007).

invest in individual heating systems. The financial payoffs seem to be much lower in the case of modernization. However, based on specialized studies, a modernized district heating seems to offer at least the same benefits as household systems at the individual level, but much higher benefits at the social level in terms of pollution and efficiency.

Considering this situation, and knowing that in an n-player game the spontaneous collective decision is unlikely to appear, the state seems to be needed to intervene at the level of the game to change rules and design new regulations. Put it in a different way, if the alternative of modernization of heating systems is really the best individual and social solution, the main condition for the modernization of heating systems to be less expensive than the investment in individual boilers is to have a high enough number of households investing in the former as the monthly costs to be the lowest possible. The following equations are formally explaining this statement and computing the minimal number of households needed.

As described before, the net benefit (*nb*) per household within *individual system* case can be noted as

$$nb(IHS) = b_2 - c_2 - E_2,$$

where $b_2 = Com_2 + Cont_2 + Ef_2$ is the benefit implied, E_2 refers to externalities (pollution)⁴¹, and $c_2 = I_2 + MC_2$ is the quantifiable cost composed of investment and monthly bill. If this equation is considered for the entire community, with N households, we have the following form:

$$N \cdot nb(IHS) = N \cdot (b_2 - c_2 - E_2) = N \cdot x$$

where x is the net benefit from the individual system.

In the same perspective, the net benefit equation for the *modernized district heating* is the following:

$$nb(MDHS) = b_3 - c_3 - E_3,$$

where, $b_3 = Com_3 + Cont_3 + Ef_3$ is the benefit implied, E_3 is the externality produced by the system, and

$c_3 = \frac{I_3}{N} + MC_3$ is the quantifiable

cost which includes in the investment the number of households that contribute to the modernization process. In the case of N-player game, the equation is the following:

⁴¹ In this part of the paper, externalities, for both heating systems analyzed, are being treated separately from the total cost, due to the fact that only the investment and the monthly maintenance costs can be quantified.

$$N \cdot nb(MDHS) = N \cdot (b_3 - c_3 - E_3) = N \cdot y - I_3$$

where y is the net benefit from the modernization and I_3 is the value of investment in the modernization.

When talking about collective action the question is not only if an alternative or a decision is rational, but *when* or in what conditions this decision is rational. Thus, having the two equations for the two heating cases, the main condition for the consumers to choose the modernization strategy is $N \cdot x < N \cdot y - I_3$, which means that the social benefit in the case of individual heating systems is lower than the social benefit in the case of

modernized district heating systems. Considering this instance and the fact that collective action must be coordinated by an external actor, the state needs to create that condition under which the number of the individuals that invest in the modernization is higher than $\frac{I_3}{y - x}$.

In numerical terms, it means that if the total investment in the system is around, 1,447,500,000 Euro, as stated before, and using the data from the 2007 case, the equation becomes the following:

$$N > \frac{I_3}{y - x} \Rightarrow N > \frac{1.447.500.000}{Com_3 + Cont_3 + Ef_3 - 1367,21 - E_3 - (Com_2 + Cont_2 + Ef_2 - 785,26 - E_2)}$$

$$N > \frac{1.447.500.000}{-1367,21 + 785,26} \Rightarrow N > \frac{1.447.500.000}{581,95} \Rightarrow N > 2.487.327$$

It means that, at an average of three⁴² persons per household, the number of households that must invest in the modernization in order to have a socially optimal situation is 746,198. This number shows that less than the number of households that are still connected to the centralized system need to invest in modernization in order to have social optimality. Only the households that are connected to the

centralized systems have been included in the computations. However, since one of the main aims in the case of modernization is that households pay the smallest amount of money possible, the number of investors needs to be as high as possible.

The above described situation is the problem of “critical mass”⁴³ that must contribute to collective action, in this case, the investment in the modernization of the district heating systems, in order to accomplish the

⁴² Gerald Marwell and Pamela Oliver, *The Critical Mass in Collective Action. A Micro-Social Theory*, (Cambridge: Cambridge University Press, 1993), 9.

⁴³ Gerald Marwell and Pamela Oliver, *ibid.*, 1.

state of social optimality. As voluntary participation in collective action is not necessarily a very likely situation, the state is supposed to intervene in order to establish social optimality. By first informing people about their options, about the costs and benefits for each case and, second, by constraining enough people to choose the best social situation, state needs to change the Prisoner's Dilemma into a cooperation game.

10. Conclusions

Heating systems in Romania have caused heavy problems due to high rates of disconnection from centralized systems and to the level of pollution generated by individual heating boilers. This article has analyzed, from a formal perspective, if purchasing individual heating systems or investing in the modernization of district systems induces a more effective management of common-pool resources and provides greater benefits at both the individual and social level.

As the specialized literature emphasizes, the modernization of district heating in general seems to be desirable due to numerous disadvantages of the old systems, for instance, lack of efficiency, high prices, and wasted energy. Thus, by the renovation of old systems, common-pool resources, as water and gas, can be better managed at both the individual and social level. Due to the fact that heating agencies may not be able to afford to invest in the modernization of

all district heating systems at the same time, this article proposes a more efficient alternative that can improve both agencies' and individuals' conditions: collective contribution in the modernization investment process.

In the case of large communities and limited resources, as the situation of heating systems, the most appropriate incentive seems to be that of developing regulations. Although it is believed that by purchasing individual heating systems people make a rational decision, at the social level these decisions are likely to be sub-optimal. At least three aspects can be mentioned in order to sustain this statement. First, there is the issue of pollution generated by improper installation of the individual systems' smokestacks, by the lack of technical revisions or by the poor quality of second hand mechanisms. Second, although both individual boilers and modernized district systems are characterized by high degrees of comfort and control, in the long run, and at the social level, the two systems are very likely to differentiate themselves in terms of efficiency. Third, as the empirical part of the article shows, if the number of households investing in the modernization of district heating systems is high enough, financial monthly costs per family decrease significantly. By using a cost-benefit model and by developing a Prisoner's Dilemma situation, I have shown that, in the case of Romania, individuals' investments in the modernization of district heating is an efficient alternative

both for consumers and for heating agencies.

In sum, as the data show, the hypothesis of this article is sustained by the empirical evidence. The investment in the modernization of district heating systems seems to be a more efficient solution than purchasing individual boilers. At least two conditions must be accomplished in this case: the state must create incentives for better management of common-pool resources and design regulations, and enough households must play the collective game of modernization in order to increase optimality at both individual and social level.

Although Romania has started the program of modernization, the total improvement by using cogeneration in the district heating sector seems to be the most appropriate alternative for guaranteeing climate protection. Due to the fact that modernization requires energy saving, a demand driven policy is needed. Thus, as part of the modernization process, the installation of meters in the households connected to the centralized systems is a solution for improving the temperature control issue.

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WELFARE STATE REGIMES IN TRANSITION COUNTRIES: ROMANIA AND MOLDOVA COMPARED.

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Abstract

This article seeks to enrich the current debates in the field of social policy on the welfare states classifications and their modifications. The debates reside in the fact that not all welfare states fit into the traditional welfare state typologies as that of Gøsta Esping-Andersen's classification. Since the typology refers originally only to Western European state, with the conjuncture of the European Union enlargement and presence of other welfare types with different evolution, the need for reconsideration of the traditional approach appears.

The article points to the main discussions on Western and Central, Eastern European welfare states. Moreover, it offers a more in depth analysis of the welfare state characteristics of Moldova and

Romania. The main aim of research is to identify the place of Romania and Moldova in the context of Esping-Andersen's welfare state typology. Based on secondary data and the use of Hierarchical Cluster Analysis, the analysis shows that according to the social protection expenditure, Romania and Moldova are in the same cluster, even if not forming a clear separate

group. Moreover, although separated from clusters formed by EU-25, there are high discrepancies in social protection in terms of GDP expenditure on social protection between these two countries.

1. Introduction

The transition to the market economy entrained transformation in many sectors including social protection sphere. The main objective of this article is to investigate the features of welfare state in Moldova and Romania in particular and to attribute features from the selected countries to the existing welfare regimes of Gøsta Esping-Andersen in general. Hierarchical Cluster Analysis is needed to detect similarities and differences in the features of these welfare systems compared to the EU-25 countries. The methodology is based on a theoretical comparison. The main findings show that there are differences in the features of social protection system of Romania and Moldova.

The article is mainly organized in smaller and larger subchapters. At first, it starts with reasoning the use of welfare state regimes classification and the countries selection (Why Romania and Moldova). The introductory part followed by main discussion on welfare state classification of Gøsta Esping-Andersen and other classifications, with reference to Central and Eastern

European welfare states classification. At last, and the most important is the part that includes the Empirical Comparison Moldova and Romania's Social Protection System in a European Context, based on Hierarchical Cluster Analysis of 27 countries, including Moldova and Romania and its main findings.

All in all, the article is summarized in the last part, where the main findings and conclusions are described.

2. Why there is need for welfare regimes classification?

The existence of such a rich literature on classification of welfare state regimes stems from many reasons. Firstly, the classification of welfare regimes offers to the researcher/analyst or to the policy maker a clearer view on how various welfare states work in providing wellbeing and a more in depth comprehension on the specific issue of a certain country in a comparative perspective. Secondly, '(...) Typologising is useful if it is not simply used to produce clusters of welfare state, but to explain cross-national variations in the type of welfare state which exists'¹. Through comparative social policy analysis and identification of various welfare regimes a larger horizon of theoretical and empirical explanations is opening. As regards to the classification of the welfare regimes of countries in

¹ Cousin M. *European Welfare States. Comparative Perspectives* (Cornwall: Sage Publications Ltd, 2005), 108.

transition, according to H.J.M. Fenger, the classification of this welfare state is an useful instrument for assessing the welfare state development, by considering the relation between institutional path-dependency theories on the one hand and theories of policy diffusion on the other hand².

3. Why Moldova and Romania?

Romania and Moldova are bound by strong historical, cultural, economical, political common heritages. In 1941 Romania entered the World War II on the side of Nazi Germany, taking the region of Bassarabia (the present Republic of Moldova) back from United Socialistic Soviet republics (USSR) dominance, but from 1945 till 1991 Bassarabia remained under Soviet rule and maintained the name of Socialist Soviet Republic of Moldova. Romania was a socialist country, but did not belong to the USSR. In the communist era, the contact between Moldova and Romania was extremely

² From a path-dependency perspective, we might expect the communist legacies to be strong enough to impose a distinct path of development on at least some of the post-communist countries (Pierson 2004). On the contrary, from a policy diffusion perspective we would expect the transfer of ideas, knowledge and other resources to guide these countries developments in the direction of one of the well-known welfare regimes. - Fenger H.J.M. *Welfare regimes in Central and Eastern Europe. Incorporating post-communist countries in a welfare regime typology*. (Nijmegen: Paper for the NIG Conference, 2005), 2.

constrained. After the collapse of Soviet Union in May 1991, the Socialist Soviet Republic of Moldova changed into the Republic of Moldova and on 27 August the same year it proclaimed itself as an independent and sovereign state. Even if recognized first by Romania, “officials spoiled that gesture by subsequently branding the new republic as an “artificial state”³. After the dissolution of the Soviet Union, the transition from planned to market economy started. In most ex-socialist countries, the transition began in 1989. For some of the countries the impact was profoundly negative (for instance Moldova, where the GDP per capita in the period of 1989-1999 decreased on the whole by 62-63%⁴).

There are strong historical features that link the analyzed countries; nonetheless with respect to social protection system they differ in terms of allocations. The present article seeks to find those differences by the use of Hierarchical Cluster Analysis and secondary data. It is assumed that the situation in Romania with respect to social security schemes and social protection as a whole is better than in Moldova, even if it is considered that, at present, both countries have an increase in their economical development. At last, but not least, the reason of selecting

Moldova and Romania is also due to author’s closeness and familiarity of the revealed topic in the discussed countries.

4. Main discussions on welfare typologies

The main objective of the article is to describe the main features of the welfare regimes of the countries in transition, particularly in Romania and Republic of Moldova. More precisely, the aim is to find their place in the existing welfare regimes with specific reference to that of Gøsta Esping-Andersen, followed by description of the attempts to classify Central and Eastern European countries.

In his classification, Esping-Andersen identifies first the Liberal welfare regime, which includes countries like UK and US. This regime is characterized by its strong emphasis on liberal values, such as self-responsibility and a strong believe in the market, low decommodification. A core feature of the liberal regime is its residual character, meaning that schemes are often means-tested and directed to the poor. Another important element is its encouragement of the market to provide welfare. The principle of stratification in this welfare regime leads to division of the population into minority of low-income dependants and majority of people able

³ Chris Springer “Moldova and Romania: The broken Engagement" available on web version at: <http://www.east-west-wg.org/cst/cst-mold/springer.html>

⁴ Stropnik N. *European Population Forum 2004: Population challenges and policy responses*. (Geneva, 2004).

to afford social private insurance⁵. The second regime is the Corporatist welfare regime, which is represented by countries like Germany, Belgium and France. It is characterized by a medium level of decomodification. This regime-type has a strong emphasis on status maintenance, relying rather on earnings-related benefits than universal benefits or poverty relief (means-tested benefits). One of its main features is that the state will interfere when family's capacities to service its members is exhausted. The third regime type is that of Social Democratic and it functions mainly in the Scandinavian countries. It is characterized by a high level of decomodification and a strong commitment to full employment for men and women. The principle of stratification is directed towards achieving a system of generous universal and highly distributive benefits not dependent on any individual contributions. In addition, Maurizio Ferrera proposes the fourth welfare regime: the Southern welfare states regime, that includes countries such as Greece, Italy, Portugal. The Southern Europe regime is characterized according to the criteria and the conditions under which the benefits are offered, on the regulations to finance social protection and at last, the administrative-organizational aspect of managing social security schemes. Even if the welfare typology of Esping-Andersen is widely accepted it is also

⁵ Gelissen Arts W., J., *Three worlds of welfare capitalism or more?*. Journal of European Social Policy 12 (2, 2002): 141.

highly debated. Various opinions are presented by different authors regarding the traditional welfare classification. In this sense, it is informative the synthesis of alternatives of various classifications of Western welfare states presented by Arts and Gelissen in the article "Three worlds of welfare capitalism or more?" (See Appendix 1).

At the beginning of the transition period from planned to market economy, it was not considered as necessary to create a separate category of welfare state regimes for ex-socialist countries. The difference of these states and the three main models (Liberal, Corporatist, and Social Democratic) was assumed to disappear after a short transition period. It was believed that in few years the social policy of these countries will reflect Esping-Andersen's typology together with a new term that would describe the unique post-communist conservatism of ex-USSR countries⁶. On the other hand, Deacon also suggested the occurrence of a possible future "post-communist conservative corporatist" model comprising Bulgaria, Poland and Romania. According to Bob Deacon this model would consist from "the ideological and practical commitment to socialist values, the maintenance in power of some of the old guard, and the social deal struck with major labour

⁶ B. Deacon & Standing G. *Social Policy in Central and Eastern Europe* Journal of European Social Policy (3), 1993.

interests”⁷. Nonetheless, without empirical evidence, the author abandoned the classification⁸.

However, after some years it became clear that these countries follow another path than that of Western welfare states. Various opinions about Central and Eastern European welfare occurred. Sengoku Manabu claims that in many cases the emerging welfare systems of the CEE countries have been considered as not derived from the European Welfare Model, but influenced by the model presented by international financial organizations such as World Bank and IMF⁹. Zsuzsa Ferge argues that there are formal similarities between the Bismarckian welfare states and Eastern European welfare system. But the essence of European Model¹⁰ is almost absent, because CEE governments have to acquire the goodwill of foreign capital and

supranational agencies to manage their financial problems.¹¹

One of the most illustrative works on welfare regimes in CEE countries and which is approached in this article is that of H.J.M. Fenger. This study empirically assesses if the post-communist welfare states of the Central and Eastern European countries can be attributed to one of the well-known welfare types, or if they still form a distinct group of their own.¹² Fenger concluded that there is a clear distinction between the traditional European welfare and that of Central and Eastern European countries¹³, by using variables focused on three main dimensions: *characteristics of governmental programs, social situation variables and political participation*. Analyzing to what extent the post-communist countries of CEE fit the welfare state typology of Gosta Esping-Andersen, the author concluded that there is a clear distinction between Western traditional welfare states and countries of CEE. Also, that additionally to Esping-Andersen typology of welfare state other types

⁷ H.J.M Fenger *Welfare regimes in Central and Eastern Europe. Incorporating post-communist countries in a welfare regime typology*. (Nijmegen: Paper for the NIG Conference, 2005): 2.

⁸ Cerami A. *Social policy in Central and Eastern Europe. The emergence of a new European Model of Solidarity?* Published online by Electronic Text Center, available from the Digitalen (Bibliothek Thuringen, 2005): 44.

⁹ Sengoku Manabu *Emerging Eastern Europe Welfare States: A Variant of the “European Welfare Model?”* (2002): 230.

¹⁰ European Social Model is “not a unitary concept, but a mixture of values, accomplishments and aspirations, varying in form and degree of realization among European states” (Giddens, 2005), 2.

¹¹ Deacon B. *Eastern European welfare states: the impact of the politics of globalization*, *Journal of European Social Policy* 10 (2, 2000).

¹² H.J.M. Fenger *Welfare regimes in Central and Eastern Europe. Incorporating post-communist countries in a welfare regime typology*. Nijmegen: Paper for the NIG Conference, 2005.

¹³ Fenger, *Welfare regimes*, 2

have emerged in Central and Eastern Europe. The current analysis is an illustrative example in showing the position of two transition countries within the typology of Esping-Andersen. In the subsequent chapter, the Hierarchical Cluster Analysis will follow.

5. Empirical Comparison Moldova and Romania's Social Protection System in the European Context

The research problem consists of positioning Moldova and Romania within Esping-Andersen's typology of welfare states. And this chapter provides an empirical interpretation of the social protection system of Romania and Moldova in the context of the discussion from the first chapter. The most relevant method to proceed in this case is the use of Hierarchical Cluster Analysis¹⁴, which presents the process of finding the closest pair of cases and combining them to form a cluster.¹⁵ It measures the concept of social protection based on GDP expenditure. HCA is used in this case due to its relevance in presenting how far or close is the social protection expenditure of Moldova and Romania from Western

and Central European states. The analysis and interpretation of HCA follow.

Before presenting the main findings it is important to mention that we have to be aware when using expenditure on social protection as a welfare indicator. Esping Andersen states that expenditures are epiphenomenal to the theoretical substance of welfare states and that by scoring welfare state on spending it is assumed that all spending counts equally¹⁶. He affirms that the findings of the first generation of comparative studies that the level of social expenditure adequately reflects a state's commitment to welfare are difficult to evaluate, that the generosity of the state can be mismeasured by using social expenditure number. Nonetheless, it is an attempted to analyze the social protection system through the perspective of how much are the spending of the state on social security. The main variables according to which the cluster are formed are: *social protection expenditure, health care, pension, old-age dependency ratio, unemployment benefits, family benefits* and *rate of at-risk of poverty after social transfer* as % of GDP. The selection of the variables is related to the fact that they represent the most important branches of social security. The data was collected from various sources: mainly from national statistical

¹⁴ Cluster Analysis measures the distance between cases on a combination of dimensions and uses this to identify groups of cases within which there is considerably homogeneity and between which there are boundaries. (Gough I., 2001).

¹⁵ Gough I. *Social assistance regimes: a cluster analysis*. Journal of European Social Policy 11 (2). Sage publications., 2001.

¹⁶ Esping-Andersen G. *The three worlds of capitalism. The three political economics of the welfare state*. Chapter I. (New Jersey: Princeton University Press, 1990), 19.

loadings of Western states, no more description about these clusters is going to be made, but rather focus on the main cluster (8) –Romania and Moldova.

On the other hand, our findings are completely consistent with, Fenger’s results showing that there is a clear distinction between Central and Eastern European countries and Western welfare state. There is also a clear distinction between Cluster 8 and the rest of the clusters. Although it can not be stated that Moldova and Romania form a distinctive cluster, for further references it will be analyzed as a separate cluster.

The same as in Fenger’s analysis, Romania and Moldova are in the same cluster, even if it does not form a clear group. The “developing type” as the

H.J.M. Fenger calls it, differentiating at the distance of 25 from the all included countries, shows the high discrepancy of social protection in terms of GDP expenditure on social protection.

Another important finding is that even if sharing some common features of the two social protection systems, Cluster 8 seems to differentiate at the distance of 10, meaning that there is a relatively high difference between these two social security systems, despite some common features. The long distance between these two countries and the EU-25 prove that there is a high discrepancy with respect to social protection in Moldova and Romania and member countries. There is also a long distance between Moldova and Romania and Central and Eastern

Table 1: Expenditure on Social Protection

2005	Scandin .	Contine ntal	Souther n	Liberal	Romania	Moldova
	Denmar k	German y	Italy	UK		
Expenditure on social protection as % GDP	29,5	29,8	25,6	27,2	9,6 ¹⁷	15,8 ¹⁸
Expenditure per capita PPS ²⁰	121,8	110,0	100,7	117,0	34,2 (USD)	2374 ¹⁹ (USD)

¹⁷ Expenditure for year 2003. Florescu L., Pop L *Program implementation matters for targeting performance. Evidence and lessons from ECA region. Country Study: Romania*, 2005. Available at:

http://www1.worldbank.org/sp/safetynets/Training_Events/ECATargetingSeminar/Romania_ppt.pdf#search='unemployment%20benefit%20formula%20Romani

¹⁸ Human Development Report, 2006

¹⁹ Eurostat web-portal.

²⁰ GDP per capita, PPS, for year 2005. Draft of Republic of Moldova: National Report on Human Development *Quality of Economical growth and its impact on human development*, 2006.

European countries. On the ranking of social protection expenditure of EU member countries, Scandinavian countries have the higher rate of spending, and Southern European countries have lower (see the Table 1 below).

The same author adds that even if the fiscal level is almost at the same level as in EU countries, the population of Romania seems to benefit less from social programs in comparison to European Union citizens. The social expenditure in Romania is lower than in Moldova, but it shows a significantly higher expenditure per capita on social protection.

It is also important to mention again that social expenditure as % of GDP does not necessarily reflect their true value, since this indicator depends on the overall GDP of the country. The evidence also indicates that necessary resources and their efficient use are indispensable to exit the vulnerable social protection in these two countries. In this sense, it is interesting what Wilensky²¹ mentions that, extremely different social security expenditure as % of GDP creates cross-national variations, which can be explained by: the number of pressing problems linked with the transition and amount of available resources, which is the case of Romania and Moldova's social security system.

²¹ M. Naldini, *The family in the Mediterranean welfare state* (Routledge, 2003), 101.

6. Conclusions

The main research question is to place Romania and Moldova within the context of welfare regimes and see whether these two countries can be attributed to the Esping-Andersen's typology of welfare regimes. According to the analysis, it can be concluded that Moldova and Romania do not belong clearly into one of the clusters presented by Esping-Andersen. Nonetheless, there are some similarities with the Southern European welfare regime, such as lower GDP expenditure on social protection, a high degree of familiarization, segmented and often inefficient family policies that would support the wellbeing of an individual.

To respond more in depth to the research question, the concluding remarks are organized in two level comparisons. The first consists of positioning the analyzed countries into the European Union context. The second level resides in an internal comparison of Moldova and Romania's social protection systems.

The first level of comparison, using results of the Hierarchical Cluster Analysis, shows that Moldova and Romania are placed on a far distance from the EU-25, meaning that there is a big difference financial allocation in the social protection system of Romania with that of Moldova. Even if Romania's social protection system is a lot higher financed than that of Moldova, it is still lower than average of European Union countries. There is a

high contrast between the financial resources allocated to social protection system and also to the GDP per capita of the EU-25 countries and Moldova and Romania, as presented in the Appendix 2.

An explanation of these discrepancies is that the Soviet legacy left negative imprints on the social protection of the post-socialist countries. Moreover, the period which followed after the collapse of the Soviet Union influenced profoundly negative the economical evolution of Moldova and Romania (for instance, Moldova in 1990 had a decrease of 65% in GDP²²).

There is a high contrast on the level of comparison of the studied countries not only in the EU context, but also on internal level of comparison of the protection systems from Moldova and Romania. On the second level of comparison, it can be concluded that due to a higher GDP and a higher GDP per capita, the Romanian citizens are better off than Moldavian citizens regarding social protection system. As a consequence the poverty rate among the vulnerable groups (pensioners, unemployed, etc.) is lower in Romania than in Moldova.

One of the explanations could pertain to the external pressure that Romania faces as a member country of the European Union, which is not that

evident in Moldova, as a non-candidate country. Resuming can be stated that there is better provision of social services in Romania than in Moldova. Even if facing great increase in social allocations as an EU country, Romania still do not hold sustainable social security system in the European Union context. Moldova possesses a very weak social security schemes that reflects through very formal and mal functioning legislative framework; weak capabilities on elaboration and implementation of policies addressed to various social programs; fragmented financial sector that do not allow consecutively and systematically the development of the system, which is indispensable in a sustainable mechanism.

Overall, the empirical analysis of Moldova and Romania's social protection show that they do not belong clearly in any of the clusters presented by Esping-Andersen, even if there are some similarities with the Southern European welfare states. Thus, in the case of the other states with different historical evolutions and different welfare type, where should these states be placed? Research of the question needed to be explored further.

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APPENDIX 1

Authors	Types of welfare states and their characteristics	Indicators
Gosta Esping-Andersen (1990)	1. Liberal: Low level of decommodification; market-differentiation of welfare 2. Conservative: Moderate level of decommodification; social benefits mainly dependent on former contributions and status 3. Social-democratic: High level of decommodification; universal benefits and high degree of benefit equality.	Decommodification Stratification
Stephan Leibfried (1992)	1. Anglo–Saxon (Residual): Right to income transfers; welfare state as compensator of last resort • Poverty, social insurance and tight enforcer of work in the market place and poverty policy 2. Bismarck (Institutional): Right to social security; welfare state as compensator of first resort and employer of last resort 3. Scandinavian (Modern): Right to work for everyone; universalism; welfare state as employer of first resort and compensator of last resort 4. Latin Rim (Rudimentary): Right to work and welfare proclaimed; welfare state as a semiinstitutionalized promise	Poverty, social insurance and poverty policy
Manuel Castles & Mitchell (1993)	1. <i>Liberal</i> : Low social spending and no adoption of equalizing instruments in social policy 2. <i>Conservative</i> : High social expenditures, but little adoption of equalizing instruments in social policy 3. <i>Non-Right Hegemony</i> : High social expenditure and use of highly equalizing instruments in social policy 4. <i>Radical</i> : Achievement of equality in pre-tax, pre-transfer income (adoption of equalizing instruments in social policy), but little social spending.	<ul style="list-style-type: none"> • Welfare expenditure • Benefit equality • Taxes

<p>Alan Siaroff (1994)</p>	<p>1. <i>Protestant Liberal</i>: Minimal family welfare, yet relatively egalitarian gender situation in the labour market; family benefits are paid to the mother, but are rather inadequate 2. <i>Advanced Christian-democratic</i>: No strong incentives for women to work, but strong incentives to stay at home 3. <i>Protestant Social-democratic</i>: True work–welfare choice for women; family benefits are high always paid to the mother; importance of Protestantism 4. <i>Late Female Mobilization</i>: Absence of Protestantism; family benefits are usually paid to the father; universal female suffrage is relatively new.</p>	<ul style="list-style-type: none"> • Family welfare orientation • Female work desirability • Extent of family benefits being paid to women
<p>Maurizio Ferrera (1996)</p>	<p>1. <i>Anglo–Saxon</i>: Fairly high welfare state cover; social assistance with a means test; mixed system; highly integrated organizational framework entirely managed by a public administration <i>continued over</i> 2. <i>Bismarck</i>: strong link between work position (and/or family state) and social entitlements; benefits proportional to income; financing through contributions; reasonably substantial social assistance benefits; insurance schemes mainly governed by unions and employer organizations 3. <i>Scandinavian</i>: social protection as a citizenship right; universal coverage; relatively generous fixed benefits for various social risks; financing mainly through fiscal revenues; strong organizational integration 4. <i>Southern</i>: fragmented system of income guarantees linked to work position; generous benefits without articulated net of minimum social protection; health care as a right of citizenship; particularism in payments of cash benefits and financing; financing through contributions and fiscal revenue</p>	<ul style="list-style-type: none"> • Rules of access (eligibility) of financing • Benefit formulae benefits • Financing regulations • Organizational–managerial arrangements

Giuliano Bonoli (1997)	<p>1. <i>British</i>: Low percentage of social expenditure financed through contributions (Beveridge); low social expenditure as a percentage of GDP</p> <p>2. <i>Continental</i>: High percentage of social expenditure financed through contributions (Bismarck); high social expenditure as a percentage of GDP</p> <p>3. <i>Nordic</i>: Low percentage of social expenditure financed through contributions (Beveridge); high social expenditure as a percentage of GDP</p> <p>4. <i>Southern</i>: High percentage of social expenditure financed through contributions (Bismarck); low social expenditure as a percentage of GDP.</p>	<ul style="list-style-type: none"> • Bismarck and Beveridge model • Quantity of welfare state expenditure
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APPENDIX 2. Socio-economic and social expenditure indicators for selected EU countries

	Scandinavian	Continental	Southern	Liberal	EU-25	Analyzed cases	
	Denmark	Germany	Italy	UK		Romania	Moldova
General indicators							
Total population, <i>mln</i>	5,411,4	82,500,8	58,462,4	60,034,5	459,488,4	22, 733	3, 359
Old age index ¹	22,3	25,9	26,9	17,1	16,5	-	-
Fertility rate ²	1,18	1,34	1,29	1,71	1,52	1,3	1,3
Divorce rate	2,8	2,5	0,7	2,7	2,0	1,52	4,1
Marriage rate ³	7,0	4,8	4,3	5,1	4,8	6,2	7,1
Women employment rate ⁴	71,7	59,2	45,2	65,6	55,7	50,7	47,7

¹ Old age index: people over 65 as percentage of the working age population (15-64) (sources: Eurostat 2003, national statistics)

² Estimated values for 2003. Source: Eurostat 2003; National stastics 2003

³ For 2004 in UK, rest 2003

⁴ Employed persons as a share of the total population aged 15-64 data referred to 2004

Male employment rate	79,7	70,8	70,1	77,8	70,9	62,9	50,4
Gini index ⁵	22	25	29	31	-	30,3	36,9
<i>Social Protection</i>							
Expenditure on social protection as % GDP	29,5	29,8	25,6	27,2	27,5(EU 15)	9,6	11
Expenditure per capita PPS	8095,4	7291,7	6266,3	7002,0	6747,6	7,200 ⁶ (in USD)	2374 ⁷ (in USD)

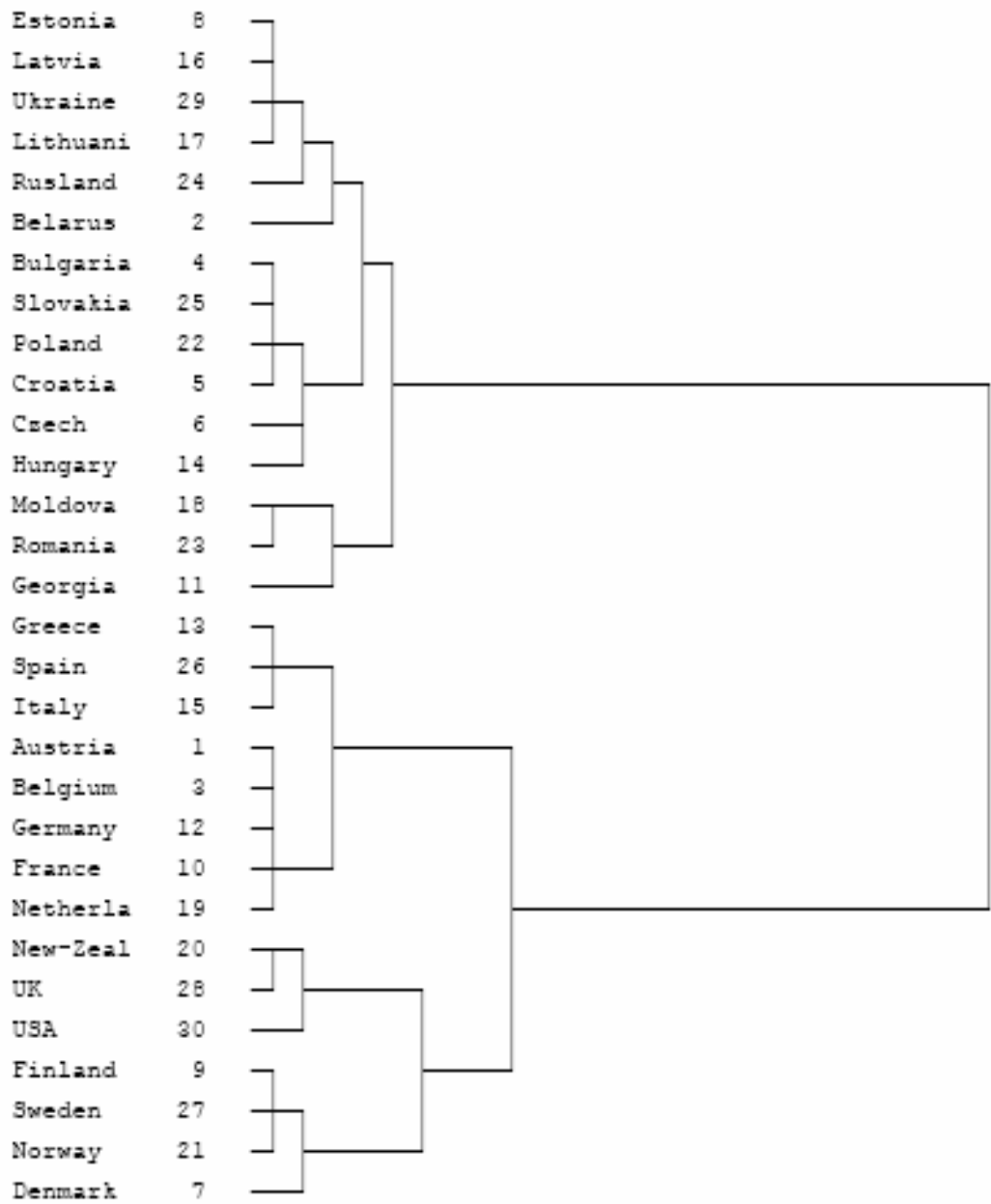
Source: Kazepov Y., Sabatinelli S., (2005). *The Droit a l'integration social in the European context*. Peer review in the Field of Social inclusion policies, on behalf of European Commission, DG Employment, Social Affairs and Equal Opportunities.

⁵ For Romania and Moldova is 2002

⁶ GDP per capita, PPS, for year 2003. UNDP Romania. Country Profile, web-site version at: http://undp.ro/profile_romania.php

⁷ GDP per capita, PPS, for year 2005. Draft of Republic of Moldova: National Report on Human Development (2006) *Quality of Economical growth and its impact on human development*.

APPENDIX 3. Output of Hierarchical Cluster Analysis by H.J.M. Fenger



Source : Fenger H.J.M. (2005). Welfare regimes in Central and Eastern Europe. Incorporating post-communist countries in a welfare regime typology. Paper for the NIG 2005 Conference, Nijmegen.

ORGANIZATIONAL DEVELOPMENT AND SUSTAINABILITY OF NON-GOVERNMENTAL ORGANIZATIONS IN CENTRAL AND EASTERN EUROPE

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Abstract

This article tackles the challenges faced by NGOs in Central and Eastern Europe in the beginning of the 21st century. With an organizational development and sustainability approach, the main issues taken into consideration are the internal problems (shortage of funds, lack of capacity, inefficient management of projects) and external problems (lack of supportive networks, information unavailability, no common perspective on priority issues, and overlap of interests) Moreover, in addition to developing NGOs at the national level, the trans-national character of issues facing civil society and sustainability require that NGOs develop a regional platform.

The main conclusion of this article is that if NGOs working in sustainability want the message they drum to be heard, they must start taking themselves seriously in order for their target

groups – government, businesses, citizens – to take up the rhythm.

1. Introduction

In the beginning of 2004 a program was initiated that sought to establish a regional network of non-governmental organizations (NGOs) from Central and Eastern Europe (CEE) dealing with joint issues of environmental protection and consumer protection. Such a network would identify the need around the region to have a common platform that can facilitate work on cross-boundary cooperation; to look at problems affecting the region from a broader angle; and to increase the capacity of civil organizations as well as strengthen their mandates to operate in their countries.

The role of NGOs in reforming society is widely recognized (Kaldor et al., 2003), yet the capacity of these organizations to perform optimally is limited. Especially around CEE region,

NGOs face internal problems (shortage of funds, lack of capacity, inefficient management of projects) and external problems (lack of supportive networks, information unavailability, no common perspective on priority issues, and overlap of interests). Most of these problems are not unique to single organizations but occur widely and in similar circumstances across the region.

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The term Non-governmental Organization (NGO) is adopted and modified from the operational definition of the Johns Hopkins Comparative Nonprofit Sector Project.² The project identifies five structural or operational features that make up NGOs. These are: *Organizations* (with some structure and regularity to their operations); *Private* (with no affiliation to political parties and are not part of the apparatus of the state, even though they may receive support from governmental sources); *Not profit distributing* (i.e., they have no corporate affiliations and are not primarily commercial in purpose and do not distribute profits to a set of directors, stockholders, or managers); *Self-governing*; and membership or participation in them is *Voluntary*.

In the context of this paper, the use of the term, non-governmental organization, will generally be limited to those involved in issues of consumer protection, human rights, environmental protection or sustainable development. This therefore excludes the likes of churches, hospitals, schools, boy scouts, etc., without any contradiction to previously defined characteristics. Further, the term Civil Society Organizations may be used as a broad adaptation of the other forms of appellation such as “Civil society organizations”, “associations,” “non-

profit organizations,” “voluntary organizations,” “charitable organizations”, etc.

Today, the CEE Network is a partnership of 26 NGO member organizations in CEE and six partners, mainly international organizations and state agencies. Material for this article is based mainly on a three-year process of consultation, interviews and focus group discussions. The three-year period includes the preparatory phase for the establishment of the network (brainstorming, consultation and interviews), the founding conference (interview, focus group discussions and workshop outputs) and the current phase (post-foundation) during which the network has to become active.

The article explores a balance between practical implementation and theoretical academic/scientific concepts on NGOs and their networks. While supported by data, it is mainly qualitative. It is also explorative and some parts are based on the systematic observations of the author, being Project Manager of the process leading up to the establishment of the organization and currently the Chairman of the network.

This article is meant to explore possible grounds from which to further develop the new network, but also to challenge the current thinking of the NGO community in the region, with the hope that the search for answers would give it a stronger hand in dealing with the increasingly demanding mandates handed to NGOs both by the public and

² Lester Salamon, M., Anheier, Helmut K., *The Emerging Nonprofit Sector: An Overview*, Manchester, (Manchester University Press, 1997a).

by the inclusive nature of the process towards more sustainable societies.

2. Opportunities and Challenges

Some of the most influential changes in countries of Central and Eastern Europe (CEE) in recent years have been: the shift in the region to a market-based economy; and the accession of 12 former communist countries to the European Union, as well as current negotiations with more countries.³ These have brought about new opportunities and new challenges. In both cases, the role of civil society in contributing to democratic and democratizing governance, in influencing production modes in the economy, and thereby contributing to developing a sustainable society has been heightened. This role is executed through civil society organizations, in effect non-governmental organizations.⁴

³ Joseph Stiglitz, E *Globalisation & its Discontents*, (New York: Norton, 2002).; Joseph Stiglitz E., and Hoff, Karla 'The Transition from Communism: A Diagrammatic Exposition of Obstacles to the Demand for the Rule of Law', in *Policy Research Working Paper Series* number 3352, The World Bank, (2004).

⁴ Sustainability, *The 21st Century NGO: In the Market for Change*, London, Sustainability, 2003. See www.sustainability.com; Kaldor, Mary; Anheier, Helmut and Glasius, Marlies (ed.), *Global Civil Society 2003*, Oxford, Oxford University Press, 2003.

Kaldor, Mary; Anheier, Helmut and Glasius, Marlies (ed.), *Global Civil Society 2003*, Oxford, Oxford University Press, 2003.

For over forty years prior to the transition, the heavily controlled political system destroyed the non-profit traditions that had existed in these countries⁵; spun off organizations which were supposed to represent the voice of the masses but which were never independent of government and were in fact "institutions of social control" by communists⁶; and raised a generation that was so psychologically indoctrinated in command-and-control systems that people were indoctrinated as receptors, or at times passive resisters, of external orders.

The Johns Hopkins Comparative Nonprofit Sector project discusses the "larger processes and developments that have been, and are, taking place across the countries of [the CEE] region" as follows:

Their rich philanthropic traditions, and their relatively well-developed systems of private nonprofit institutions in the nineteenth and early twentieth centuries, were disrupted by war and the subsequent establishment of communist regimes. Only after the mid 1980s did the countries of Central and Eastern Europe move towards a true multi-sector society, when cautious

⁵ Eva Kuti, "Hungary", in *Defining the Nonprofit Sector: A Cross-National Analysis*, Salamon, Lester M., Anheier, Helmut K. (eds), Manchester, Manchester university Press, 1997. 471 - 492

⁶ Salamon, Lester M., Anheier, Helmut K. (eds) *Defining the Nonprofit Sector: A Cross National Analyses*, Manchester, Manchester University Press, 1997b.

reforms opened up the first opportunities for the establishment of private institutions...Overall, however, before 1989, so-called “social organizations,” i.e., nationalized and government-controlled institutions took some of the roles nonprofit organizations assume in democratic market economies...these organizations were incorporated into the State apparatus, and enjoyed no independence.⁷

The older generations especially find it hard to comprehend the dwindling state availability, or “the withdrawal and redefinition of the State”.⁸ Fifteen years of post-communism have proved not to be enough time for recovery, to fully regain such mental attitudes or to set up the mechanism and infrastructure that are needed to build an independent, organized and proactive civil society.

Yet the younger generation (born in the last, waning days of communism, or just after) is coming up, and characteristically seeks to assert its independence. One means of exercising this freedom has been an uneducated rush towards consumerism⁹; however

those in the alternative, growing civil society movement, have equally shown a passion. It is perhaps in this light that the most progressive NGOs in the region are those run by the younger generation. Some of that passion needs to be tamed and channeled, and there is compelling indication that this is coming to consciousness.

3. New Roles and Growing Responsibilities

In addition to developing NGOs at the national level, the trans-national character of issues facing civil society and sustainability require that NGOs develop a regional platform. Kaldor et al.¹⁰ highlight the development of civic networks as a means of building “social capital” by “building relationships of trust and cohesion”, the importance being that “self-organization across borders creates social cohesion within trans-national communities.” However, an international cooperative effort should not overshadow the need for cumulative efforts to provide a subtle balance between generic, transferable action and action which truly reflects to local conditions.

- “Prompted in part by growing doubts about the capacity of the state to cope with its own welfare,

⁷ Lester M Salamon,., Anheier, Helmut K. (eds) *Defining the Nonprofit Sector: A Cross National Analyses*, Manchester, Manchester University Press, 1997b.

⁸ Eva Kuti, “Hungary”, in *Defining the Nonprofit Sector: A Cross-National Analysis*, Salamon, Lester M., Anheier, Helmut K. (eds), (Manchester, Manchester university Press, 1997),471 - 492

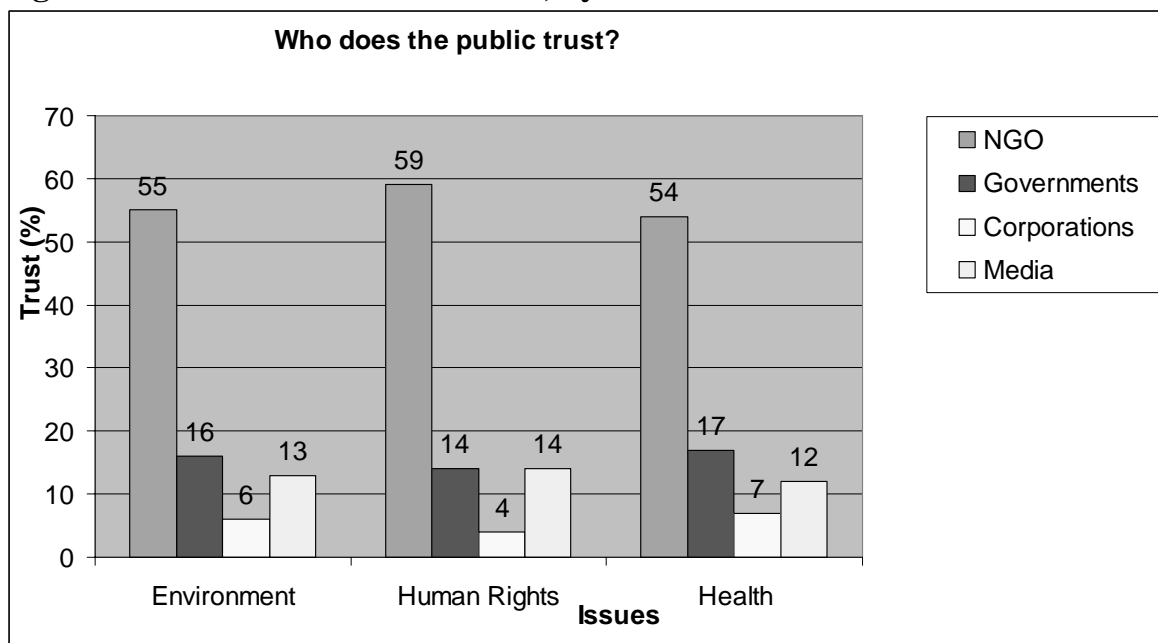
⁹ Cohen, Maurie J. *Sustainability: Science, Practice, & Policy*, Volume 1, Issue 1, (Spring 2005) <http://ejournal.nbii.org/>

EEA, *Household Consumption and the environment*, EEA, Copenhagen, 2005.

¹⁰ Mary Kaldor, Anheier, Helmut and Glasius, Marlies (ed.), *Global Civil Society 2003*, (Oxford, Oxford University Press, 2003).

developmental, and environmental problems,” wrote

Figure 1: Public trust in institutions, by sectors



Source: Edelman Trust Barometer, 2003

Kaldor et al.¹, “analysts across the political spectrum have come to see NGOs as strategic components of a middle way between policies that put primacy on ‘the market’ and those that advocate greater reliance on the state.” This mandate to NGOs is further emphasized by the public: data from annual surveys repeatedly reveal that the public trusts NGOs most – ahead of governments, media and corporations.

Below are some of the reasons for why NGO support continues to grow:

the opening up of ex-communist and other emerging or transition economies to markets, democracy and civil society models;

- the communications revolution, with the internet and other information

technologies linking and empowering individuals and groups worldwide;

- the withdrawal of government from many areas of service provision, especially to vulnerable communities;
- falling trust in traditional institutions (governments, church, business);
- on-going social inequality and continued environmental degradation.

To fill these new shoes, NGOs need to step up their game, not as responders but as drivers, leading the agenda for sustainability. For this to happen, they need to set a common vision for themselves, professionalize their working culture, develop sustainable financing mechanisms, and to engage in stakeholder dialogue and constructive partnerships. These issues are explored below.

¹ Kaldor et. Al., *Global Civil Society*, 2003

4. Lack of Vision

Most of what is understood as sustainability within civil society organizations is intuitive rather than clearly defined. In a focus group session during the founding conference of the CEE network, 23 participants were asked to describe what was to them the vision of a fully sustainable society. As it turned out, largely all participants had differing answers, even when they shared some intersecting aspects. It was observed that some participants who came from the same organization had different views of what sustainability is. By and large, there were patterns; it emerged, albeit loosely, that environmental NGOs had a vision which was different from what consumer NGOs had, and which also differed from what cultural and grassroots NGOs had in mind. Though there are similarities in the sector, the so-called third sector, of what has come to be understood as NGOs; there remain large gaps between and among the organizations.²²

The above example highlights one of the main issues affecting the NGO movement: a lack of shared vision. This

operates in two levels as described below:

- At the level of individual organizations, several NGOs do not have a common vision of what they are working towards. Some organizations have a vision written down on paper, but there is no common understanding of it by employees; it doesn't necessarily translate into the strategy or daily tasks of the staff.
- At a broader level, and perhaps more troubling, there is lack of a sectoral vision. There is no single shared and commonly interpreted vision of where the third sector is going with the society they are out to build, of what a sustainable society would look like, if achieved. In a broad sense, most NGOs attest to the unsustainability of contemporary lifestyles. They consider the need for sustainability as opposite to these lifestyles, a negation of the current system. The variety of interpretations of this leads to denial of what is at present. This might not be wrong in itself, yet it fails to propose a much needed alternative way. In refusing contemporary structures and yet not presenting a visionary direction of what a sustainable society would look like, NGOs are caught in a limbo.

²² Sustainability, 2003, Salamon and Anheier, *The emerging nonprofit sector*, 1997; Salamon, Lester M., Anheier, Helmut K., *The Emerging Nonprofit Sector: An Overview*, Manchester, Manchester University Press, 1997a.

Lester M Salamon,., Anheier, Helmut K. (eds) *Defining the Nonprofit Sector: A Cross National Analyses*, (Manchester, Manchester University Press, 1997b).

As a consequence, there is sometimes no coherence in activities carried out by the organization. Programs become disjointed from one phase to another, weakly linked, and fail to see common direction in actions.

Also because of a lack of vision and set direction, NGOs tend to become responsive (to government and business

agenda), instead of being proactive, leading the way to sustainability.¹³ This reactive pattern has clearly been seen in the area of fundraising for programs, where NGOs respond to donors' whims, and also in policy processes where NGOs quite often limit themselves to making comments on policy drafts – a phase past the point where they could lobby for inclusion of their own ideas.

The mandate of the third-sector is thus not clearly understood by NGOs themselves, and less so by the public. Internal confusion has easily led to mixed signals for external stakeholders. This could be due to the sometimes low public awareness of issues they advocate, and loss of some of the public support they should have. In fact, analysts seem to suggest that NGOs generally enjoy a high amount of public trust, not mainly at the strength of their own workings but seemingly owing to the disappointing failures of governments, business and the media.¹⁴

The issue of lack of vision of a sustainable world is not limited only to NGOs. It extends to governments and to businesses, too. Because of the long

term nature of sustainability against the myopic perspectives of electoral-cycle government policies and corporate profit activities, visioning a sustainable society poses a challenge which neither policy instruments nor traditional economics methods are designed to handle.¹⁵ In recent decades, Environmental Economics has fast become a “fashionable” academics area (see Financial Times, 2006) not least because of the new kinds of challenges that it opens.

5. *Developing a Shared Vision*

A vision, according to Brian Murphy¹⁶, “involves ‘seeing how things are’, particularly how things are for *oneself* – creating our own knowledge and perception and relevance rather than merely absorbing or adopting a prescribed perception. In seeing how things are, vision also involves seeing ‘how things are *not*’. And, finally, vision involves creating intention, ‘see how things might be’.”

An organization's vision (*where* it wants to go) lends to its mission (*what* it must do to get there) and is then broken down to a strategy (*how* it want

¹³ Peter Drucker, *Managing the Non-Profit Organization* (Oxford: Butterworth – Heinemann, 1990).

¹⁴ Evelyn Iritani, “From the streets to the inner sanctum” in *Los Angeles Times*, (February 20, 2005); Fuchs, Doris, and Lorek, Sylvia, “Sustainable Consumption Governance: A History of Promises and Failures”, in the *Journal of Consumer Policy*, 28 (2005):261 – 288.

¹⁵ David C Korten, *When Corporations Rule the World*, (Kumarian Press, 1995).

Stiglitz, Joseph E *Globalisation & its Discontents*, New York: Norton, 2002.

¹⁶ Murphy, Brian K., *Transforming Ourselves, Transforming the World: An Open Conspiracy for Social Change*, (London, Zed Books., 1999).

to get there).¹⁷ These three are interlinked, and are effective in accomplishing objectives.

In the same focus group discussion referred to above, less than 50% of organizations said that they had a concrete strategy developed by breaking down the vision and mission of the organization. The rate dropped to 25% when asked those who had action plans derived from the strategy. It was then argued by some organizations that not being confined by a tight strategic action plan allowed the organization to be more organic, making it more flexible to adopt new trends and hop onto niche programs. (As shall be seen later, this attitude is part of the working culture of organizations that are donor-driven). The organic, spontaneous projects run by NGOs are easily adaptable to fluctuations in issues arising on the political agenda. Yet if these projects do not fall within a coherent pattern, each project building upon the previous, guided by an ultimate vision, there is a resulting inefficiency. It allows organizations to stretch themselves thin by engaging in irrelevant activities, at times in favor of those that are tempting to donors but less strategically relevant.

Together then, NGOs need to develop a vision, one which is commonly understood and shared. Such a vision must ideally be able to attract people

¹⁷ Covey, Stephen R. *The Seven Habits of Highly Effective People: Powerful Lessons in Personal Change*, (London, Simon & Schuster, 1989).

towards it. Each organization will then set its mission under this common vision. Peter Drucker¹⁸ highlights a common mistake when NGOs set to developing their mission: setting a mission that is too broad and not feasible for the organization, “a hero sandwich of intentions”. A mission statement must be operational. This is then further broken down to a strategy, action plans, and periodic activities. To stay relevant, the mission and strategy should constantly be reviewed and adjusted against internal and external changes in the operational environment. A well defined vision would give room for creativity¹⁹ and would present the organization as a force for policies and businesses to then respond.

6. Work Culture

6.1 Staffing

Workers in non-governmental organizations would usually fall under one of the following: full-time employees, part-time employees, or volunteers.

a) **Full-time employees.** They are usually the daily administrative and overall management staff. Because NGO employees' salaries are

¹⁸ Drucker, Peter *Managing the Non-Profit Organization* Oxford: Butterworth – Heinemann, 1990.

¹⁹ Brian K.. Murphy. *Transforming Ourselves, Transforming the World: An Open Conspiracy for Social Change*, (London, Zed Books., 1999).

comparatively low, these positions do not necessarily attract the most formally qualified persons. Occasionally however, the head of the organization would be reasonably qualified, fortified by a strong sense of commitment. This head would also have most likely spent a long time within the NGO, thus is experienced in its field of activity and has a “feel” of the internal sense of the organization.

b) The more usual type, and a higher number, of workers are **part-time employees**. Usually they would be project coordinators, coordinators of minor programs, or persons responsible for periodic tasks within the organization. Quite likely, a part-timer would split his time to work for more than one organization, or would also be self-employed. Another category of workers for NGOs would be persons who are frequently subcontracted more specialized but less frequently occurring tasks, such as translation work, soliciting support for an idea or project, etc.

c) Because staffing is limited, NGOs usually rely on **volunteers**. These form, in numbers, the majority of workers within the organization. Most of them are students, part-time employees who volunteer the rest of their time to the organization, or persons of sympathy to the group’s course. According to statistics in Hungary, in 2000 “the number of volunteers exceeded 400,000; the almost 35.5 million hours of volunteer work corresponded to the working hours of about 17,000 full-time

employees. The value of volunteers’ work was estimated to approach HUF 18 billion” – approximately € 64 million (www.nonprofit.hu). Organizations with the highest number of volunteers are those that organize public campaigns or demonstrations, such as environmental groups, human rights groups, or generally groups dealing with issues to which the public is sensitive.²⁰ Volunteers usually have a high sense of motivation and loyalty to the objectives of the organization. Occasionally, some qualified professionals or retirees are called up to offer their services. Still, most volunteers are untrained for their particular tasks, and because they are offering their time out of good will, are not obliged to carry out work that, although might be necessary, they do not feel comfortable with. This last point, as shall be demonstrated soon, affects the way NGOs are managed.

6.2 Management

The NGO movement gathered momentum in the 1970s as a new, “alternative movement” (Harrison, Newholm and Shaw, 2005). It rose from the fringes of communities to the center of civil society by challenging

²⁰ Sustainability), *The 21st Century NGO: In the Market for Change*, London, Sustainability, 2003. See www.sustainability.com

human rights obscurities, Northern hemisphere-dominated trade, etc. This struggle against the mainstream has

Table 1: Workforce and Revenue Patterns in CEE²²

	All countries *	Developing and transitional	Eastern Europe	Czech Rep.	Hungary	Poland	Romania
Workforce (*A)							
FTE paid	2.8%	1.2%	0.8%	1.3%	0.9%	0.6%	0.4%
FTE volunteers	1.6%	0.7%	0.4%	0.7%	0.2%	0.2%	0.4%
FTE total	4.4%	1.9%	1.1%	2.0%	1.1%	0.8%	0.8%
Composition of workforce (*B, *D)							
Service	63.3%	62.5%	44.7%	42.4%	40.0%	49.5%	58.2%
Expressive	32.4%	32.7%	50.3%	54.0%	55.2%	46.2%	36.9%
Other	4.3%	4.9%	5.0%	3.6%	4.7%	4.3%	4.9%
Cash revenues (*C, *D)							
Fees	53.4%	62.3%	49.0%	46.6%	54.6%	60.4%	28.5%
Government	34.9%	21.6%	31.5%	39.4%	27.1%	24.1%	45.0%
Philanthropy	11.7%	16.1%	19.5%	14.0%	18.4%	15.5%	26.5%
Total support (with volunteers) (*D, *E)							
Fees	42.4%	51.4%	42.9%	37.9%	52.7%	57.1%	13.0%
Government	27.2%	16.9%	24.6%	32.1%	26.2%	22.8%	20.5%
Philanthropy	30.4%	31.7%	32.6%	30.0%	21.1%	20.1%	66.5%
* Workforce: 35 countries; composition, revenues, and total support: 32 countries.							
*A - As percent of economically active population.							
*B - As percent of total civil society workforce (paid and volunteers).							
*C - As percent of total cash revenues.							
*D - Percentages may not add to 100% due to rounding.							
*E - As percent of total cash and volunteer support.							

Source: Johns Hopkins Comparative Nonprofit Sector Project

paradigms that were considered given at the time²¹ –corporate led globalisation,

come to characterize the NGO movement, more strongly so in newly democratizing areas where civil society activism is at a young stage and gaining momentum. In positioning themselves against the dominating and ill-effects of capitalism, for example, NGOs have

²² Note that contents of the table are drawn from a broader definition of NGOs than is used in this paper. Data on this table includes churches, hospitals, universities, etc.

²¹ Ed Mayo in Harrison, Rob; Newholm, Terry and Shaw, Deirdre (ed.), *The Ethical Consumer*, (Sage Publications, 2005).

sought to define their operational style to be as far away from the corporate style as possible – irregular working hours, unclear hierarchy and structure, casual, sometimes streetwise dressing, community activism, low salaries, etc., are but a few. This is the “alternative cool”, said a participant in an NGO management course in Brussels organised by the European Consumers’ Organization, on behalf of the European Commission Directorate General for Health and Consumer Protection.¹³

Part of the attraction of this alternative cool – especially to young people and volunteers - is the *laissez-faire* involved at work. Some volunteers comment seeing NGO offices as community ground rather than a workplace per se. There may be work to do, and it eventually gets done – even if at self-determined paces – but people do not feel compelled to be as serious or “performance-driven” as in corporate offices. Many NGO staffs are friends with each other, thus it is hard to see the organizational hierarchy, to be strict with each other, or to know the line between professional relationships and personal ties. Some contend that this leads to the feeling of involvement and “job satisfaction” when people feel cared for and personally connected to the work environment. Others argue that there is a need for moderation; that the present situation has too much *laissez-faire*, professional standards are

thus lowered, and work ethics are mixed with interpersonal liaisons.

The period just after the founding meeting of the CEE network in 2004 was summer. This is an especially unruly time to expect intense output from NGOs in the region. Summer months, especially July and August, are unofficial NGO holidays. The sector-wide silent consensus is not to carry out serious tasks or to demand such of others. Activities slow down; phones go almost dead; one or two persons linger around the offices, usually alternating, to show a face; emails are not answered. After the founding conference, in spite of the agreement on follow-up tasks and close deadlines, some organizations could not be reached for joint project proposals that had been agreed upon weeks back.

Another trend worth exploring is the angry-activist predisposition. This refers to persons who are angry about, for example, the encroachment of capitalism into the cultural sphere – and foreign-owned multinational companies into areas considered traditionally of national significance. The NGO is generally popular among such people, who see it as a forum to fight against such unfair, exogenous forces and defend individual, cultural or universal human interests.²⁴ It is perhaps telling of these NGOs that many of their

¹³ See www.BEUC.org, www.eu.int/comm/dgs/health_consumer/index_en.htm.

²⁴ Neera Chandhoke in Kaldor, Mary; Anheier, Helmut and Glasius, Marlies (ed.), *Global Civil Society 2003*, (Oxford, Oxford University Press, 2003), 410.

volunteers, and quite often their employees, are angry persons who join to fight off corporations. There is a similar case with human rights activists, environmental activists, anti-globalization activists, etc. Sustainability (2003) writes that “the values that many of those who have gone into NGOs hold are skewed when compared with those working in the mainstream worlds of business and government.” “They prioritize ethical; social or environmental issues in different ways and feel a stronger sense of outrage when these values are offended.”

From their side, corporations regard NGOs as unprofessional – not trained to cover their roles, acting emotionally, and without a clear agenda or proposed solutions to resolve issues they are up against. Governments are reluctant to take up the arguments of NGOs, owing to the lack of well-researched material to back their claims, and also for fear of being on the wrong side of companies – the backbone of the economy. Owing to these external perceptions, NGOs tend to operate in a sort of limbo, trusted and mandated by the public, unheard by the governments and institutions, ignored by corporations.

Peter Drucker, after 40 years of working in the nonprofit sector, reflects on a situation in the US 40 years ago that is still very much prevalent among CEE NGOs: “‘management’ was a very bad word in nonprofit organizations. It meant ‘business’ to them, and the one thing they were not was business.

Indeed, most of them then believed that they did not need anything that might be called ‘management’. After all, they did not have a ‘bottom line’.”

He continues, on identifying one of the major reasons why good management models for NGOs are difficult to come by:

...little that is so far available to the nonprofit institutions to help them with their leadership and management has been specifically designed for them. Most of it was originally developed for the needs of business. Little of it pays any attention to the distinct characteristics of the nonprofits or to their specific central needs: to their mission, which distinguishes them so sharply from business and government; to what are ‘results’ in nonprofit work; to the strategies required to market their services and obtain the money they need to do their job; or to the challenge of introducing innovation and change in institutions that depend on volunteers and therefore cannot command. Even less do the available materials focus on the specific human and organizational realities of nonprofit institutions; on the very different role that the board plays in the nonprofit institution; on the need to attract volunteers, to develop them, and to manage them for performance; on relationships with a diversity of constituencies; on fund-raising and fund development; or (a very different matter) on the problem of individual burnout, which is so acute in nonprofits precisely because the individual

commitment to them tends to be so intense.²⁵

To their credit, NGOs are beginning to develop management training programs tailored to the NGO sector, and to have some sort of internal volunteer management programs. A longer stride, one which has been admitted to be costly, would be to actively engage in research into their core fields of activities, in order to present facts (rather than only raise emotions), analyses and proposals, and even move on to consulting stakeholders.

7. Financial Sustainability

7.1 Classification of Revenue Sources

The issue of financing has a pivotal contribution to the character of NGOs and their operations. It is not only a matter of how *much* funds are (not) available; it includes *how* the funds are raised, and from which donor.

The Johns Hopkins Comparative Nonprofit Sector Project²⁶ identified three broad classes of non-profit sector revenue:

²⁵ Drucker, Peter *Managing the Non-Profit Organization* (Oxford: Butterworth – Heinemann, 1990), 175.

²⁶ Salamon, Lester M., Anheier, Helmut K. (eds) *Defining the Nonprofit Sector: A Cross National Analyses*, Manchester, Manchester University Press, 1997b.

Salamon, Lester M., Sokolowski, S. Wojciech, List, Regina, *Global Civil Society: An Overview*, (Baltimore, Johns Hopkins University, 2003).

- Private Charitable Giving, including gifts from individuals, corporations, foundations, and bequests, whether given directly or through various federated fundraising efforts;
- Government Support, or Public Sector Payments, including outright grants, as well as contracts for particular services and payments by public sector organizations to non-profit providers;
- Private Fees and Payments that the non-profit sector receives from the sale of its own services or some other product directly to the consumer.

Organizations in CEE show patterns in accord with the above classification. Financial income sources can be further classified into internally generated income and external funding sources.

External funding includes private charitable giving and government support or public sector payments. Characteristics of external funds are:

- **Core Funding.** This is financial assistance to support the basic operations and maintenance of the organization. It includes overheads, administrative cost, primary human resources, and the main activity of the organization. Such funds are available mostly to major organizations or to networks. Although such funding is rare in the region, well-branded organizations or those that have established strategic partnerships with donors sometimes benefit from them. Typical donors would be ministries of Western governments (especially of the Scandinavian countries, the Dutch and the English), ministries of countries in

which the recipient organization is based, The European Union (mainly to NGO networks active at the European Union level) and Foundations. The Soros Foundation, established by billionaire philanthropist George Soros is a major funding source of civil society core activities in the region (www.soros.org).

- **Project-based funding.** Usually NGOs have to design a project and then write proposals to donor organizations to fund the project. The European Union is the major single source of funding of civil society projects in the region. There are also government funds, as well as those operated by private foundations. Usually the donor organizations would send out “calls for proposals” announcing the availability of funds, specific themes which it supports through the funding program, deadlines, application procedures etc. Project-based funding is the primary type of funding available to NGOs in the CEE.

- **Donations.** They come from private individuals (mostly those who sympathise with the cause of the NGO) and Foundations. In most cases, NGOs have to go out fundraising to get such donations and, again, only image-friendly or well-branded NGOs who have public sympathy end up cashing in. It should be mentioned that private donations to NGOs are not a very common thing in the region. The spirit of philanthropy needs to be uplifted to come close to matching levels of problems being handled by NGOs. However, in non-financial terms, donations could also be volunteers

giving their time and expertise at no charge to help in operations run by NGOs. If this is factored in and calculated according to paid hours, considering the booming nature of NGO volunteering in the region, the proportion of donations would rise considerably.

- **Corporate Funding.** Although quite often in needy situations, a majority of NGOs in the CEE have not yet come to terms with accepting financial donations directly from companies. The few that have accepted money speak about it in only low tones, and refuse to be mentioned, with the insinuation that a certain boundary within the sector has been transgressed. Corporations are interested in funding NGOs; for one, it presents their image to the public as more socially responsible. Tempting as the funds might be to the NGOs; they are still rejected and remain controversial.

Internal income sources are mainly Private Fees and Payments that the non-profit organization receives from sales of its own services or product directly to the consumer, e.g. membership fees, sales of publications or memorabilia, and consultation done to stakeholders on information, research, ‘green’ projects, development of ethical or environmental strategy, etc. There exists some degree of internally raised funds, but this is limited compared to the external. Internally raised funds are less pursued, partly due to the amount of effort involved in developing and maintaining the mechanism, but also because the public still has to learn or

be able to financially support NGOs championing public interest causes to which they subscribe.

7.2 Funding Challenges

Of all complaints raised during discussions about issues faced by NGOs, shortage of funds comes out on top. A tacit is that solving the problem of financial availability would go a long way to solving the other problems faced by these NGOs. But international NGOs and the more experienced ones of the West know that this is not necessarily the case.

Besides the general shortage of funds, when they are available they generally have short-term financing cycles. This curtails the ability of NGOs to plan well ahead; it derails a substantial amount of staff time towards fundraising, at the expense of operations more targeted towards strategic objectives; and it puts much pressure on the staff, sometimes forcing the organization to feel compelled to be more accountable to the donor than to other stakeholders of their causes.

Donor organizations, especially in the case of project-based funding, usually follow the contemporary “fashion” in civil society activity fields. As trends move from human rights to globalization to terrorism, etc, the fund allocations also sway. NGOs depending on these funds have to keep tailoring their project objectives – or become project-design artists - to be able to access funds. Furthermore, donor

funding limits the flexibility and autonomy of recipient NGOs as they need to follow the guidelines set by donors.

Many of the funds that were available to countries of the region after the collapse of communism are drying out. Funds by the European Union Directorate General for Enlargement, including the popular PHARE program²⁷ have dried up, most US and UK charities and foundations, respectively, formerly financing operations in so-called former soviet-bloc countries have now moved out of the richer new EU member countries towards the East. Slovenia, Hungary and Czech Republic especially suffer from this Eastward donor drainage given the relatively visible public affluence of these countries. A heated discussion among NGOs is the precarious donor vacuum that has been created and how to fill it.

Paradoxically, governments of the region have window dressing budgets for NGO activities that never materialize when needed. In the year 2000, in Hungary “28% of the [NGO] sector’s total income was allocated from central and local government budgets. However, this percentage is still far below the level of the government support to non-profit organizations in [Western] European Union countries.”²⁸

²⁷<http://ec.europa.eu/comm/enlargement/pas/phare/>

²⁸ www.nonprofit.hu

A spin-off of the above is that governments have taken advantage of the internal competition by NGOs for limited funds to create a “divide and rule” approach. Governments foster competition and even rivalry by playing one NGO against the other in order to weaken their strength and ability to criticise or orchestrate opposition to unpopular ministry programs. At least three national level NGOs reported having been offered “exclusive contracts” by the governments only to be later withdrawn and given to another NGO.

7.3 Towards a Stable Financial Base

In a capacity building training on fundraising strategy for NGOs organized by the Association of Conscious Consumers Hungary, Consumers International, the international umbrella organization for consumer advocacy groups, identified the following characteristics as those of a financially sustainable organization:

- It has more than one source of income to ensure balance and avoid overdependence on any one specific donor source. It also needs a reasonable spread of donors but not so many that it spends too much time on reporting;
- It has more than one way of generating income. It also internally generates a reasonable percentage of its income to ensure that it is not totally dependant on donors;
- It has adequate financial systems, and overhead costs are as low as

possible (no more than 15% to 20% of total expenditure);

- It has a good public image to secure public trust and donations;
- It is clear about its values and has them built into its objectives, strategy, activities;
- It has built up reserve funds to sustain it for at least a year in case of no income.

After elaborating the above, the trainer asked the participants to use the criteria to evaluate their organizations whether they were in financially sustainable situation or not. Of the 12 represented, no organization was.

Owing to the critical nature of their work, NGOs do need to have financial autonomy from their donors. This would allow an organization to be able to make its own decisions about how it spends its funds, and to be able to reject external income that comes with strings attached as such funding could compromise its integrity or legitimacy. One step needed to start addressing the funding issue is for each organization to consciously develop a strategy on how to raise funds, which should be aligned with the organizational strategy. Such a strategy should be well focused, consider the efficient use of limited resources, and give room for the organization to perceive threats and opportunities. Elements of a fundraising strategy, according to an internal training pack by Consumers International, include:

- assessing the contemporary situation of the organization;

identifying organizational and budgetary needs;

- determining the fundraising target, i.e. the total amount to be raised within a certain period of time;
- identifying possible sources of funding and set income targets for these;
- identifying strategies for securing funds from those sources;
- identifying the resources the organization has available; drawing an action plan.

Certainly, such a plan can only work if it is a process that involves the management of the organization, and it is continuously being monitored and evaluated against the internal and external environment of the organization in view of its objectives.

NGOs in the region need to develop financial management systems which take into account the need to raise their quotas of internally generated income (through sales of publications, consultations to stakeholders in fields of their core competence, membership fees, etc). Given the current climate of donor drainage, the financially successful NGOs would have to be creative beyond traditional means that have worked until now.

8. Stakeholder Engagement

As the challenges of sustainability become increasingly evident, so are strategies needed to achieve the

objectives of NGOs²⁹. Increase in stakeholder diversity and complexity and the range of issues NGOs champion call for relevance of more active engagement in partnerships.

For several international organizations, the last decade has seen a move from confrontation (which has proved a highly effective means for raising awareness of critical issues) to cooperation with other stakeholders to produce solutions to pressing global challenges.³⁰ This trend is now mostly shown by large, brand name NGOs such as Greenpeace, WWF, Oxfam, etc, based in Western countries. This does not discount the need for partnerships among smaller, grassroots NGOs. The United Nations Environmental Program, Accountability, and Stakeholders Research Associates Canada acknowledge that in economically less advanced countries where formal structures are still coming in place, “stakeholder engagement often has emerged from adverse outcomes of poor governance practices by local or national governments. At one end of the spectrum, engagement by NGOs can mean an informal arrangement to hold discussions or to be present at an event.

²⁹ Partridge, Katharine; Jackson, Charles; Wheeler, David; Zohar, Asaf, *The Stakeholder Engagement Manual Volume 1: The Guide to Practitioners*, (2005).

³⁰ Ben Schiller, *Business-NGO Partnership*, (Ethical Corporation, London, 2003).
World Economic Forum, *Partnering for Success: Business Perspectives on Multistakeholder Partnerships*, World Economic Forum, 2005
www.greenpeace.org.uk

At the other end, engagement can be marked by long-term collaboration or partnership with business to complete a defined task or to achieve common goals.”³¹

In the CEE region, NGO projects usually have community impact but have a tendency of not having influence at levels that could bring in larger, systemic changes that are necessary. Their experience in community water management schemes, for example, developing local farmers’ markets, preservation of local plant species, etc, could have wider implications than just immediate benefits by the involved communities. Though these projects have public relevance, the management and outputs have no liaison to influential places that could make more meaningful use of outcomes and experiences – no seats in policy groups, thus their experience cannot help in designing better policy for wider benefit; their products or schemes cannot be used as replacement of less sustainable corporate models either. The potential of NGO efforts is thus not maximised.

According to Ethical Corporation³² and Sustainability, a partnership is a cross-sector alliance in which individuals, groups or organizations agree to work together to fulfill an obligation or undertake a specific task; share the risks as well as the benefits;

³¹ Partridge, *The Stakeholder*, 2005.

³² Schiller, Ben, *Business-NGO Partnership*, Ethical Corporation, (London, 2003).

and review the relationship and revise the agreement regularly.

8.1 NGO Stakeholders and Levels of Engagement

Levels of engagement could vary as below:

- no engagement, in which stakeholders operate independently in spite of intersecting interests. Such was the case in the 1970s when the civil society movement was gaining strength³³ in stringent opposition and adversarial attitudes towards, say, corporations – in the case of (anti-)globalization.

- one-off consulting, in which they work together once, say, on a common project;

- collaborative/retainer relationship, by which they come together more than once whenever a mutual need arises; and

- partnership based on a shared sense of mission and objectives.

There can either be intra-sector or inter-sector partnerships. Intra-sector partnerships are the more common, for example, business to business partnerships, or NGO partnerships, the CEE network of which is an example. The focus on this part is more on inter-sector partnerships.

³³ Rob Harrison, Newholm, Terry and Shaw, Deirdre (ed.), *The Ethical Consumer*, (Sage Publications, 2005).

Harrison, Rob; Newholm, Terry and Shaw, Deirdre (ed.), *The Ethical Consumer*, (Sage Publications, 2005).

NGOs have relationships with several types of stakeholders. These may include: the corporations that they seek to influence; the communities they serve or operate within; other NGOs; individual members, volunteers and supporters; trade unions and industry associations; governments and public authorities; media; institutional funders, etc. For purposes of limited space, I will only dwell on NGO engagement with corporations and governments – the two being very strategic stakeholder groups where influence is possible, and yet the most difficult to map.

8.2 Engagement with Businesses

At the World Summit for Sustainable Development in Johannesburg, 2002, Greenpeace and Shell shared a platform to talk about their partnership, bringing to a high profile presence a trend that has been in the making for a while.³⁴ Analysts of the situation have commented that the Johannesburg summit “heralded a new era for companies and NGOs to interact, helping to accentuate, cultivate and legitimise NGO-business partnerships in sustainable development” (See Ethical Corporation, 2005,³⁵ .

Some common examples of business-NGO partnerships are: Norwegian oil company Statoil and Amnesty Norway,

³⁴ Cowe, Roger. “Business/NGO Partnerships: What’s the Payback?” in *Ethical Corporation*, (April 2004).

³⁵ Partridge, *The Stakeholder*, 2005. Cowe, “Business...”, 2004.

to train employees of Statoil to identify and solve business dilemmas in relation to human rights issues; FedEx and Alliance for Environmental Innovation, to reduce the environmental impact of FedEx’s vehicle fleet; German power company RWE and CARE International, to develop an “easyJet model” to deliver power supplies in emerging markets. Almost all major international NGOs could highlight one such partnership.

Down from the international level however, akin to corporate funding of NGOs, NGO-Business partnerships are still by far very controversial, not the least around the CEE region. “NGOs worry about getting ‘too close’. They fear falling out with their old-time supporters or losing their integrity. In dressing like business people, eating and drinking like business people, attending conferences like business people, they run the hazard of becoming just like ‘them’ – softened, co-opted and embedded.”³⁶

On their part, companies fear that getting into partnerships with NGOs might just be talking and wasting time³⁸ or simply being funders of NGO projects.¹⁶ Still, at the international

³⁶ Ethical Corporation, “Business/NGO Engagement All the Rage” in www.ethicalcorp.com, (London, Ethical Corporation, 2005).

³⁷ Tuxworth, Ben; Sommer, Florian *Fair Exchange?: Measuring the Impact of Not-for-profit Partnerships*, (London, Forum for the Future, 2003).

³⁸ Ben, Schiller, *Business-NGO Partnership*, (Ethical Corporation, London, 2003).

level, companies and NGOs have braved the risks involved and moved towards each other to work towards common objectives.

“There is now a widespread recognition that many of the world’s complex

social, environmental and economic challenges can only be resolved through cross-sector collaboration, such as partnerships, which often pool resources, competencies and

Table 2: Potential Risks of NGO-Business Partnerships

NGOs	Business
Being overwhelmed by corporate culture	Wasting time in talks, being inefficient
Being used for “Greenwashing” and offering lip service, for business PR	Divulging insider information to NGOs which could be misused
Losing objectivity; compromising on their principles and campaigns	Being treated as “cash cows” - mere funders, not partners
Extra work/costs; diverting scarce NGO resources	Legal risks should something go wrong
Losing public support for “selling out”; damage to reputation and loss of legitimacy	
Division, risks of creating divisions among supporters and within the NGO community	
Being used to do community engagement work on behalf of companies	

Adapted from Schiller, 2005; Partridge et al., 2005; Sustainability, 2003

Table 3: Success Factors for Effective Partnerships

1. Openness, transparency and clear communication to build trust and mutual understanding;
2. Clarity of roles, responsibilities, goals and “ground rules”;
3. Commitment of core organizational competencies;
4. Application of the same professional rigor and discipline focused on achieving targets and deliverables, that would be applied to governing, managing and evaluating other types of business alliances;
5. Respect for differences in approach, competence, timeframes and objectives of different partners;
6. Focus on achieving mutual benefit in a manner that enables the partners to meet their own objectives as well as common goals;
7. Understanding the needs of local partners and beneficiaries, with a focus on building their own capacity and capability rather than creating dependence.

Source: World Economic Forum, 2005

knowledge. NGOs are increasingly adopting this as a core defining strategy rather than as an activity that they pursue in addition to their key vision and mission,”³⁹

8.3 Engagement with Governments

To make broad systemic changes that sustainability requires, a change in our contemporary framework of operations is necessary.⁴⁰ Since capitalism is the dominating system and the state is the regulator, both have to be involved in the change process, with the state providing the framework within which businesses can act.⁴¹ NGOs have been hard campaigners for this process of stronger regulation to support the move towards sustainability.

But capitalism is well established and market competition favours traditional models of operation - business-as-usual strategies – unless something major gives or governments step in. Yet the same business-as-usual models have been shown to be highly unsustainable. NGOs at both national and international levels must then move beyond campaigning. “Campaigning has been crucial in creating the pressure for business to take social and environmental issues seriously, but few companies have been willing to

sacrifice their competitive position for an ethical stance. This highlights the need for governments to regulate, in order to create the incentives for companies to do the right thing and to sanction those who breach acceptable standards.”⁴²

NGOs have gathered more strength and public trust in the region, “partly explained by a deep distrust of central government and its institutions”, writes Eva Kuti.⁴³ “There seems to be a general preference to ‘work around’ government in an attempt to control economic, political, and social processes as directly as possible. The nonprofit organizations seem appropriate vehicles for this” (ibid). However, NGOs must resist the temptation to be heroes on a passionate rush to sidetrack governments. More inter-sectoral collaboration, not division, is needed to achieve a sustainable society. NGOs must therefore not “bite off more than they can chew”, while weighing their mandates.

The importance of the NGO sector is being more and more recognized by the state. In Hungary, “according to a decision by Parliament, nonprofit organizations providing basic social, health, and cultural services have a right

³⁹ Partridge, *The Stakeholder*, 2005. Cowe, “Business...”, 2004.

⁴⁰ Tuxworth, *Fair Exchange?*: 2003.

⁴¹ Maurie J. Cohen, *Sustainability: Science, Practice, & Policy*, Volume 1, Issue 1, (Spring 2005) <http://ejournal.nbii.org/>

⁴² Sustainability, 2003.

⁴³ Eva Kuti, “Hungary”, in *Defining the Nonprofit Sector: A Cross-National Analysis*, Salamon, Lester M., Anheier, Helmut K. (eds), (Manchester, Manchester university Press, 1997), 475

to the same per capita subsidies as public institutions.”⁴⁴

Government agencies, including the Department for International Development in the UK and the Canadian International Development Agency, also now have programs specifically promoting NGO engagement with stakeholders. NGOs must start to influence policies, politicians, governments and regulators with more direct methods of engagement, and possibly partnerships. Green Liberty, a member of the CEE network, has been working with government personnel to draft better policies on green procurement. As another example, the Association of Conscious Consumers Hungary recently signed a contract with the Ministry of Environment Hungary to develop the section on Sustainable Consumption and Production of the Environmental Operative Programme, which is part of the National Development Plan from 2007 to 2013.

Engaging directly with the governments, regulators and policy makers is by far the most effective way of bringing large-scale changes, by putting effective frameworks within which stakeholders should act - NGOs can channel experiences and outcomes of their work, give expert opinions, consult on creating mechanisms and

infrastructure for a sustainable futures. If NGOs are to optimize their impact in the new market paradigm, they must shape their campaigning, advocacy and lobbying to ensure that public sector frameworks, rules and initiatives are efficient, effective and crucially politically sustainable (Sustainability, 2003).

9. Conclusion

NGOs are having increasing amounts of responsibilities in a region caught in rapid transition. The very nature of what a non-profit, non-governmental organization is means that they deal with issues or use approaches that are apart from those of other stakeholders such as governments, businesses, religions. NGOs usually deal with important issues which, because they are not necessarily profitable to the financial bottom line or popular for short-term electoral mandates, are ignored by businesses and governments respectively. But because of the means used by NGOs (considered rather unprofessional, not backed by researched facts and data, altruistic, emotionally charged) it makes it hard for the points to get across. Thus more often than not they are inefficient and fail to realize substantial results.

In the above regard, there is much that can be learned from countries with more established and effective NGO cultures. Of primary necessity are the following: to create a common and shared vision for the NGO community and for a sustainable society; to develop

⁴⁴ Eva Kuti, “Hungary”, in *Defining the Nonprofit Sector: A Cross-National Analysis*, Lester M/ Salamon, Anheier, Helmut K. (eds), (Manchester, Manchester university Press, 1997), 482.

management systems that take into account the best of NGO working culture in combination with professional management styles; to build mechanisms of sustainability and gain financial autonomy; and to engage with stakeholders from a micro level through key actors (citizens and businesses) to the macro level (governments, regulators and policy). If NGOs working in sustainability want the message they drum to be heard, they must start taking themselves seriously in order for their target groups – government, businesses, citizens – to take up the rhythm. Perhaps a good place from where to start demanding change would be within the NGO community itself. Until that in-house cleaning and some internal adjustments are done, and soon, it would be hard for them to convince stakeholders of the importance and urgent nature of their call.

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BOOK REVIEWS

Steven P. McGiffen. *The European Union: A Critical Guide.* 2nd Ed: Pluto Press, London and Ann Arbor, MI. 2005. xvii + 222 pp. Includes bibliography, index, and recommended readings.

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There is no shortage of books critical of the European Union and its policies. There are few, however, which question the overall *raison d'être* of EU by attempting to criticize it across almost all of its policy competencies. McGiffen, self-described as “left-minded” [p.179] and with almost two decades of experience working for the European Parliament, has sought to fill this gap. The book’s 18 chapters are devoted to critiquing—at a fundamental level—the European Union from the inside-out. In the process, McGiffen takes aim at a host of individual EU policies as well as the institutions and interests that produce them.

Taking this discursive, rather than in-depth approach, McGiffen links his various and sundry critiques when he writes that the EU “is a neoliberal project and an antidemocratic one” [p.177]. He argues that the only agenda served by European integration is the agenda of multinational firms. As integration proceeds, ordinary citizens are left out; their health and well-being

is increasingly put at risk as more and more decisions are made by European institutions that they do not understand, let alone influence. From EU energy policy (“militating against conservation measures”) [p.59] to environmental policy (“driven by commercial considerations”) [p.122] to the common fisheries policy (a “spectacular and persistent failure”) [p.137], the interests of business eclipse those of ordinary citizens.

McGiffen reserves some of his most serious criticism for the European Monetary Union (EMU). According to the EMU, member states that adopt the euro are required to hand control of their macroeconomic policymaking to the independent European Central Bank (ECB). The author cautions that a one-size fits all approach to monetary policy is misguided: what may be a good interest rate for Portugal may not be good for Germany. McGiffen then goes further by calling the inability of citizens and their governments to set macroeconomic policy “the biggest single act of subversion of democracy committed in the name of the European Union” [p.185]. Yet the author fails to note that many national banks, prior to joining the eurozone, were just as independent of political control as is the ECB (most notably the German Bundesbank, after which the ECB is modeled). Nonetheless, criticizing the independence of central banks puts McGiffen in the comfortable company of Nobel Prize laureate Joseph Stiglitz, and criticizing the euro aligns him with a majority of German, French, and

Italian nationals, among whom the currency is increasingly unpopular.

What irks the author continually throughout the work is the blind embrace of the EU integrationist project. Liberalization, deregulation, privatization and a general drive for “competitiveness” are the unchallenged and defining features of European integration, rather than the lines upon which genuine public debate can occur. It has become taken for granted that private enterprise, for example, is better suited than public enterprise in all cases; no demand is made that evidence be presented of the tradeoffs inherent with private ownership.

Towards the end of his work, McGiffen includes a concise explanation of the major provisions of the proposed Constitution, as well as an analysis of its failure. He sees the negative referenda results in France and Holland as partial evidence of the success of leftist arguments—namely, that signing the Constitution would weaken public services and impinge upon citizens’ autonomy. He also sees this failure as affirming his claims that integration is an elitist project that has mistakenly proceeded without demonstrating its benefits to its mass of citizens.

McGiffen does at times indulge in excessive or unsupported rhetoric, such as when he claims that life in developed parts of the EU is “simply much better” [p.99] than in the United States. He makes the common mistake of treating the United States as monolithic—a

misstep obvious to anyone who is familiar with the wide variation in living standards across America. And, in claiming that “the most internationally-minded people see globalisation as a threat” [p.95], the author unjustifiably presumes that those who are less skeptical of globalization are by default less globally conscious.

In general, however, the McGiffen puts forth a strong and well-supported critique of the EU, one informed by experience and expressed in a clear, accessible style. The author also includes a list of carefully compiled recommended readings, helpful to anyone who is interested in topics ranging from fisheries to foreign policy. Despite its title, the book is not best read as an introduction to the EU, as descriptions of the EU institutions themselves are quick and dense. Readers with at least some background on how policy is created and implemented by European institutions will be better positioned not only to understand McGiffen’s arguments, but also to question them.

Robert Kagan, *Paradise and Power: America and Europe in the New World Order*, London: Atlantic Books, 2003, pp. 112.

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In *Paradise and Power*, Robert Kagan presents a controversial argument on

transatlantic relations. He asserts that: “it is time to stop pretending that Europeans and Americans share a common view of the world, or even that they occupy the same world.”(p.3) Kagan traces the roots of the fundamental divergence between Europe and America, explores the implications of this rift, and offers some suggestions to adjust to new reality.

The growing divergence between American and European approaches to the all-important question of power lies at the heart of the problem. Whereas Europe has entered into a post-historical *Kantian paradise*, where rules, negotiation, and multilateralism are valued, and military might is denounced, the U.S. remains ‘stuck in history,’ i.e., in the *Hobbesian world*, where international norms and multilateralism are unreliable and concerns for true security and a liberal order require commitment to power politics. He challenges those claiming that the rift stems from the *national characters* of Americans and Europeans. Kagan reminds us that historically the European continent was the playground for power politics, and Americans are not unfamiliar with idealistic discourse. They traded places because “especially in the recent decades, the power equation has shifted dramatically,” (p.10) which inevitably led to two opposing perceptions of world: While Europeans view the world through the eyes of the weak and develop a discourse fitting to their situation, Americans are approaching

international relations from the position of strength.

Kagan is not fully content with a sole power-based analysis, and seeks to bring other factors into analysis. He argues that the historical experience of Europe in the past century, coupled with the transatlantic disparity of power, led Europeans to develop a unique philosophy of power, which in turn created a broad *ideological gap*. The interplay between these material and ideological differences pits Europe and America against each other. To Kagan, the divergence dates back even to the Cold War era; he therefore maintains that 9/11 and ensuing developments crystallized, rather than generated, the transatlantic divergence. His policy recommendations are equally provocative. He advises Europeans to expand their military capabilities if they want to have their voice heard, though he is not optimistic about their willingness to follow this course. Therefore, as the price for their holiday in paradise, Europeans could at least appreciate the need for a powerful America fighting the dangers of the Hobbesian world. He reminds Americans that Europeans are neither capable of contributing to American power, nor able to restrain it. Americans no longer need to rely on the *nostalgia* that they need Europeans to meet the challenges around the world. Rather, as it currently does, America can manage NWO alone.

Kagan’s assessments and conclusions about the NWO are largely driven by

realist teachings. By defining the main problem as one about the approaches to *the perennial issue of power*, and explaining the current divergence primarily on the basis of *power disparity*, and underlining the utility of *the language of military power*, Kagan asserts basic realist premises about international affairs.

His discussion about *ideological differences* seems to contradict with his realist outlook. However, he still argues heavily from a realist standpoint. Rather than giving a balanced account of *material* and *ideological* gaps, he focuses mainly on power asymmetry. In the final analysis, moreover, he reduces ideological differences to power disparity. He devotes a section to *psychologies of power and weakness*, where he argues that different endowments of power shape the way states develop their strategic culture. Europeans denounce power politics because they cannot bring force to bear on world affairs. Because Americans are capable of doing so, they are content with staying in Hobbesian world. Here, he denies the possibility of an idealist approach to international relations, and prefers to treat references to idealist/liberal principles as tactical/rhetorical tools used in power politics to conceal an underlying gap.

Moreover, although Kagan repeatedly claims that power disparity is only one part of the explanation, his alternative explanations are barely independent of power. For instance, other than psychology of power and weakness, he

claims that “different threat perceptions are also grounded in a practical reality that is another product of the disparity of power.” (p.33) In short, power is at the center of Kagan’s arguments.

If power is the *ultima ratio*, the puzzle is why Europeans are shunning away from balancing American power, which Kagan is aware of. When he engages it, he parts company with a power-based analysis and seeks refuge in ideology: “the answer lies somewhere in the realm of ideology in European attitudes not just toward defense spending but toward power itself.”(p.53) He argues that it is technically easy for Europeans to increase military spending and fix the gap, but the problem is the lack of political will. This is where snake bites its tail. He starts with power analysis, and goes as far as claiming that European attempts to emphasize international norms and multilateralism are weapons of weak; thus reduces Europeans’ *ideological* discourse to power disparity. But, in explaining their denunciation of power, he appears to assign ideology an explanatory power of its own. We are left wondering whether ideas enter into his analysis as an independent variable. Similarly, his claim that American national character has always been to expand territory and influence for realizing the transcendent role of America in the world (pp.86-88) adds to the ambiguity around his position on the role of non-power factors.

His exploration of the sources of *new European ideology on power* is equally

provocative. He argues that it is the product of unique European historical experience since the end of the World War II. But, he at the same time argues that this European paradise was made possible only because the U.S. provided security from outside –solved the Kantian dilemma for Europeans (p. 58). By highlighting this paradox, he denies independent ontological existence of Kantian paradise, and treats it as an anomaly within Hobbesian world. The emphasis on external security provision mirrors another realist assault on democratic peace, or civilian power Europe arguments.

To the dismay of the reader, Kagan does not discuss why this postmodern paradise and Europeans' denouncement of power politics could not be permanent. Why cannot the European continent give birth to a new organizing principle for international system after Westphalian order? He characterizes European paradise with such phrases as 'geopolitical fantasy', 'miracle', or 'sacred mystique' (p.58). He is cynical of 'Europe's new *mission civilisatrice*' of transmitting the European miracle to the rest of the world 'with the evangelic zeal of converts.' (pp.60,61) Similarly, like Mearsheimer, he keeps reminding Europeans of 'the fear of sliding backward' or 'the fear of Germany,' which supposedly still hangs over them (p.63). This suggests that Kantian paradise is bound to remain exceptional. He reemphasizes this point boldly by maintaining that "global security and a liberal order –as well as Europe's 'postmodern' paradise- cannot

long survive unless the United States does use its power in the dangerous Hobbesian world that still flourishes outside Europe.”(pp. 75-76) His faith in the logic of power is the primary reason for his controversial treatment of 'post-modern European paradise' as a temporary phenomenon, and his failure to discuss possible transformation of world order.

The book is still one of the required readings to those who want to grasp the future of transatlantic relations in the NWO. It provides hints about the underlying rationale of neo-con approach to American foreign policy. It at the same times presents limitations of an exclusively power-based inquiry into international relations.

Thomas Faist and Andreas Ette (eds.), *The Europeanization of National Policies and Politics of Immigration. Between Autonomy and the European Union.* Palgrave Macmillan, 2007.

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In the current context of global insecurity, with the increase of the perceived terror-threat, questions regarding security arise worldwide. These concerns are closely connected to that of migration and influence policies regarding the movement of people.

Already in the late 1990s – as countries recognized it was an issue of their common interest – migration has become a supranational policy area of the European Union.

As integration of member-states advances and processes become more institutionalized, the attention of researchers turns from the European level back to the national level. In this context, the book belongs to the third generation of studies about the EU: the question now is not how particular states can contribute to a common European policy and how policies are made on the European level, but rather the Europeanization of national policies and politics, i.e. the impact of European policy and politics on the domestic level.

The Europeanization of National Policies and Politics of Immigration comprises 12 studies written by 16 authors, and is organized into three chapters. The first chapter deals mainly with theoretical concerns regarding migration policies and politics, as well as their analysis, whereas the next two chapters include 9 case studies. The case studies in Chapter 2 concentrate upon EU core member states and include the detailed analysis of Germany, Britain, Sweden, Spain and Greece, whereas Chapter 3 focuses on new-, non-member and respectively peripheral states including the detailed analysis of Poland, Turkey, and Albania and some aspects regarding Russia, Ukraine, Morocco, Belarus, Lithuania etc. After delving into concepts, levels

of analysis and problematic questions of interpretation in the first chapter, the studies that are to come are easy to follow and compare with each other, while recognizing the importance of each country's uniqueness.

The introductory study of the editors in the first chapter sets the frame for the whole book, and it assesses some of the findings of the research carried out in the above mentioned states. By identifying the structure and the main questions to be answered, the study makes the case-studies presented in further chapters easily comparable, which is one of the virtues of the book.

The process of Europeanization is analyzed according to the three-step approach ((1) there are particular policies on a European level that cause pressure on national governments/policies, (2) policies are influenced in the process of implementation by the national circumstances, which (3) finally lead to country-specific outcomes), the studies make use of the concept of *goodness of fit* (the larger the differences between the national and European levels, the higher the pressure for change on the domestic level) and explain the extent of Europeanization along this concept. Having different institutional structures and also different past and present goals, it is shown that EU states are highly differentiated with respect to the Europeanization of immigration policies and politics. One of the main conclusions is that being embedded into national institutional frameworks,

politics proves to be harder to Europeanize, thus changes are mainly recognized on policy-levels.

There are many aspects of the book that make it a valuable piece among the volumes on Europeanization: discussing debatable issues, and identifying points of interest are only some of these aspects: being of special interest for those preparing case-studies in different states, the study of Andrew Geddes identifies concepts that come into question when analyzing the situation of different countries in the context of Europeanization. It is discussed whether the responses given by the EU concerning immigration policy are unique or some issues have already been similarly addressed in other parts of the world. Also, regarding the interpretation of results, the question of causality and coincidence is raised. He focuses on the ways EU can influence domestic systems of governance, examines the relationship between European integration and Europeanization and distinguishes between the Europeanization of policy and the politics of Europeanization. He also touches the issue of the so-called liberal paradox, where mobility of capital, goods and also labor are encouraged and at the same time countries strengthen their borders and keep them closed to *unwanted* migration flows.

Regarding methodology it has to be noted that even if Europeanization is defined as a top-down process for purposes of clarity, (i.e. the way the

European level influences the national), the authors manage to deal with the complexity of the impacts among the European and domestic levels. To name one example, in the case of Germany Kathrin Prümm and Stefan Alscher note that the easiness to adapt to EU “standards” and the *generally small degree of misfit had been connected to Germany’s role as agenda-setter*. This is said about a country that has been a leader in European integration in the past, but nowadays reluctance and resistance to European influence even in the question of immigration can be noted and proved with the increasing influence of the *Länder* in the political field.

The book deals with timely issues, such as exercising pressure on the migration policies of countries that lack accession perspectives. This is of high importance from the perspective of the EU, because after the accession of Bulgaria and Romania the EU is surrounded by states that lack accession perspectives. Sandra Lavenex identifies three possible ways to influence such countries, and namely: using positive incentives in intergovernmental negotiations, promoting transgovernmental networks, and mobilizing international organizations.

Supporting the argument about the timeliness of the book, the study of Petra Bendel places the question of immigration policy and politics into the actual international political setting, by showing how the policies implemented on EU level have proved to be

inadequate, since alternative channels of irregular migration have appeared and challenged the image of *Fortress Europe*. Thus, the case studies appear in this wider context of the policymaking agenda. It is stated that even though the Tampere guidelines set forth in 1999 represent a change of paradigms concerning immigration and asylum policies (i.e. they present immigration as a chance and not a threat), recent changes in EU member states (more conservative governments coming to power) and security issues raised after 9/11 have led again to the strong presence of restriction and control in immigration policies, while other aspects have been neglected (such as the protection of refugees, the prevention of refugee movements, the integration of migrants, and the attraction of special groups of immigrants), a process that led to inefficiencies.

The above mentioned aspects are only a few of those discussed in the book. The differences among countries regarding immigration policies draw a picture about European diversity that is explained in the context of Europeanization. The book is of special interest for those looking for easily comparable studies about the effects of European immigration policies and politics on both EU-countries and the neighboring ones. Also, dealing with timely issues, it may prove to be useful for policy-makers and for all those interested in pursuing research of the same kind, while it contributes to the list of studies that analyze the effect of

common European politics and policy on domestic issues.

Ronald Dworkin, *Is Democracy Possible Here? Principles of a new political debate*. Princeton, London: Princeton University Press, 2006.

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Throughout the last few decades, political philosophers have been trying to form a background to make political debate possible among differing worldviews. Under the attack of strong communitarian and republican criticisms of liberalism, liberal philosophers attempt to rescue liberalism from instability and dissociation. John Rawls, in *A Theory of Justice* (1971) introduced the concept of justice as a means of narrowing the range of public disagreement. With the concept of 'justice as fairness', he aims to find a political agreement that supports the good of all citizens as free and equal persons. Rawls appeals to this practical conception since he believes that philosophy (or morality or religion) cannot provide a shared basis. His aim of avoiding disputed philosophical question is not for the sake of neutrality (as most liberals do) but he thinks that there is no way to resolve them politically. Contrary to Rawlsian *political liberalism*, legal philosopher Ronald Dworkin thinks that a genuine political debate can be achieved within

civil society without insulating political convictions from deeper moral, ethical, and religious convictions.

In his book *Is Democracy Possible Here? Principles for a New Political Debate*, Dworkin's point of departure is the polarization and trivialization problem among Democrats and Republicans in American politics. He argues that there is no decent argument among them. He suggests two principles that would make a national political debate possible among two conflicting cultures. After clarifying the principles that any American would accept (common ground) in the first chapter, he tries to show the force of these shared principles on concrete policies that divide Americans in each of the following chapters: issues about human rights, the place of religion in public life, social justice, and the character of democracy. In the first instance, he describes two principles of human dignity as the basis of common ground: according to the first principle (*the principle of intrinsic value*) each human life has a special kind of objective value; the second principle (*the principle of personal responsibility*) holds that each person has a responsibility for realizing that value in his/her own life. These principles are those same principles of ethical individualism he introduced in *Sovereign Virtue* (2000). As one of the specific cases, Dworkin takes the issues of terrorism and human rights that have been on top of the agenda of American politics since September 11, 2001. He gives the examples of torture and

capital punishment as cases that violate human rights as a baseline matter. And he argues that the US's policy of imprisoning suspected terrorists indefinitely violates human rights. Then, Dworkin speaks about the issues through which religion engages in American public life. By elaborating some matters of controversy among liberals and conservatives case by case such as abortion, gay marriages, and pledge of allegiance, he tries to set the boundaries between the religion and the government. Another issue Dworkin tackles is about tax reductions and their impact on the increased gap between rich and poor. Dworkin's aim is to propose a connection between tax levels and fairness through determining a tax policy in the light of his foundational principles. He claims that a theory of just taxation must include both a theory of equal concern and a conception of the consequences of personal responsibility. Finally, Dworkin deals with two rival views of democracy in the US: the *majoritarian* view that considers democracy as government by will of majority expressed in elections; and *partnership* view of democracy according to which people govern themselves each as a full partner in a collective political enterprise. In designing a sketch of partnership democracy, he emphasizes the importance of procedures in reaching a collective decision in situations of disagreements.

Dworkin tries to find a common ground upon the principles of a certain level of abstraction and apply them on concrete

policies. In order to be a coherent alternative, both the principles and their application should be sound. His principles reflect the two competing political values of Western political theory: equality and liberty respectively. These main principles of Western liberal thought have been challenged by communitarian scholars: the principle of liberty ignores the fact that personal choices are determined by the culture. On the other hand, treating each individual equal is universalizing in its nature, and equal access is an illusion (the myth of equal opportunity denies the social reality of unequal treatment). Furthermore, liberal conception of the self is an 'unencumbered' self (Michael Sandel's critique) that is not constituted within a community and does not permit a constitutive community to develop. It only allows for an 'instrumental community' in which individuals promote their self-interest. Dworkin's principles do not offer 'a radical alternative' to classical construction of a liberal individual which is necessary for establishing a common ground within a constitutive community.

On the issues concerning religion, Dworkin seems not to take conservative counterarguments seriously enough (especially on same-sex marriages). And by stressing 'scientific explanation' and questioning the reasonableness of theological hypothesis in evolution-creation debate, he actually wants to suppress religion as 'irrational' and 'unreasonable'. This is an illiberal attitude from the Rawlsian

perspective. Political liberalism proposed by Rawls, as a viable alternative, does not question the correctness or truth of comprehensive doctrines because a constitutional regime does not require an agreement on comprehensive doctrine.

Dworkin's endeavor is worthwhile in the sense that it questions the legitimacy of democracy in America in a time when the US administration is set on exporting democracy throughout the globe. The strongest point he made is the democratic character of procedural conception—which is widely accepted within contemporary liberalism. In Rawlsian liberalism, too, the procedures for public policy are based on fairness without any implication of ethical, moral or religious convictions. However, this aspiration to neutrality criticized by communitarians as being too thin to maintain a genuine civic engagement in public life. Dworkin's principles would work well only in a hypothetical ideal situation where people really behave as rational and free individuals in a free-market economy. The model of liberalism he defends is one committed exclusively to economic liberalism. This is because personal responsibility—for him—can only be realized in a free-market economy. In spite of the deepness of the philosophical arguments raised for fairness in a market society, it would be continue to be disputable. Thus it seems still hard to make substantial political argument possible at least in the issues of fairness. Set aside the ideal situation,

his philosophical arguments do not bring a fresh inspiration to liberalism. Since he ignores personhood and bondedness, people would not be able to form cohesive solidarities and stable movements in liberal politics –as stated by Michael Walzer. Thus, Dworkin’s principles bear the deficiencies of liberalism in general. Their application to specific cases is even more problematic in terms of the coherence of his proposal. At many points, Dworkin is caricaturizing the conservative counterarguments and trying to prove the accuracy of liberal views –as if to impose them upon his fellow citizens. This attitude would not seem to enable a ‘descent’ political debate possible.