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Table of Contents

Editorial Board

Table of Contents

**Information gathering by employees of local municipalities in Japan:
Case study of Shunan city (by Wada Takashi)**

**Developing an Industrial Strategy for Cyprus in Europe (by
Charalambos N. Louca)**

**Regional Growth and Immigration: The Case of Greece (by Alexiadis
Stilianos, Ladias Christos and Milionis Sotirios)**

**Can the Euro ever be a Global Reserve Currency? The Impact of
Politics and Economics (by Pantelis Sklias and George Maris)**

**Cooperation and Community-Based Development: Notes on the
Hungarian Case (by Bruno Grancelli)**

Book Review

Call for Papers

Instructions to Authors

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Table of Contents

Editorial Board	3
Table of Contents	4
Paper 1: Information gathering by employees of local municipalities in Japan: Case study of Shunan city (by Wada Takashi)	6
Paper 2: Developing an Industrial Strategy for Cyprus in Europe (by Charalambos N. Louca)	18
Paper 3: Regional Growth and Immigration: The Case of Greece (by Alexiadis Stilianos, Ladias Christos and Milionis Sotirios)	44
Paper 4: Can the Euro ever be a Global Reserve Currency? The Impact of Politics and Economics (by Pantelis Sklias and George Maris)	54
Paper 5: Cooperation and Community-Based Development: Notes on the Hungarian Case (by Bruno Grancelli)	70
Book Review	84
Call for Papers	86
Instructions to Authors	87

Information gathering by employees of local municipalities in Japan: Case study of Shunan city

Abstract:

I clarified the opportunities in which employees of Shunan city hall have in obtaining information useful for policy making by focusing on the routes through which and spaces from which they obtain it. Employees of Shunan city hall obtain such information through various media. The main opportunities available for information gathering are through the strategic categories of “database” and “accumulation”. The main space they obtain information from is city hall. The factors that create differences in available opportunities are employment level, characteristics of each department, and employees’ experiences living in the community. I found two patterns concerning the relationship between available opportunities and space. The first pattern is that entry-level employees, those dealing with their clerical duties, and those who do not have much experience living in the community tend to obtain information from city hall and cyberspace. The second pattern is that senior management level employees, those dealing with changing situations, and those who have experience living in the community tend to obtain information outside city hall and in real space.

Keywords: local municipality, policy making, information gathering, Japan

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1. Introduction

Recently, many geographers have been interested in how knowledge is acquired and how people learn. The main field for this interest is geography of economics, specifically manufacturing and industrial agglomeration. Knowledge and learning have not often been studied in geography of politics, societies, and culture. Decentralization of power has been conducted since the late 1990s in Japan, and local municipalities have been required to improve their policy making skills. In Japan, there have been a number of geographical studies that have focused on policy making.

Several studies have reported the importance of policy making by local municipalities. As Yokoyama (1994) points out, local municipalities should be a primary subject in making policies about regional development. Kajita (1997) pointed out that small municipalities in Japan function as planners and producers. Heery (1998) and Arai and Iijima (2002) discussed municipalities' abilities in making plans for regional development. Other studies have discussed policy making in broader geographic areas. In a study by Ballou (1995), broader units have substituted small municipalities in policy making in England. In a study by Miyazawa (2006), connections with the central government are important when a local municipality forms and implements a plan. He points out that local municipalities are able to obtain information and subsidies and use social networks from bureaucrats of the central government through such connections. Other studies have reported the importance of citizen participation and social governance. Ueda (1989) found that volunteerism had been institutionalized as a cogwheel of city management. Matsumoto (2008) studied urban design in a small district triggered by citizens' initiative. Ocelli (2005) discussed the importance and possibility of e-participation through a case study in Italy. However, policy making has not been studied from the viewpoint of knowledge and learning.

This study is the first to investigate actual conditions of policy making from the viewpoint of knowledge and learning. The primary purpose of this study was to investigate the opportunities that employees of local municipalities have in obtaining information useful for policy making. More specifically, I attempt to clarify routes through which and spaces from where they obtain such information. I studied models of political communication and control. According to Deutsch (1963), political organizations manage themselves by using information they obtain from their surroundings, and the ability to make policy is undoubtedly related to the ability to link information and build a new pattern. I also studied capacity building in a series of processes in policy making. I investigated the actual conditions of capacity building of the employees of a local municipality.

This study took place in Shunan city, Yamaguchi prefecture, Japan (See Figure 1). Yamaguchi prefecture is located in the westernmost region of Honshu Island, and Shunan is located in the center of the prefecture. Two cities and two towns were incorporated to form Shunan in 2002. In 2010, it had a population of 149,508. Heavy industries, specifically petrochemical, have been located in the area since 1960s. The reasons this study focused on Shunan are as follows. 1. Organizational reform was accomplished in 2009 in order to standardize policy making. Therefore, I assumed the city employees should have a positive attitude towards policy making. 2. The pattern of information gathering by city employees depends on the size of the city. I assumed that city employees of large cities tend to use documents and those of small towns tend to communicate with the citizens to make policy. Shunan is a mid-sized city. Therefore, I believe that Shunan has characteristics of both large cities and small towns.

I used two data collection methods to analyze organizational support for information gathering by the employees of Shunan: collecting documents and interviews. Interviews were conducted in October 2010 with the training department staff members. Then I e-mailed 650 questionnaires to the employees to analyze their personal improvement and received 382 responses; a response rate of 58.5%.

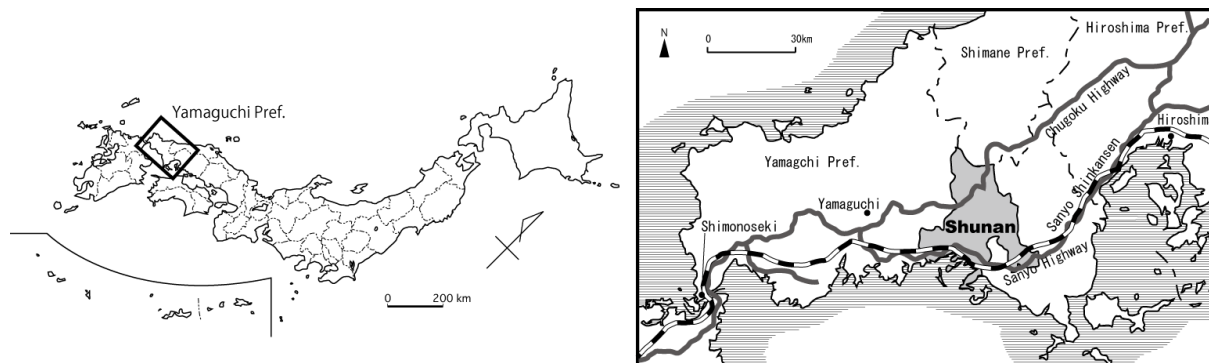


Fig. 1 Study area

2. Organizational support for capacity building

Shunan city hall developed a staff training plan in 2008. The plan consists of seven training areas: self-training, on-the-job training, effective training programs for all employees to improve their general skills, improving specific policy making skills, improving management skills of managers, developing a training system according to employment level, and dispatch or exchange of employees for them to learn about different areas of expertise. Figure 2 shows the required skills of each employment level in Shunan city hall. Basic competency and faculty are required for non-managerial employees, management skills are required for senior management, and policy making skills are required mainly for mid-

management. That is to say, required skills and staff training programs depend on employment level.

employment level	non-managerial employees	mid-management	senior management
capacity building	basic competency	faculty	policy making capacity
required skills	ability to carry out work	policy making capacity	management skills
	ability to communicate	policy making capacity	management skills

Fig. 2 Required skills of each employment level in Shunan city office
Source: Shunan city

The methods of staff training are divided into three groups: self-training, on-the-job training, and off-the-job training. Self-training includes research conducted voluntarily by employees and e-learning. On-the-job training means that an employee’s daily duties are evaluated by the section manager, senior employees, and coworkers. Off-the-job training is carried out in two ways: set and dispatch. Set trainings are often carried out for groups according to employment level. A total of 3,130 employees enrolled in this type of training in 2009. A total of 138 employees enrolled in dispatch training sent to train in another city in 2009. Ninety-two were dispatched to Yamaguchi city, the capital of Yamaguchi prefecture, and forty-six were dispatched to the Tokyo metropolitan area. That is to say, most employees who enrolled in the trainings Shunan city hall planned were trained in Shunan, and only 4% went outside Shunan.

In 2009, sixty-nine lecturers were invited for off-the-job training held at Shunan city hall. Thirty-two lecturers (46.4%) lived in Shunan, twenty-four (34.8%) lived in Yamaguchi prefecture outside Shunan, and thirteen (18.8%) lived outside Yamaguchi prefecture. As for the lecturers invited to give lectures to new employees, twenty-two (53.7%) lived in Shunan, eighteen (43.9%) lived in Yamaguchi prefecture outside Shunan, and only one (2.4%) lived outside Yamaguchi prefecture. As for the lecturers who lived in Shunan, most of them were senior staff of Shunan city hall. As for the other lecturers, ten lecturers (35.7%) lived in Shunan, six (21.4%) lived in Yamaguchi prefecture outside Shunan, and twelve (42.9%) lived outside Yamaguchi prefecture. That is to say, new employees tend to take classes by lecturers who live in Shunan, most of who are senior management of Shunan city hall. This tendency also reveals that basic competency and faculty are required for new employees and that policy making and management skills are required for senior staff.

3. Personal improvement

3.1 Characteristics of employees' duties

According to the questionnaires, the employees of Shunan city hall spend on average 25.7% of their work day on policy making and 74.3% on policy implementation. The percentage of policy implementation is about three times larger than that of policy making.

I now discuss the number and ratio by percentage of policy making during work day. On average, 24.1% of employees spend 20-39% of their work day on policy making and 23.6% spend 1-19% of their work day on it. Only 5.5% of employees spend 80% or more of their work day on it, and 5.2% spend 60-79% on it. Surprisingly, 21.4% of employees spend 0% of their work day on policy making.

Next, I discuss the characteristics of the work day according to employment level, department, and employees' experiences living in the community. The results suggest how employment level is related to the work day. The percentage of policy making of senior management is higher than that of non-managerial employees. Senior management spend 44.8% of their work day on policy making, and non-managerial employees spend 14.2% of their work day on it. On the other hand, the percentage of policy implementation of non-managerial employees is higher than that of senior management. Non-managerial employees spend 85.6% of their work day on policy implementation, and senior management spend 55.2% of their work day in it.

The results also suggest how employees' experiences living in the community are related to the characteristics of their duties. The percentage of policy making of employees who have been living in the community for a long time (experienced) is higher than that of those who have not (inexperienced). Experienced employees spend 28.7% of their work day on policy making, and those who are inexperienced spend 19.9% of their work day on it. On the other hand, the percentage of policy implementation of employees who are inexperienced is higher than that of those who are experienced. Inexperienced employees spend 80.1% of their work day on policy implementation, and experienced employees spend 71.6% of their work day on it.

These results also suggest that the percentage of policy making depends on the department. The percentage in departments dealing with changing situations is higher than that in other departments. For example, the staff members of the Department of Rural Development spend 51.7% of their work day on policy making, and those of the Department of Planning and General Affairs spend 38.2%. On the other hand, the staff members of the

Department of Financial Affairs spend 14.8% of their work day on policy making, and those of the Department of Welfare spend 19.7%.

3.2 Employee thoughts on self-improvement

According to the questionnaires, the employees of Shunan city hall improve their skills in policy making based on three areas: information gathering, planning, and realization. Regarding information gathering, employees show improvement based on three points: using various media, referencing another cases, and understanding civic and citizens needs. For example, one employee always collects information he or she thinks is useful for policy making from books, documents, websites, and so on. Regarding planning, employees stress clarification of purpose and methods of policies, originality, and cost-effectiveness when they make a plan. Regarding realization, they stress clear presentation, interpersonal relations, and consensus building. They believe being understood by their managers is essential in creating policy. Therefore, they make efforts to make their managers understand the purpose and methods of the policies they make.

The employees believe that there are three problems when making policies: personal, organizational, and environmental. They point out the shortfalls in their own policy making and explanation skills as personal problems. They also point out the following three organizational problems: shortage of time for policy making, non-sharing of information useful for policy making, and difficulty in making agreements in city hall. Regarding shortage of time for policy making, they point out that the increase in the amount of paperwork reduces this time. They also point out the following four environmental problems: shortage of funding and human resources, limitations restricted by laws, diversification of citizen needs, and citizens' criticism toward government employees. They feel they cannot make policy without restriction due to these problems.

Despite these problems, most city employees believe that policy making is important for local autonomy and are eager to improve their skills and improve organizational culture to further facilitate policy making. Particularly, they believe it necessary to having exchanges with people outside city hall to understand civic and citizen needs and to improve their skills in information gathering, data analyzing, and presentation.

3.3 Information gathering by employees for policy making

Table 1 lists the different strategies of information gathering by the employees of Shunan city hall. The strategies are categorized into four groups: database, learning, social network,

and accumulation. “Database” includes books, documents, DVDs, websites, and so on. “Learning” includes information gathering through participations in seminars, trainings, inspections, bulletin boards, question and answer sites, and so on. “Social network” includes information gathering through ties with his or her friends and experts. This includes ties formed on the Internet, for example, social networking services. “Accumulation” includes the knowledge the employees obtain from organizational achievements and his or her personal experiences. Table 1 shows that the employees depend mainly on “database” and “accumulation” in information gathering for policy making. “Database” accounts for 33.0% for all available opportunities and “accumulation” accounts for 32.1%. On the other hand, “social network” accounts for 18.9% for all available opportunities and “learning” accounts for 16.0%.

Table 1: The opportunities available for information gathering by the employees of Shunan city office, 2010

opportunity (category)	ratio (%)
database	33.0
learning	16.0
social network	18.9
accumulation	32.1

Source: Questionnaire

Table 2 presents the media often mentioned by the employees of Shunan city hall to obtain information useful for policy making. Organizational achievements, documents on the Internet, and knowledge obtained from personal experiences were often mentioned. From the top ten media in this table, we can see that every category is listed and the media of “learning” are listed in the lower ranking.

Table 2: The media often mentioned by the employees of Shunan city office, 2010

Medium	Category	ratio(%)
organizational achievements	Accumulation	15.0
documents on the Internet	Database	12.1
knowledge obtained from personal experience	Accumulation	10.5
colleagues or senior employees of the same department	social network	8.1
staffs of other departments	social network	4.1
books and magazines in Shunan city hall	database	4.0
personal experience as an employee of Shunan city office	accumulation	3.5
documents in Shunan city hall or public facilities	database	3.3
lectures or trainings held by other municipalities	learning	3.3
lectures or trainings held by Shunan city office	learning	3.0

Source: Questionnaire

Next, I discuss the opportunities available for information gathering according to employment level, department, and the employees' experiences living in the community. The following results demonstrate how employment level is related to the opportunities available for information gathering. The percentages of "accumulation" and "social network" with regards to senior management are higher than those with regards to non-managerial employees. For example, "accumulation" with regards to senior management accounts for 37.2% and that with regards to non-managerial employees account for 29.7%. "Social network" with regards to senior management accounts for 19.1% and that with regards to non-managerial employees accounts for 17.0%. On the other hand, the percentage of "database" with regards to non-managerial employees is higher than that with regards to senior management. "Database" with regards to non-managerial employees accounts for 37.7% and that with regards to senior management accounts for 27.2%.

The following results demonstrate how employees' experiences living in the community are related to the opportunities available for information gathering. The percentages of "accumulation" and "social network" with regards to experienced employees are higher than those with regards to inexperienced employees. For example, "accumulation" with regards to experienced employees accounts for 32.8% and that with regards to inexperienced employees accounts for 30.3%. "Social network" with regards to experienced employees accounts for 19.6% and that with regards to inexperienced employees accounts for 17.4%. On the other hand, the percentage of "database" with regards to inexperienced employees is higher than that with regards to experienced employees. "Database" with regards to inexperienced employees accounts for 36.4% and that with regards to experienced employees accounts for 31.6%.

The following results also demonstrate that the opportunities available for information gathering depend on the department. For example, the percentage of "database" is highest in the departments of Planning and General Affairs, Welfare, and Industry and Tourism. The percentage of "accumulation" is highest in the departments of Financial Affairs, Civic Life, Urban Design, and Education.

3.4 Relationship between available opportunities and space

In this section, I discuss the relationship between available opportunities and space. Table 3 shows the relationship between the opportunities available to all Shunan city hall employees and space. "City hall" accounts for nearly half of the spaces to obtain available information. All other spaces account for about one-third that of "city hall". Regarding "city

hall”, “accumulation” accounts for more than half for all opportunities and “social network” accounts for nearly half that of “accumulation”. The percentage of “database” is highest in all opportunities in “Shunan city” and that of “learning” is highest for all opportunities in “other areas (outside Shunan city)”. Regarding “cyberspace”, “database” accounts for almost all opportunities. That is to say, the employees depend mainly on “accumulation” in city hall and “database” on the Internet to obtain information for policy making. “Accumulation” in city hall refers to the organizational achievements of each department and “database” on the Internet mainly refers to websites.

Table 3: Relationship between available opportunities and space, 2010

	city hall	Shunan city	other areas	cyberspace	amount
database	5.5	7.6	5.3	14.0	32.4
learning	4.9	2.3	6.2	1.5	14.9
social network	12.2	2.2	3.8	0.1	18.3
accumulation	25.5	2.9	2.9	0.1	31.4
amount	48.1	15.0	18.2	15.7	100.0

Source: Questionnaire

Next, I discuss the relationship between available opportunities and space according to employment level, department, and employees’ experiences living in the community. The following results demonstrate how employment level is related to the relationship between available opportunities and space. The percentages of all available opportunities in “city hall” and “database”, specifically in cyberspace, with regards to non-managerial employees are higher than those with regards to senior management. “City hall” with regards to non-managerial employees accounts for 52% of all spaces and that with regard to senior management accounts for 47.9%. “Database” in cyberspace regarding non-managerial employees accounts for 14.8% of all spaces and that with regards to senior management accounts for 11.4%. On the other hand, the percentages of “social network” and “accumulation” both in “Shunan city” and “other areas” with regards to senior management are higher than those with regards to non-managerial employees. For example, “social network” in “other areas” with regards to senior management accounts for 5.1% for all choices and that of non-managerial employees accounts for only 1.7%. That is to say, senior management tends to use “social network” and knowledge obtained from outside city hall to obtain information for policy making.

The following results demonstrate how employees’ experiences living in the community are related to the relationship between available opportunities and space. Compared to experienced employees, inexperienced employees tend to obtain information mainly from “accumulation” in city hall and “database” in cyberspace. “City hall” with regards to

inexperienced employees accounts for 49.6% for all spaces and that with regards to experienced employees accounts for 47.4%. “Cyberspace” with regards to inexperienced employees accounts for 18.1% and that of experienced employees accounts for 14.7%. On the other hand, compared to inexperienced employees, experienced employees tend to obtain information in “Shunan city” and “other areas”. “Shunan city” with regards to experienced employees accounts for 16.1% for all spaces and that with regards to inexperienced employees accounts for 12.2%. “Other areas” with regards to experienced employees accounts for 18.5% and that with regards to inexperienced employees accounts for 16.8%.

The following results also demonstrate that the relationship between available opportunities and space depends on department. For example, compared to the staff members of the Department of Financial Affairs, those of the Department of Rural Development tend to obtain information from outside Shunan. Compared to the staff members of the Department of Rural Development, those of the Department of Financial Affairs tend to obtain information from inside city hall. These results imply that employees’ clerical duties requires information on procedures of their duties accumulated inside city hall and changing situations require new information dispersed mainly outside Shunan.

4. Conclusion

I clarified the opportunities in which employees of Shunan city hall obtain information useful for policy making by focusing on the routes through which and spaces from which they obtain such information. The major findings are as follows.

The employees of Shunan city hall obtain information useful for policy making through various media. The main opportunities available for information gathering are “database” and “accumulation”, and the main space they obtain information from is city hall.

The factors that create differences in available opportunities are employment level, characteristics of each department, and employees’ experiences living in the community. Regarding employment level, differences in required skills and staff training according to employment level are striking. Regarding the characteristics of each department, employees’ clerical duties require information on procedures of their duties accumulated inside city hall and changing situations require new information dispersed mainly outside Shunan. Regarding employees’ experiences living in the community, experienced employees tend to obtain information in Shunan and other areas, and inexperienced employees tend to obtain it inside city hall and in cyberspace. These experiences seem to be useful for employees to understand civic and citizen needs.

As for the relationship between available opportunities and space, two patterns were found. One is that non-managerial employees dealing with their clerical duties, and those who do not have much experience living in the community tend to obtain information inside city hall and in cyberspace. On the other hand, senior management dealing with changing situations, and those who have experience living in the community tend to obtain information outside city hall in real space.

This study took place in a mid-sized city. Future studies will need to take place in a large city or a small town. When these studies are complete, we can determine the differences in opportunities available for information gathering by city employees according to city size. Additional studies on the relationship between available opportunities for information gathering and the actors are suggested. I believe that non-profit organizations or companies likely obtain information useful for regional development differently from local municipalities. When these studies are complete, we can determine the differences in opportunities available for information gathering for regional development according to actor and clarify social governance from the viewpoint of knowledge and learning.

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Developing an Industrial Strategy for Cyprus in Europe

Abstract:

This paper within the existing theoretical background, discusses the industrial strategy of the Republic of Cyprus. The industrial policies adopted in Cyprus in the last two decades are presented and examined. The industrial strategies and policies of other countries such as Malta and Ireland are discussed and a comparative analysis with those of Cyprus is made. Assumptions regarding the possible applicability of these policies in the Republic Cyprus are made. Based on the theoretical background and the existing international experience, suggestions are made regarding the industrial policy that the Republic of Cyprus can adopt in Europe. Finally, the paper concludes by pointing out the applicability of the industrial theory and makes suggestions for further research.

Keywords: Industrial strategy; industrial policies; international experience; Republic of Cyprus.

JEL: M10

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1. Introduction

During the last two decades the issue of industrial strategy (IS) has gained considerable attention worldwide. The Republic of Cyprus has always been interested in developing competitive industrial strategies and policies for achieving economic growth especially after the Turkish invasion in July 1974. We may distinguish the industrial strategies of Cyprus before and after the accession to the EU.

Following from the above said, the aims of this paper are: (1) to define and describe industrial strategy as such; (2) to discuss the industrial strategy of Cyprus; (3) compare it with the industrial strategy of other economically similar countries (i.e., Malta and Ireland) as well as with industrially advanced countries such as Asia's four Dragons; and (4) to suggest a competitive industrial strategy for Cyprus in Europe able to give solutions to the problems caused by the 2009 economic crises.

The word "Strategy" has its origins in Greece and is derived from the words, "στρατός" (army) and ηγούμαι (to lead) (*Pitelis, 1994*). In a managerial context, the word "strategy" means leading a group of people toward common goals. Respectively the word strategy came to be widely used within the contexts of corporate strategy (COS), strategic management (SM), competitive strategy (CS) and the industrial organization (IO).

Another term, the "industrial policy" (IP), is used to refer to any government policy that is able to affect the industry as such. An IP affects the industry directly, leading to the achievement of specific governmental objectives. An IS should be thought of as a "coherent set of industrial policies which aims at achieving a long-term objective concerning an industry" (*Pitelis, 1994*).

Different countries, through international trade can achieve economic growth. The competitiveness of a given country is an indicator of its performance. Thus, IP and IS can either improve or suspend competitiveness.

For an IP or IS to exist, a physical institution is necessary responsible for formulating and implementing policies and strategies. The institution can be only the "government" of a given country. Governments are also responsible for important issues such as resource allocation which might be crucial for an IP or an IS.

Finally, the welfare of a country does not only depend on the strategies and policies the Government has designed and implemented but also on the governmental attitude towards the issue. A government might act as an interventionist and reactive or be proactive, forecast and avoid potential problems and take advantages of any available opportunities. Either way

the activities should be directed at developing a country's competitiveness and achieve economic growth.

This paper adopts the structure used by Pitelis (1994) and is divided into five main paragraphs. Following the introductory paragraph, the paper analyzes the theoretical background on the issue. An insight is given into the theory of IP and IS relating these to the industrial organization of countries and the debate between privatization and nationalization. On the basis of these theories the paper tries to answer the question, "how countries choose their industrial strategies?" In the third paragraph the paper analyzes Cyprus' industrial policy in the last two decades. Later in the same section Cyprus IP is compared to the IPs of the Far East (the four dragons), Malta's and Ireland's. Assumptions are made, whether the Industrial Policies adopted by these countries could be adopted by the Republic of Cyprus as well.

Following the discussion on the above issues, paragraph four discusses the changes that have occurred before and after Cyprus' accession to the EU, including the issue of uniformity that the EU imposes. Assumptions are made on what strategies and policies the Republic of Cyprus is likely to implement in the future. Finally, the paper concludes and suggestions for further research are given.

2. The Theoretical Background

2.1. Models of Industrial Organization

In this paragraph, the basic theories and models applied in the development of an industrial policy are presented. These theories are then related to the theory of industrial organization (IO) and the issue of market Vs government failure is discussed. As Pitelis (1994) mentions, IO has an impact on the attitudes and on the legislation adopted. The debate on failure is linked to the boom of privatization in the 80's.

It is of great importance to understand the theoretical background of the competitive and monopolistic models. Competition gained importance after the famous assumptions of Adam Smith (1779). He suggested that a monopoly, unlike competition would prevent the markets from adopting their so-called natural prices, which in turn represent the average of wage rates, profits and rents. Later, Schumpeter (1942) debated the idea of "perfect competition" by claiming that such a state of the economy is practically impossible due to the non-rivalry assumption. He rather suggested that as long as businesses are motivated by profits, competition is just a process of looking for innovative ideas, products etc. Schumpeter's way of thinking is also reflected in Karl Marx's works (1959). He saw the

relationship between perfect competition and monopoly as a dialectical process where one state would lead to the other.

This view on competition also takes “perfect knowledge” as given where demand and costs are known, in a way facilitating the decision making process. As Pitelis (1994) points out this is the so-called neo-classical perspective. Also he refers to the fact that monopoly under this perspective is viewed as producing a lower output for a higher price which results in consumer loss. Such market failures however need to be dealt, as usually done with the intervention of institutions like the Government. To link the just mentioned facts to the Industrial Organization, the perfect competition/monopoly dispute lies at the roots of IO theory.

To continue with the neo-classical approach, IO is often associated with what is called the Structure-Conduct-Performance paradigm. This model traces the relationship between how an industry is structured (the products, the entry barriers etc.), what the conduct of the industry is (strategies, pricing policies), how the industry performs (e.g. its efficiency) and explains how the factors of these three determinants influence each other (Aleksandrova and Lubys, 1974).

The background on market structure and market performance can be traced to the well known Cournot and Bertrand models. A contrasting summary of both models is given below:

- Model assumptions resemble, model implications differ;
- Bertrand suggests that duopoly will lead to perfect competition;
- There is no superiority between the two models. Priorities are selected according to the industry; and
- Bertrand model is preferred when capacity and output can be changed easily, while Cournot is favored when the two factors are not so easily adjusted.

Besides the Cournot and Bertrand models, three other ones are worth being mentioned (Pitelis, 1994). The model of Bain (1956) argues that entry barriers in a market structure are able to influence the pricing strategies of the firms as well as the potential entry threats. This has led to the idea that profit maximization is actually restricted. The model of Cowling and Waterson (1976) contradicts the model of Bain (1956) and implies that new entries should not prevent already existed firms from maximizing their short-run profits. Finally, a third perspective (Baumol, 1982) focuses on discussing potential entry rather than actual entries like the Cowling and Waterson model does. The Bertrand model of oligopoly, acts as a supporting one here. The model also points out the notion of contestability, assuming that producers

should possess similar technology; fixed and not sunk costs are permitted; prices cannot be changed suddenly; and market adjusts quickly to changes.

After having discussed the above mentioned three models, Pitelis (1994) argues that all of them give heavy weight to entry issues; in particular the role of entry barriers and the role of possible competition. Moreover an allusion is made to “*strategic entry deterrence*” keeping in mind that factors such as “*capacity expansions*” are influential indeed. Also, an entry does not necessarily mean a completely new business; already existing businesses might decide to expand into new markets. In this latter case, the attitude of the already existing firms is different because of the power that both have to influence each other, a phenomenon called “*inter-industry collusion*”. Definitely possible entries might sometimes cause uncertainty which would lead to prices that would tend to maximize joint rather than individual profits.

Thus, we may conclude that only actual and not potential rivalry is able to result into competitive pricing. In some cases though, even actual rivalry may lead to the above mentioned collusions. Therefore our debate on monopoly pros and cons continues and it is enough to remember the neoclassicisms who claim that monopolies and oligopolies result into social welfare losses.

As a reaction to anti-monopolistic ideas Williamson (1968) argues that a monopoly would actually be able to achieve lower unit costs than a perfectly competitive market would. However, efficiency is present in a monopoly but not in perfect competition. Furthermore, Schumpeter (1942) proposes the hypothesis that a monopoly is more successful at innovating due to its access to international markets and the achievement of scale economies. Therefore any social welfare losses are expected to be “compensated” from the export surplus.

2.2. Industrial Organization Theory

There are several theories that are generally mentioned when discussing Industrial Organization. Our analysis is based on the following (as in *Pitelis*, 1994):

- Neoclassical perspective; and
- Alternative perspectives (Marxist, post-Keynesian/Kaleckian and the Chicago School/Austrian)

The works of Marx (1959) include discussions on expansion and the need of large-scale production, thus creating cost incentives for large firms and forcing small firms to leave the market. Joint forces of already big firms would lead to an even further expansion of the latter. This might be due to potential competition threats which would provoke integration strategies thus promoting the consolidation of a monopolistic structure. An economic crisis

for example would then force the smaller, weaker firms out of the market leaving the strongest ones only.

However, in a capitalist economy, as observed by Baran and Sweezy (1966) firms would tend to reduce their prices so that they can keep up with their competitors. This is how the idea of collusion between oligopolies arises. Definitely one may think not only about prices but also about issues such as promotion and advertising costs.

The Baran and Sweezy (1966) point of view is nevertheless contradicted by Austrian and Chicago school theorists who emphasize the competitiveness of a market independently of its structure. Demsetz (1973) with his “*differential efficiency hypothesis*”, stated that the size and the profitability of large firms should not be considered as a sign of market power. Market power as such is argued to be a consequence of differential efficiency and not its cause. At this point is appropriate to mention again Schumpeter (1942) who claimed that firms that are successful in finding innovations are the first candidates for creating temporary monopolies.

Both Demsetz and Schumpeter’s views stress that both the size and the level of concentration are the results of efficiency. Moreover firms strive for efficiency in order to increase profits. However when the power of this firms is restrained the issue of competition (potential) arises. Potential competition in turn is exercised by the firms that are successful in further finding innovative products, ideas etc. When this happens the effect of the previous innovations diminishes along with the gained monopolistic power. Therefore, there is a continuous threat and profits can be consolidated only by penetrating new markets and finding other, yet undiscovered innovations.

One thing however, that the Austrian and the Chicago Schools do not seriously consider are the entry barriers. In economics, barriers are in place only when there are certain production costs that new entrants will bear and incumbent firms will not. The only barriers that are considered by some Austrian authors are those that arise from the control of resources by specific firms who block the access of new entrants to these resources.

Our theoretical background however, is mainly based on closed economic assumptions. In real business however, the issue of internationalization may arise and the concept of market can be referred to a group of countries (or even the whole world) rather than to a single country. Even the term competition can be extended to international competition. Thus, the threats to the incumbents are even greater, given the fact that steps have been taken to remove trade barriers, as in the case of EU for example, with transnational

corporations (TNCs for short) expanding into new markets. This is even more dangerous when one thinks that TNCs do not face the same difficulties as smaller firms do.

In conclusion, Pitelis (1994) with reference to Cohen et al. (1979) draws our attention to the fact that firms in the domestic market tend to collude in order to take advantage of a bigger size and high growth rates as a monopoly would. With consideration to the TNCs and the threats arising from foreign competitors, collusion in global terms is likely to occur producing a global monopoly in turn.

2.3. The Market, the Government and the Issue of Privatization

Another important point that we have to make before going into the analysis of IP and IS for certain countries, is the argument on market and government failure. Pitelis (1994) mentions that there are some questions that we need to point out before proceeding:

- Does the government has to intervene or not?
- To what degree should the government intervene?
- What is the probability that intervention will really increase performance?

In general terms the state might be regarded as the major institution to allocate resources, the other two being the market and the firm. In the '80s however both developed and less-developed countries have come to the conclusion that governmental intervention has to be limited. On the other hand it has been observed, in market economies, that the demand for public services has been increased, resulting in a respective growth of the public sector.

The '80s were also a time of concerns about why governments fail to allocate resources efficiently. Of interest are the views of two Chicago School economists. Friedman (1962) suggests that the state is under the control of strong organized groups such as business people or trade unions. Stigler (1988) in turn points out that as long as the tendency towards excessive growth persists, there will be governmental failures due to the rise in redundant costs.

Regarding the issue of privatization, there are several supportive theories. The first one is the neoclassical view on property rights and a denial of the fact that communal ownership can be successful. Another approach (Hayek, 1945), emphasizes the importance of “*dispersed knowledge*”. According to Hayek (1945), knowledge in a society can be efficiently used only when prices are dictated by the markets. Finally, Alchian and Demsetz (1972) consider the issue of “*inefficient utilization of resources*”.

The above theories can be further used and combined to show that the state is actually a slave to capitalist concerns (Miliband, 1969). As Pitelis (1994) emphasizes the

governmental profit rates are steadily dropping, due to the fact that governments often spend more than they receive in highly capitalized countries. That is how the idea of the private sector being more efficient than the public sector arises. The private sector is always under a continuous pressure to conform to the shareholders' needs. These pressures do not exist in the public sector. Competition is another important force as well. It does not affect the public sector to the extent that it affects the private one. Also, of great importance are the ownership, the competitive forces and the regulatory policies themselves.

As opposing to what we have already said Rees (1986) argued that the public sector does not exist just for the sake of existence, rather it emerges as a reaction to market and not to governmental failure. We know from classical theory however that markets themselves can allocate resources efficiently. One should not forget however that this is possible only in the total absence of market failure. Market failure nevertheless does exist and therefore the above mentioned possibility is not absolute.

In conclusion, the theory that we have discussed does not provide evidence on whether efficiency really varies across these two ownership structures. The arguments are rather inconclusive and depending on the sources one chooses to use, the final outcomes will be different if not opposite even.

2.4. TNCs and IS theory

In the market economies there are two sectors that act independently; the private and the public one, with the latter one defending national interest. This national interest can be measured by an increase in the indexes of welfare (i.e., GDP per capita). In order to achieve index growth however there might be a need to become competitive in the international markets.

Another important issue that must be mentioned is the fact that the allocation of resources and the global division of labor is primarily performed by the firm (TNCs mostly) and the state. Clearly we have to relate the TNCs with the state and with several international organizations. As Pitelis (1994) mentions, a lot of literature has been dedicated to this fact. Furthermore the market and the firm are often under alternative resource allocation institutions. A market is all about voluntary transactions while a firm is generally based on "*authority and direction*".

The state supports the market mechanism in settling the resource allocation problems (Coase, 1960). Coase emphasizes that firms and market transactions are generally regulated

by state legislation and cannot follow stand alone rules and thus become complementary to the state.

What concerns the emergence of TNCs and their relationship to the state, it could be said that these provide benefits for both the home and the host country. Arguments on this statement could be made using the already stated transaction cost problem. We should not forget however, that these are not as important as the technologies used, the know-how and the creation of employment places. On the other hand opinions have been given that TNCs might create problems when the power of the state is challenged (Vernon, 1971). Such situations are thought to occur due to the stationary nature of the state and the opposite relative flexibility of TNCs. Still both institutions have a comparative advantage, while the state can always consolidate its power over the national legislation, the TNCs contribute actively to production.

An important link to be traced is regarding the international state organization. Kindleberger (1986) discusses how international goods relate to international governments (e.g. the European Union). Kindleberger also views the relationship between international firms and international governments as complementary rather than substitutive, the same principle being applied between national and international states.

From the above said it is clear that the links between the discussed institutions are mostly considered complementary. The market, the firm and the state all take part in resource allocation. Furthermore each of the institutions will be likely to specialize in the domain where it is more efficient (Pitelis, 1994).

In addition to the so-called mainstream perspective that we have been discussing above, Pitelis (1994) also describes the public and private sectors from a Marxist point of view. This perspective does not give a clear answer on whether the TNCs are able to weaken the power of the state. While some authors (Murray, 1971) respond affirmatively, others like Warren (1971) would hardly agree. A third view on TNCs, is that of Hymer (1976) who supports the thesis that TNCs can weaken the power of the state, especially in less developed countries. In broad terms however, TNCs are important in supporting the development of the host state.

Pitelis (1994) concludes therefore that the Marxist perspective also views the state, the market and the firm as being complementary institutions. The only difference from the traditional perspective is that Marxists discuss the capital's interests and not efficiency as the traditionalists do.

To sum up, international organizations are the institutions that will be responsible for the international division of labor; for the TNCs, responsible are the states themselves. For this to be effectively achieved certain policies are needed to reach consensus. The next subsection focuses on the issue of national strategy and on the issue of taking over the state.

2.5. The Theory of National Strategy

Another theoretical aspect that needs discussion is the concept of national strategy (NS). According to Pitelis (1994) Industrial Strategy is just a portion of a “bigger” idea, that of national strategy. NS as such can be applied therefore to both a state and an organization (e.g. the EU). The national strategy often raises the question of “*government capture*”. This is believed to be performed by interest groups who by doing so decrease the efficiency of allocating resources.

Having analyzed the Marxist and several other approaches to government capture, Pitelis concludes that the state should aim at reducing the transaction and production costs of the private sector. However this is possible only if the potential of the state to be captured is eliminated. Therefore competition should exist in both private (product and labor markets) and public sectors (governmental positions filled in a competitive manner).

When the government succeeds in reducing private sector costs it is said to be pursuing a national strategy for growth. On the other hand costs are not the only issue to be targeted. Governments may also aim at influencing the revenue side. In this case, growth is due to both domestic and foreign demand. For example, revenues can be increased by focusing on sectors that have a higher return. In an open economy the approach is intended to be significant.

A further link can be made to industrial strategy and size. If there are big institutions, the threat of capturing the state is increasing, while the national strategy tends to be hampered. Then a national strategy pursuing growth by reducing costs (transaction and production) is not feasible when both the IS and IP foster the emergence of TNCs.

A way out from the above mentioned situation is to promote an IS which would support the existence of interconnected small firms or industrial districts which in turn would be the competitive basis of the existent TNCs. Therefore, as Pitelis finds out, this last solution is best fitted. Both problems of capture are lessened and a NS exists to promote efficiency by reducing costs.

3. The Industrial Policy of Cyprus Compared to Other Countries

3.1. A Historical Background of the Industrial Policy of Cyprus

According to the Brussels report (2001) on Cyprus' preparation for the accession to the EU, Cyprus is characterized as a country with a powerful entrepreneurial culture; a fact which is demonstrated by the large number of small and medium sized enterprises most of which function within the tourism industry. Currently the government is looking forward to liberalize economic sectors such as the air transport and the electricity. The telecommunications and the postal services have been already liberalized.

Cyprus has an open economy and although the volume of trade between Cyprus and other EU countries is high, more weight must be given to the business relations with other EU countries and especially with UK which is the biggest tourism market for Cyprus. Cyprus has also developed strong economic liaisons with countries from Central and Eastern Europe as well as with the Middle East and Russia.

The economy of Cyprus is mostly based on the tourist industry and the financial services.

In Cyprus the IP is proposed by the Planning Bureau every five years. Historically, during the '80s investors have been encouraged to invest in technology rather than in other possible areas. The IP of those years considered the frequent mergers of the local firms whereas the foundations for creating public companies have just been put.

A decade later, the focus has shifted towards an IS that would favour specialization, co-operation among the local companies, renewal of technologies used and increased attention to quality. This shift was due to new governmental objectives which viewed the manufacturing industry as a potential competitor in the high-quality markets rather than the traditional ones (the Middle East, the Gulf and Eastern Europe).

Technocrats have suggested that the IS should involved technological renovation in all the economic sectors of the country. In fact some of these recommendations were delayed, others were ignored (Musyck, 2002). Opposed to these, the Government has permitted the import of unskilled and semi-unskilled human resources.

Therefore the '90s turned out to be a decade of decreased competitiveness for Cyprus. Apart from the already mentioned problems, international competition was rising and the protectionist tariff was cut down as well due to the entry of Cyprus into the World Trade Organization in July 1995. The latter has lead to higher labor costs and a respectively lower productivity. Ultimately a decrease has been recorded in the growth of production, exports and employment.

Due to these difficulties, the Government of Cyprus has modified the existing policy into a technological oriented policy in order to achieve industrial development. The Government has set four major aims to be achieved (Astarita, 2004):

- Stimulation of new technologically advanced industries development;
- Reformation and facilitation of the traditional Cyprus industry;
- Enhance productivity; and
- Stimulation of foreign capital intensive investment.

Before the year 2000, both policy and legislations supported growth and development. The industrial policy was characterized as protectionist and interventionist. Domestic producers were favored “at the expense of foreign competitors” (Brussels, 2001).

In 1999 the Cyprus Ministry of Commerce, Industry and Tourism has adopted a policy known as “The New Industrial Policy”. Its scope was to provide help and support for the new hi-tech businesses. As to the effectiveness of the policy, companies in the copper mining, IT, fish farming and laser/solar power technology industries have benefited. In relation to this, the Brussels report (2001) regarding the accession of Cyprus to the EU, mentioned that the implementation of the Cypriot industrial strategy had at its basis the New Industrial Policy which was made up of twelve schemes. Ten of them were aimed at the traditional industries and the other two at IT.

Two years later it has been confirmed that the Cypriot industrial strategy basically met the requirements of Europe (Brussels, 2003). The EC industrial policy has been characterized as one that boosted industrial competitiveness, employment and structural changes. For comparison, the Cypriot industrial strategy is “*market based, stable and predictable*” (Brussels, 2003). Also, the incumbent administrative organizations are not strong enough.

Discussing industrial policy, we shall not omit the issue of privatization and restructuring that according to both reports mentioned above, little change has been recorded in Cyprus.

The Brussels report of 2003, also mentioned that the SME policy required a better business environment in order to meet the requirements for EU accession. Cyprus has managed to achieve such indicators by following the instructions provided by the Strategic Development Plan for Cyprus (1999-2003).

Finally, the IP of Cyprus aimed at stimulating entrepreneurship. This was part of a larger strategy which included improvements in the areas of education as well as in the employment policies.

In the Brussels report of 2003, several issues targeted by the already mentioned New Industrial Policy and the Strategic Development Plan are summarized. These are:

- Incentives for high technology business incubators and R&D;
- Support co-operations, joint ventures and subcontracting;
- Access to financial means by the SME;
- Energy conservation;
- Tax incentives;
- Incentives to internationalization;
- Development of the Larnaca Free Zone; and
- Grants for the manufacturing industry.

All the above mentioned have been considered as part of the Cyprus IP in order to solve structural problems related to high costs of production and low productivity levels. A further area of interest is the way Cyprus has used IP and IS after its accession to the EU. This issue is discussed later in this paper.

In the next subsection we shall look at several exotic countries and their industrial policies. The discussion will be therefore directed at what we know to be as the “*Asia’s Four Little Dragons*”.

3.2. Asia’s Four Little Dragons

Asia’s Four Little Dragons are Hong Kong, Singapore, South Korea and Taiwan. This is an allusion to the industrial development that the four countries have managed to attain starting with the 60’s through the 90’s.

Berg and Markides (1986) have mentioned that the countries have had a real growth rate of more than 9% in 1965 through 1984. Each one of the four countries has chosen a different approach to Industrial Policy. In Hong Kong the growth was not a result of governmental intervention, rather a consequence of the market forces present. In contrast, the government of Singapore exercised its managerial abilities to foster the development. A total different approach was taken by South Korea, where the famous chaebol (the big business groups) focused on growth while the government was working out the economic policy. Finally Taiwan, similar to Hong Kong, experienced little governmental intervention. The focus was on individuals getting better off and not the nation as a whole.

Other discussions have pointed that though differences are important there have been similarities that allow us to group these countries together. The development has been achieved by encouraging exports to the industrialized countries while home consumption was

kept low due to tariff policies. Also, part of the policy was the concentration on increased productivity which has led to changes in the educational system of these countries as a whole, starting with elementary education and finishing with higher university education.

In the 60's, these four countries were rather poor. However, there was enough cheap labor force available at which the educational reform mentioned above was targeted. In such a way the countries disposed both low cost and highly productive workers. A point to mention is that along with the industrial policy, an agricultural one was in place too, including tariffs and subsidies. The idea was to enforce property rights and keep agricultural workers satisfied as well.

Common characteristics of these countries can be summarized as shown below:

- Exports targeted at richer industrialized countries;
- High growth rates;
- High import tariffs;
- A political system involving relative authoritarianism; and
- A high rate of savings.

The industrial background of the 80's and half of the 90's thus was more like a result of the IS pursued in the 60's than a new separate strategy. In 1997 however an economic phenomenon known as the Asian financial crisis occurred. The crisis would affect the *Tigers* in different ways and different degrees of currency devaluation. The opinions on what the causes of the crisis might have been vary. Some point out the "*excessive real estate speculation*"; others at the macroeconomic (protectionist) policies.

Some of the major consequences of the crisis were currency devaluation, a decrease in stock market prices, political and social instability. As we already know the four economies were relying on exports-demand rather than import demand and were thus dependant on the economic indicators of the countries they were exporting to. Therefore when the latter decreased their imports, the crisis began.

However, when these economies recovered from the crisis, they have already lost their comparative advantage. Once these economies managed to stabilize, special institutions were developed to eliminate the possibility of another possible crisis.

From what is mentioned above, the similarities between the IS of the Four Dragons and the previously discussed IS of Cyprus are very few. This is due to the fact that the industrial policies adopted, depended on geographical, cultural, political and economic factors and constraints.

In the next paragraph a Mediterranean country, Malta is discussed on the basis of its geographical location, economic, social, technological and political factors.

3.3. Malta

Cyprus by its geographical location and economic situation is comparable to another Mediterranean country, Malta. In this section we aim to point out the differences and the similarities between the IP of these two countries.

According to Scerri (1998) Malta's economy has attained substantial success during the last decade with more than 200 international companies established in its territory. The IS of Malta has targeted direct foreign investment, especially in high-tech industries. Investments in high-tech was one of the issues raised by the New Industrial Policy of Cyprus. Moreover, Malta's diverse industry has reoriented its focus, giving emphasis on "*production skills and meticulous quality control*" (Scerri, 1998). Concerning exports, Malta exports more than 75% of its products to the European Union and has managed to increase GDP by 6 – 8%.

Therefore, the Maltese IS has given the opportunity to companies to take advantage of the country's location and the low costs and start a business in the industrial sector. Areas of favorable business alternatives in Malta are the following:

- Manufacturing of medium and hi-tech products needing particular skills;
- Manufacturing of "*semi-customised small batch products*" that need JIT delivery patterns;
- Manufacturing in sectors where quality control is at stake;
- Sectors related to the penetration in EU markets; and
- Service sector businesses that target to achieve "*international demand for their products*".

The IS of the country is supported by the fact that there is a total of thirteen industrial estates that provide readily available factories whenever needed. Government in particular is interested in drawing the attention of the investors towards the Mosta Technopark (built in 1991), a facility designated to accommodate hi-tech businesses. Again the "*Focus on World*" magazine mentions that the Maltese Government is eager to facilitate the investment process in the manufacturing industry by proposing incentives to potential investors such as the following:

- Ready to use plants with rents that are subsidized by the Maltese Government;
- Imports of factories, equipment and other necessary materials is duty free;
- Liberal work permit policies; and

- Employee training programs grants.

The recognition of the need for an IP for Malta aroused in June 1988 when the Industrial Development Act (IDA) was introduced. The act was in place to give export incentives and encourage foreign investment. At that time those issues were under the administration of the so-called Malta Development Corporation. The Act was actually a response to strict import policies, which in fact remained in place even after the introduction of the IDA itself (Beattie, 2004).

What it concerns the present competitive development of Malta, it has been mentioned that the country is trapped in-between the factor-driven and investment-driven stages (Beattie, 2004) whilst being biased toward a factor-driven competitiveness. In the first case businesses rely mostly on factors of production and technology incoming mainly from abroad. Thus, although Malta is an exporter the demand within the territory of the country for domestic products is low. As Beattie (2004) mentions, such economies are dependent on world economic cycles as well as on the exchange rates.

On the other hand, as we have well demonstrated the country turns out to be investment-driven. In this case there is both high domestic competition and a national competitive advantage that is based not only on obvious production factors, but on more sophisticated ones as well (e.g. existence of a system that enables the establishment of these factors such as educational institutions and research societies) (Beattie, 2004). In such a case the capability of the industry to invest in technology and attract technology from abroad is crucial. However, Malta has a double standard economy, being more factor-driven rather than investment-driven as a whole.

Some characteristics of the economy of Malta as mentioned by Briguglio and Cordina (2004) are the following:

- Maltese economy is highly dependent on international trade and prices;
- Scarce natural resources;
- Reduced levels of inter-industry links;
- Restricted possibilities to reach economies of scale due to the country's size;
- Restricted domestic competition that leads to oligopolies and monopolies; and
- A non-transparent and inefficient government bureaucracy.

The economic characteristics mentioned support the fact that Malta has a double-economy.

Another attempt of the Maltese government is to incorporate the country's IP into a piece of legislation called the Business Promotion Act (BPA) which came in force in 2001. It

was to cancel and replace the previous IDA. The BPA has been designed in order to adopt a strategy that would lead to higher productivity in the manufacturing sector, boost the country's foreign direct investments and increase exports and competitiveness.

With the introduction of the BPA the companies aimed at identifying and selecting potentially productive economic sectors within the country and gain the support of the government. Some of the incentives offered to these companies included tax reductions, "*job creation incentives and other non fiscal incentives*" (Beattie, 2004).

A parallel can be drawn to Cyprus here: the BPA replacing the IDA is much like the New Industrial Policy of Cyprus. Malta however has targeted also on such issues like education and training. Finally, a better comparison of the two countries can be seen by looking at the basic economic indicators as done below:

To sum up, from the table above we can clearly see that the two countries are rather similar, with Cyprus taking lead on some indicators (e.g. GDP) and Malta on others (e.g. Investment).

In the next subsection our discussion is for a country with a compatible situation to that of Cyprus; Ireland.

3.4. Ireland

The industrial policy of Ireland is different from the industrial policy of the other countries already discussed by the fact that it has been almost unchanged for more than fifty years (Grimes, 2005; Ruane and Görg, 1997). Starting with the 50's and until the 90's very few changes have taken place (Lenihan, 2005). The IP itself was and still is focused on making Ireland a tempting spot for businesses in the industrial and financial sectors. A tax policy has been established and financial support measures have encouraged domestic and foreign companies to do business in Ireland.

Such a policy could be adopted due to the fact that Ireland's financial services sector is strong enough to provide the necessary support. According to Grimes (2005) the banking sector and the insurance industry have contributed to the IP of Ireland. The Central bank of Ireland has regulated the activities of institutions such as the investment funds and the Irish Stock Exchange.

The IP of Ireland is dependant on incentives of both discretionary and non-discretionary nature (Honohan, 1998; Ruane and Görg, 1997). Examples of discretionary incentives are different grants offered to businesses in the manufacturing sector that have made new investments or prepared proposals for expansion, and specific sectors of

internationally traded services. Examples of non-discretionary incentives are low corporate profit taxes. The policy is intended to establish a non-discriminative environment for domestic and foreign firms. The reason behind this, is the willingness to encourage foreign direct investment (FDI). Honohan (1998) also supports the thesis that the IP has clearly been successful, a fact proven by the large number of high share foreign companies, which make up the 45% of the country's employment and 70% of output.

A crucial point of the country's industrial policy though, is the focus on FDI. Behind the IP, the industrial strategy of the country as a whole was highly concerned with the employment levels, especially in the 50's when it was originally introduced. In the 90's however, the IP turned its attention to other FDI characteristics such as "*profits, technology & linkages*" (Ruane and Görg, 1997). Even with the new goals, employment constitutes an important indicator of success or failure. There are two categories of IP regarding foreign direct investment. Fiscal (Automatic) or financial (Discretionary). The fiscal policy included the so called automatic tax holidays for foreign manufacturing companies, given for a period of ten years. Later the period has been extended to fifteen years, but in 1990 it was over. The 90's thus have turned to be times of evaluation and change for the Irish IP (Lenihan, 2005; Ruane and Görg, 1997), due to issues related to the European Union legislation. Before 1990, the European Commission exercised pressure on the Irish authorities to make the necessary IP changes. The reason behind it all was that the existing tax holidays provided background for a predisposition towards exports, a fact that came in contradiction with the Treaty of Rome (Ruane and Görg, 1997). Therefore starting as from 1982, new businesses were allowed a preferential 10% corporate tax rate for all profits, not only for exports.

What concerns financial support, this took the form mostly of cash grants, though after 1982 assistance in the form of training grants, subsidized rents, technology-transfer supports and other have also become available (Ruane and Görg, 1997). It is interesting to mention that fiscal incentives were provided automatically to all kinds of businesses, whereas financial support was regulated by legislation and was limited. Consequently, the Industrial Development Authority (IDA) was the body responsible for the implementation of the latter.

Ruane and Görg (1997), also pointed out that in comparison to other countries Ireland has managed to adopt a different IP regarding foreign direct investment. Due to the fact that the policy favored an export oriented approach, domestic businesses were not hurt by foreign competition in their local markets. Back in the 50's most of the Western European countries showed little interest towards FDI. A further distinctive characteristic of the Irish IP is the accent on certainty. Those businesses who have managed to obtain a tax holiday were allowed

to keep it. Strong grounds are obviously needed when making such claims. Though similarities can be found between Cyprus and Ireland, the latter is definitely different in its approaches. Again the countries can be compared on the basic economic indicators as presented below:

Table 1: Comparison of Basic Economic Indicators of Malta, Ireland and Cyprus

Indicators	Ireland	Malta	Republic of Cyprus
<i>GDP: Purchasing power parity</i>	\$172.3 billion (2010 est.)	\$10.41 billion (2010 est.)	\$23.19 billion (2010 est.)
<i>GDP: Real growth rate</i>	- 1% (2010 est.)	3.7% (2010 est.)	1% (2010 est.)
<i>GDP: Per capita</i>	\$37,300 (2010 est.)	\$25,600 (2010 est.)	\$21,000 (2010 est.)
<i>GDP: Consumption by sector</i>	Agriculture: 5% Industry: 46% Services: 49% (2002 est.) Agriculture: 2% Industry: 29% Services: 70% (2009 est.)	Agriculture: 3% Industry: 23% Services: 74% (2003 est.) Agriculture: 1.9% Industry: 17.2% Services: 80.9% (2010 est.)	Agriculture 3.8% Industry 20% Services 76.2% (2005 est.) Agriculture: 2.1% Industry: 18.6% Services: 79.3% (2010 est.)
<i>Investment (gross fixed)</i>	25.6% of GDP (2005 est.) 16.5% of GDP (2010 est.)	26.1% of GDP (2005 est.) 8.8% of GDP (2010 est.)	18.9% of GDP (2005 est.) 19.7% of GDP (2010 est.)
<i>Industries</i>	steel, lead, zinc, silver, aluminum, barite, and gypsum mining processing; food products, brewing, textiles, clothing; chemicals, pharmaceuticals; machinery, rail transportation equipment, passenger and commercial vehicles, ship construction and refurbishment; glass and crystal; software, tourism	tourism, electronics, ship building and repair, construction, food and beverages, textiles, footwear, clothing, tobacco, pharmaceuticals, aviation services, financial services, information technology	tourism, food and beverage processing, cement and gypsum production, ship repair and refurbishment, textiles, light chemicals, metal products, wood, paper, stone, and clay products
<i>Industrial Production Growth Rate</i>	5% (2010 est.)	NA%	0.1%
<i>Exports</i>	\$102 billion (2005 est.) \$115.7 billion (2010 est.)	\$2.744 billion (2005 est.) \$3.124 billion (2010 est.)	\$1.237 billion (2005 est.) \$2.232 billion (2010 est.)

<i>Exports: commodities</i>	Machinery and equipment, computers, chemicals, pharmaceuticals; live animals, animal products	Electrical machinery, mechanical Appliances, fish and crustaceans, pharmaceutical products, printed material	Citrus, potatoes, pharmaceuticals, cement, clothing
<i>Exports: partners</i>	US 20.52%, UK 16.31%, Belgium 17.78%, Germany 5.66%, France 5.56%, Spain 4.19% (2009)	US 9.4%, UK 5.9%, Singapore 12.5%, Germany 13.3% France 11.4%, Hong-Kong 6.5%, Italy 4.8% , (2009)	UK 8.78%, Greece 23.83%, Germany 9.2%, (2009)
<i>Imports</i>	\$65.47 billion (2005 est.) \$70.36 billion (2010 est.)	\$3.859 billion (2005 est.) \$5.159 billion (2010)	\$5.552 billion f.o.b (2004 est.) \$7.962 billion (2010)
<i>Imports: commodities</i>	Data processing equipment, other machinery and equipment, chemicals, petroleum and petroleum products, textiles, clothing	Mineral fuels and oils, electrical machinery, non-electrical machinery, aircraft and other transport equipment, plastic and other semi-manufactured goods, food, drink, tobacco.	Consumer goods, petroleum and lubricants, machinery, transport equipment
<i>Imports: partners</i>	UK 35.28%, US 16.87%, Germany 6.76%, Netherlands 5.86%, France 4.76% (2009)	UK 11.7%, Italy 24.4%, Germany 9.3%, China 4.2% France 7.6%, (2009)	UK 8.95%, Italy 10.67%, Germany 8.79%, China 5.52% France 4.01%, Greece 20.18%, Israel 6.99%, Netherlands 4.85% (2009)

Source: <http://www.cia.gov> (Library – Publications – The world fact book).

It is clear from the data presented in the table above, that for the year 2010 Cyprus leads in the investment area. Other indicators of Ireland are higher but these are due to the size of the country when compared to Cyprus. On the other hand we see that Cyprus is concentrated on services, while Ireland has an almost equal distribution between the industrial and services sectors.

To sum up the IP of Ireland, though in some aspects similar to that of Cyprus (e.g. emphasis on investments), has adopted a different approach (all the firms were granted incentives). Therefore it can be concluded that the Irish IP would not have worked as successfully in Cyprus as it did in Ireland. From the data given in the table above we may say that the IP of Malta is more compatible with that of Cyprus.

4. Towards a New Industrial Strategy in Europe

4.1. The Industrial Strategy for Cyprus in Europe

On 1st May 1994, The Republic of Cyprus entered the European Union. This was a significant event in all aspects including the economic one. Clearly the existed IS prior to accession should have been impacted. We have already discussed in section three what the New Industrial Policy for Cyprus is and its implications. However, lets take a look at several elements that should be included into the industrial strategy of Cyprus from a European perspective.

First of all through its membership the country wishes to maximize its benefits and take advantage of all possible opportunities. Pitelis argues that a nation adopting a growth IS should focus on how the benefits gained will be distributed. From a European perspective the following steps could be taken to foster the IS of Cyprus taking into consideration the size and power of the country:

- Set up the mechanisms and the institutions that are appropriate for supporting the idea of growth and pursue the objectives established;
- Modify the existing policies so that these fit for establishing competitive advantage, protectionism and make the domestic firms competitive as well;
- Give support to SMEs thus creating competition to the TNCs;
- The economic environment should be stable. Emphasis has to be given to human resources (e.g. education), research and development; and
- Distribute the benefits gained in a fair manner across the nation.

The above mentioned as we have said are applicable to the EU. A country like Cyprus cannot by itself establish protectionism for example without complying with the union's laws. However, one thing that could be done, is to look and ask for special and preferential treatment of the country from the side of the EU. This is a tactic that has already worked in the East as Pitelis mentions.

Finally, no matter what the actual IS will turn out to be, still the aim is growth and increasing national welfare. Of course there might be other issues to be considered in

developing an industrial strategy, but these ones follow directly from our theoretical background.

5. Conclusions

In this paper the industrial strategy of the Republic of Cyprus is analyzed and discussed by contrasting it with the available theoretical background and the IS of other countries. From the study it can be concluded that the industrial policy of the country has changed and adapted in order to meet the new needs. This can be seen from the fact that the unsuccessful IP of the '80s has been replaced with the New Industrial Policy in order to prepare for the accession to the EU in 2004. Such a step leads us to the thought that the industrial policy was reactive rather than proactive in the '90s.

The main provisions of the Cyprus IP include:

- Emphasis on technology and R&D;
- Supportive attitude towards co-operations;
- Financial incentives are given to SMEs; and
- Grants for the manufacturing industry.

Another objective of the paper was to compare the industrial policy of Cyprus with the policies pursued by other countries and to reflect on the compatibility of the latter with Cyprus. The countries have been chosen taking into consideration their comparable size and economic development. The conclusions drawn from this comparative analysis are:

- Asia's four little dragons have pursued an IP that was phenomenological for those times. Their IP however would be highly inapplicable in Cyprus due to major cultural and geographical differences.
- Malta's IP turned out to be very similar. The differences are minuscule and therefore the policies could have been used interchangeably.
- Ireland's IP though similar, contains significant differences. Ireland has chosen its policies so that these fit the country specifically and would be unfeasible for use in another context.

Our other issue has been to propose an Industrial Strategy for Cyprus considering our previous theoretical discussions, including the issue of TNCs. The IS proposed in section four thus contains several crucial steps, some of which have already been taken by the Cypriot authorities.

For Cyprus to increase its competitiveness must establish an effective industrial strategy in order to enhance economic growth. Based on the IS of Malta as an example of

good practice as well as on the theoretical background we may suggest that Cyprus must enhance privatization (Brussels, 2003), give more tax incentives to foreign as well as to domestic firms especially to new established companies, enhance investments in high-tech, enhance foreign direct investment by giving more motives to foreign companies, invest in education and health-care, decrease the contribution of Agriculture to the GDP and increased the contribution of services, enhance exports to traditional markets as well as to new markets, increase GDP per capita and enhance the establishment of more patent products. The objective of the proposed strategic measures is to enhance economic growth within the context of EU.

To conclude, the IS that Cyprus will develop, has to be well planned and be based on healthy competitiveness. This study can serve as the basis for further analysis and investigation, while at the same time might serve as a referential background for the interested authorities for developing a successful IS for Cyprus.

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Regional Growth and Immigration: The Case of Greece

Abstract:

This paper aims to discuss some implications of the contemporary trends in migration on the Greek economy. A set of variables is deployed to investigate the differential influences of migration on the economy of Greece. Possible positive and negative effects, on the host country, are identified using spatial econometric techniques.

Keywords: Immigration, Greek Economy, Regional Growth

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1. Introduction

Recently there has been a proliferation of studies on regional convergence (e.g. Coulombe, 2000; Martin, 2001). Empirically, convergence is frequently encapsulated by a negative relation between the growth rate during a given time period and initial level of per-capita GDP. A central question to the issue of convergence is, therefore, whether poor regions grow faster than rich regions. In a regional context, the spatial distribution of regions is presumed to be of some significance in determining the pattern of regional development and in contributing to any convergence mechanisms. Nevertheless, as Rey and Montouri (1999) point out, despite the fact that regional convergence depends crucially on geographical factors, these have often been ignored in the literature. More recently, however, there have been a number of studies examining the process of regional convergence from a spatial econometric perspective (Fingelton, 2001; Maurseth, 2001; Roberts, 2004). Whilst it is the case that regional convergence in Greece has been examined elsewhere (Siriopoulos and Asteriou, 1998; Tsionas, 2002), a spatial perspective has not been taken into account. This paper contributes to the empirical literature by testing for regional convergence in Greece using *spatial econometric* techniques. Furthermore, this paper attempts to examine the impact of *migration* upon the process of regional convergence in Greece. The remainder of this paper is organised as follows. Section 2 provides the model framework while an overview of regional convergence in Greece is presented next. The econometric results are provided and discussed in section 4. In the concluding section we offer a possible explanation for the results we obtain and suggest that they might afford an interesting policy conclusion.

2. Empirical Tests of Convergence

The recent explosion of interest in regional growth and convergence has not followed a uniform path. Instead, several distinct types of convergence have been suggested in the literature, each being analysed by distinct groups of scholars employing different methods. Nevertheless, two concepts of regional convergence have been used extensively in the empirical literature. The first is σ -convergence, which is based upon the cross-sectional dispersion in per-capita GDP and is defined as a decreasing tendency in the dispersion of per-capita GDP. Typically σ -convergence is measured by the *coefficient-of-variation*. If the coefficient of variation in per-capita GDP declines over a given time period, this is taken to be evidence of σ -convergence. The second concept (absolute) β -convergence is defined by Baumol (1986), as a negative relationship between growth rates over a given time period and

initial levels of per-capita output, such that poor economies will grow faster than rich economies. More formally, this concept is tested as follows:

$$g_i = \alpha + by_i + \varepsilon_i \quad (1)$$

where y_i represents per-capita GDP of the i^{th} region and $g_i = y_{i,T} - y_{i,0}$ is the growth rate over the time interval $(0, T)$ and ε_i is the error-term. If regions with relatively higher initial levels of y_i grow more slowly, then $b < 0$. This is true, however, only if *all* economies are converging to the same steady-state, given that the initial poor regions will be farther away from the steady-state^{††}. If regions have different structural characteristics, then convergence is conditional on these parameters, giving rise to different steady-states and appears as follows:

$$g_i = a + b_1 y_{i,0} + b_{\mathbf{X}_i} \mathbf{X}_i + \varepsilon_i \quad (1.1)$$

where \mathbf{X}_i represents a vector that includes a set of variables to control for differences in various structural characteristics across regions. Absolute (unconditional) convergence is signalled by $b_1 < 0$ and $b_{\mathbf{X}} = 0$ while *conditional* convergence depends upon $b_1 < 0$ and $b_{\mathbf{X}_i} \neq 0$.

In the light of recent literature it may be argued that any empirical test for regional convergence is misspecified if the spatial dimension is omitted. Rey and Montouri (1999) have incorporated the potential for spatial interaction within convergence analysis through the *spatial-error* model. This model, assumes that any effects from spatial interaction are captured in the error-terms of equations (1) and (1.1). The usual assumption of independent error-terms is abandoned, which is not implausible given the fact that regions are typically very open economies exhibiting a high degree of interaction with their neighbours. Following Rey and Montouri (1999) the error-term incorporating spatial dependence is shown as follows:

$$\varepsilon_i = \zeta \mathbf{W} \varepsilon_i + u_i = (\mathbf{I} - \zeta \mathbf{W})^{-1} u_i \quad (2)$$

where ζ is the spatial error coefficient and u_i is the new error-term, $u \sim N(0, \sigma^2 I)$. The spatial links between regions are generated by means of a spatial-weights matrix (\mathbf{W}), the elements of which (w) may be devised in various ways. For example, a common practice is to allow these weights to take the value of 1 if a region is contiguous to another and 0 otherwise. Alternatively, the spatial weights may be continuous variables, constructed so as to produce declining weights as distance between regions increases, as follows:

$$w_{ij} = \frac{1/d_{ij}}{\sum_j 1/d_{ij}} \quad (2.1)$$

^{††} In addition to testing for the presence of convergence, the coefficient b may be employed to estimate the *speed* of convergence as follows (Barro and Sala-i-Martin, 1992): $b = -(1 - e^{-\beta}) \Rightarrow \beta = -[\ln(b+1)]/T$, where β indicates the average rate of convergence.

Here, d_{ij} denotes the distance between two regions i and j , typically represented by the distance between the regions' main cities where the majority of economic activities are located. The denominator is the sum of the (inverse) distances from all regions surrounding region i , within a selected boundary. Equation (2.1) implies interactions between regions, such as spillover effects, decay as the distance from one area to another increases (hence weights decline as distance increases) and that such effects are dominated by the leading area. Thus, to introduce spatial interaction into the test for convergence, equation (2) is substituted into equation (1):

$$\mathbf{g}_i = a + b_1 \mathbf{y}_{i,0} + (\mathbf{I} - \zeta \mathbf{W})^{-1} u_t \quad (3)$$

where \mathbf{g}_i is the $n \times 1$ vector of average growth rates in per-capita GDP for n regions, $\mathbf{y}_{i,0}$ is the $n \times 1$ vector of the initial per-capita GDP and \mathbf{W} is the $n \times n$ matrix of distance weights. Similarly, spatial interaction can be introduced in a conditional-convergence framework as follows:

$$\mathbf{g}_i = a + b_1 \mathbf{y}_{i,0} + b_{x_i} \mathbf{X}_i + (\mathbf{I} - \zeta \mathbf{W})^{-1} u_t \quad (3.1)$$

The interpretation of the spatial models is that regions constitute a linked network such that the effects of a random shock on the growth rate of any one region will disperse beyond that region's boundaries, impacting upon growth in surrounding regions and, beyond. Such spillover effects will ripple throughout the national economy, their size and distribution determined by the elements of the spatial transformation matrix. Thus, a region is not an independent unit (or 'isolated island') but is a member of an interconnected system of regions. Nevertheless, it is still the case that convergence is associated with a negative relationship between growth and starting levels of per-capita output, and that converging regions are moving towards the same steady state.

3. An Overview of Regional Convergence in Greece

The regional groupings used in this paper are those identified by the National Statistical Service of Greece^{‡‡} (NSSG) and comprise the 51 NUTS-3 regions (prefectures) of Greece while data on GDP per-capita for the period 2001-2008 are employed. Data were deflated to 2001 current prices using deflators provided by the NSSG^{§§}. In constructing the spatial weights matrix we use the approach exemplified by equation (2.1) where the weights are calculated using distances between the main cities of prefectures within a boundary of 100 km, given the geomorphology of Greece and the fact that economic activities are typically concentrated in the capital city of each prefecture. The numerator thus consists of the distance

^{‡‡} Recently renamed to Hellenic Statistical Authority (EL.STAT.)

^{§§} Ideally, the data should be deflated using regional deflators. However, such deflators are not available from any official source and we use national deflators.

of the main city in a prefecture from the capital city of the prefecture with the *highest* GDP per-capita located within the range of 100 km or less. This choice is based on the assumption that spillover effects are dominated by a leading area, and that such effects from a location with high GDP per-capita are greater in the nearby locations. Figure 1 displays the pattern of σ -convergence as measured by the coefficient-of-variation and shows that the dispersion of GDP per-capita has generally narrowed during the first half of the examined period. Conversely, σ -divergence over the period 2005-2008 is suggested by the evolution of the coefficient of variation.

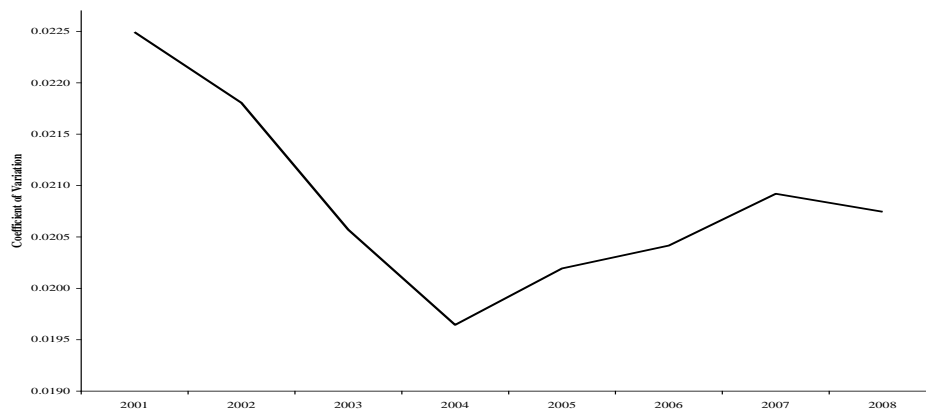


Figure 1: σ -convergence

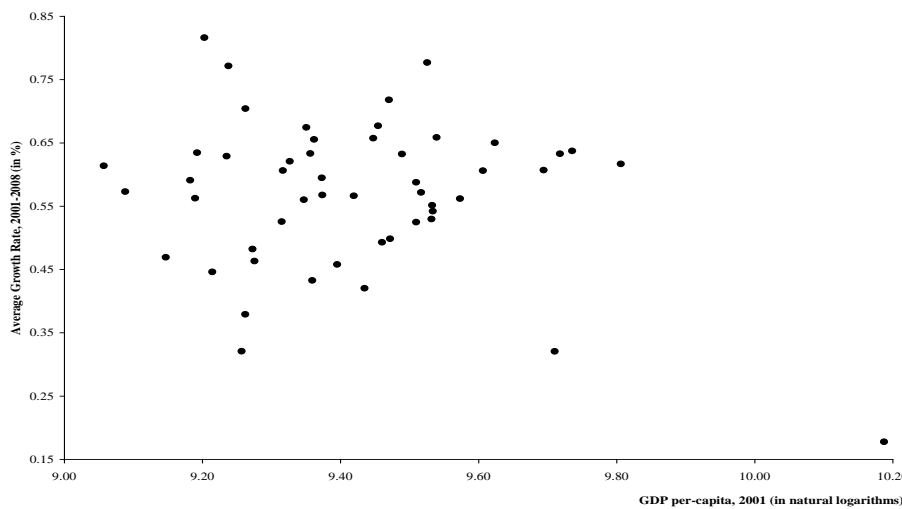


Figure 2: β -convergence

Figure 2 relates the initial level of GDP per-capita with the average rate of growth. Preliminary examination of the data indicates that β -convergence is slow amongst the 51 prefectures of Greece. Overall, the descriptive statistics discussed in this section suggest that over the period 2001-2008 there is no clear evidence of convergence. The next section will combine further examination of the convergence possibilities using the models outlined in section 2.

Table 1. Absolute Convergence, GDP per-capita, Greek Prefectures: 2001-2008

Depended Variable: g_t	Equation (1)	Equation (3)
a	0.982**	0.930*
b_1	-	-0.053**
	0.059**	
ζ		1.202**
Implied β		0.0068**
	0.0076**	
LIK	22.2572	31.0478
AIC	-40.5144	-56.0956
SBC	-36.6507	-50.3001

Notes: ** indicates statistical significance at 95% level of confidence, * 90% level. AIC, SBC and LIK denote the *Akaike*, the *Schwartz-Bayesian* information criteria and *Log-Likelihood*, respectively.

In the first instance a cross-section version of the absolute convergence model is estimated for the period 2001-2008. The results (Table 1) show the convergence coefficient to be negative and significant, and thus indicate the presence of absolute convergence in the form of a negative relationship between the rate of growth and initial GDP per-capita. Greek prefectures have, on average, shown a tendency to converge over the period 2001 to 2008, albeit at a slow rate of 0.76% per-annum. It has been argued in section 2 that geographical factors are potentially of significance to the process of regional convergence. Therefore, a subsequent step in assessing convergence across the 51 NUTS-3 regions involves testing the spatial-error model. Estimation of this model is carried out by the maximum likelihood method, as OLS may result in problems of bias^{***}. The coefficient b is negative and statistically significant. The rate of convergence, nevertheless, is still low (0.68%). From the perspective of model selection, the obtained values of the *Akaike* (AIC) and the *Schwartz-Bayesian* (SBC) information criterion for the spatial-error model suggest that this model is superior from the ‘conventional’ model for convergence^{†††}, given that the best fitting model is the one that yields the minimum values for the AIC or SBC criterion. Another selection criterion, used extensively in spatial econometrics, is the *Log-Likelihood* statistic (LIK). According to this criterion the best-fitted model is the one that yields the greatest value of the LIK (Anselin, 1988). The calculated values of the LIK statistic confirm the superiority of the

^{***} The presence of spatial interaction in the error-term in equation (1) leads to a non-spherical covariance matrix: $E[\varepsilon_t \varepsilon_t'] = (\mathbf{I} - \zeta \mathbf{W})^{-1} \sigma^2 \mathbf{I} (\mathbf{I} - \zeta \mathbf{W})^{-1}$, which results in unbiased OLS estimators but biased estimations of the parameter’s variance.

^{†††} $AIC = N \ln(RSS) + 2p$ and $SBC = N \ln(RSS) + p \ln(T)$, where RSS is the residual-sum of squares, N is the number of observations and p the number of parameters. The SBC has superior properties and is asymptotically consistent, whereas the AIC is biased towards selecting overparameterized models (Enders, 1995).

spatial model. It follows, therefore, that the ‘conventional’ model is *misspecified*, given that it does not take any account of geographical factors.

It is important to note that the spatial coefficient is positive, which suggests that the disturbances to the growth rate of a prefecture spillover to affect growth rates in surrounding areas with their pattern determined by the extent of spatial proximity. Overall, the spatial model suggests that the prefectures of Greece have been converging, although at a very slow rate. One interpretation of this slow rate is that convergence towards a unique ‘steady-state’ may not be the case for the prefectures of Greece. Instead, the alternative hypothesis of conditional convergence seems to be an interesting possibility. Given the aims of this paper, regional convergence is conditioned upon factors related to *migration* using equation (1.1). To the best of our knowledge, this issue has not received considerable attention in the relevant literature.

4. Regional Convergence and Migration in Greece

In this paper the impacts of migration in the process of regional convergence in Greece are approximated by four factors. To be more precise, immigration of ‘highly skilled labour is measured in terms of the percentage of immigrants with a tertiary education in a region (X_1). The ‘absorption’ of immigrants to a regional economy is expressed as the percentage of immigrants in a region in industrial and services sectors (X_2). Given that agriculture plays an important role in several Greek regions, the previous proxy is supplemented by the percentage of immigrants employed in the agricultural sector of a region (X_3). Finally, the percentage of illiterate immigrants in a region is considered as a proxy for negative effects of migration in the economy of a region (X_4). Therefore, a test for regional convergence conditioned upon the effects of migration takes the following form:

$$g_i = a + b_1 y_{i,0} + b_2 X_1 + b_3 X_2 + b_4 X_3 + b_5 X_4 + \varepsilon_i \quad (4)$$

Introducing spatial interaction transforms equation (4) as follows:

$$\mathbf{g}_i = a + b_1 \mathbf{y}_{i,0} + b_2 X_1 + b_3 X_2 + b_4 X_3 + b_5 X_4 + (\mathbf{I} - \zeta \mathbf{W})^{-1} u_i \quad (4.1)$$

The coefficient attached to the X_1 variable is positive and statistically significant. It might be argued, therefore, that an educated immigrant labour force constitutes a ‘facet’ of the human capital and promotes growth in a region and, by extension, regional convergence. A similar argument can be raised for the X_2 variable. This is not the case, however, for the

percentage of immigrants employed in agriculture. As perhaps anticipated, the econometric estimation of both specifications yields a negative value for the X_4 variable.

Table 2. Regional Convergence and Migration, non-Spatial and Spatial Specification

Depended Variable: g_t	Equation (4)	Equation (4.1)
a	1.3723**	1.0231**
b_1	-0.0481**	-0.0424**
b_2	0.0496**	0.0406**
b_3	0.0281	0.0203
b_4	-0.0861*	-0.1162**
b_5	-	-0.0079**
	0.0066**	
ζ		0.8542**
<i>Implied β</i>	0.0061**	0.0054**
LIK	54.3014	57.4194
AIC	-96.6028	-102.8388
SBC	-85.0118	-91.2478

Notes: ** indicates statistical significance at 95% level of confidence, * 90% level. AIC, SBC and LIK denote the *Akaike*, the *Schwartz-Bayesian* information criteria and Log-Likelihood, respectively.

Overall, the econometric estimations imply that migration restricts the process of regional convergence in Greece. Indeed, both specifications suggest a relatively low rate of β -convergence. This can be attributed to the fact that most immigrants are concentrated in the two ‘leading’ regions of Greece, Attiki and Thessaloniki. To account for this factor, the spatial-error model, which is to be preferred by the selection criteria, is estimated for the remaining regions of Greece (Table 3).

Table 3. Regional Convergence and Migration, Excluding Attiki and Thessaloniki

Depended Variable: g_t	Equation (4.1)
a	1.5021**
b_1	-0.0648**
b_2	0.0492**
b_3	0.0123**
b_4	-0.0916*
b_5	-0.0271*
ζ	1.1731**
<i>Implied β</i>	0.0082**

Notes: ** indicates statistical significance at 95% level of confidence, * 90% level.

Based on the results in Table 3, two features are most noticeable. First, the rate of convergence increases when the two ‘leading’ regions of Greece are excluded. This implies that if immigrants were more evenly distributed across the areas of Greece, then the Greek

regions would exhibit a relatively faster one. This is estimated to be about 0.8% per annum. Second, the coefficients attached to the variables approximating the 'absorption' of immigrants (X_2 and X_3) are positive. Given that these variables are measured with respect to the main sectors of the economy, it might be argued that the favourable effects of migration are directly related to the structure and characteristics of a region.

5. Conclusion

This paper contributes to the empirical literature on Greek regions by testing for regional convergence over the period 2001-2008 using spatial econometric techniques. Previous studies on Greek regions have concentrated on the application of the 'conventional' models without incorporating spatial effects. The econometric performance of an explicitly spatial model suggests that geography is a crucial factor that determines the process of regional convergence. Furthermore, the impact of migration in Greece is taken into account. One important conclusion to emerge from the econometric analysis is that if immigrants were located across the regions of Greece in accordance to the needs, the peculiarities and the characteristics of each region, then this would have positive effects for regional convergence. In terms of policy implications this implies that migration policy in Greece should take into account the educational level of the immigrants and relocate them, if possible, to certain regions. In short, migration policy in Greece should include an explicit regional dimension.

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Can the Euro ever be a global reserve currency? The Impact of Politics and Economics

Abstract:

This paper will examine whether the euro could surpass the American's greenback or it is likely to continue to exist as a subordinate currency. In order to do that we need to focus both on economics and politics as they directly or indirectly affect the role of the euro. In this article we will argue that even though the introduction of the euro in 1999 had considerable implications for the global financial, monetary, and economic system, the euro as a medium of exchange, as a store of value, and as a unit of account remains and it will continue to remain the second global reserve currency in the world. Moreover, it could be argued that not only the Eurozone the last ten years suffers from serious deficiencies that negatively affect the euro's leading role as a global reserve currency but also the political and institutional conditions do not favor such evolution. Under these conditions it could be said that it is unlikely for the euro to overcome the pre-eminence of the US dollar as a global reserve currency.

Key Words: Global Reserve Currency, European Economic Governance

JEL Code: E02, E60

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1. Introduction

In 1999, the single European currency (euro) was adopted by eleven founder members of the European Union (EU). It was the last step for the creation of the Economic and Monetary Union (EMU) whose idea was negotiated on the Treaty of Rome, was reinforced by the Delors Report, and was consolidated by the Treaty of the EU in 1991. Despite the remarkable success, some aspects of the project remained unsuccessful (Bladen, 2007). The last European crisis is a clear result of this failure in which many important issues remain questionable. One of them is whether the Euro can ever be a global reserve currency. The answer for this question is not so obvious because each currency's global role has to be earned (Baldwin and Wyplosz, 2004). The birth of the Euro triggered a new area of theoretical discussion and a new rival among the most prominent scholars was started. The global financial and economic crisis that began in 2007 has been a good opportunity for the euro to overcome the US dollar and as Cohen (2009, p. 742) states 'the joint currency of the EU could legitimately aspire to join America's greenback at the peak of global finance'. However, it could be said that this aspiration does not seem to be feasible. Not only because of the current European systemic crisis but clearly because of the systemic flaws and disadvantages that exist within the whole structures of European economic governance and their relation with the American counterpart. Thus, even though the euro has become a strong regional currency both in Europe and the Mediterranean, it has not challenged the dollar as the world's leading reserve currency and the European economic governance during the crisis has not strengthen the euro's international role (Pisani-Ferry and Sapir, 2009). In this context, as Callinicos (2009) believes the global economy may confront a new period of currency uncertainty.

Under these circumstances this essay will examine whether the euro could surpass the American's greenback or it is likely to continue to exist as a subordinate currency. In order to do that we need to focus both on economics and politics as they directly or indirectly affect the role of the euro. In this respect, this paper will begin by noting some theoretical explanations for what a global reserve currency is, and it will then go on to explain under which conditions a currency can ever be a global reserve currency. The second section of this paper will evaluate the current relationship between the US dollar and the euro in order to answer the question whether the euro can ever be a global reserve currency from economic perspective. In the third section we will focus on the role of politics and how the system of the European economic governance affects the euro's primacy. In this regard, it is important to say that the current European crisis does not affect the outcome of this paper because the

crisis is just the result of euro's long term inconsistency. In this article we will argue that even though the introduction of the euro in 1999 had considerable implications for the global financial, monetary, and economic system, the euro as a medium of exchange, as a store of value, and as a unit of account remains and it will continue to remain the second global reserve currency in the world. Moreover, it could be argued that not only the Eurozone the last ten years suffers from serious deficiencies that negatively affect the euro's leading role as a global reserve currency but also the political and institutional conditions do not favor such evolution. Under these conditions it could be said that it is unlikely for the euro to overcome the pre-eminence of the US dollar as a global reserve currency.

2. The Debate

From the early beginning many scholars agreed that the euro will challenge dollar's global dominance. However, these early predictions had one main difference, the time period that this could happen. Alogoskoufis and Portes (1997) believed that the full parity could be happened shortly after the introduction of the euro. In this case, the macroeconomic fundamentals could play a significant role. Other believed that the euro could surpass the dollar as a global reserve currency after a long period (Eichengreen, 1998). For Fred Bergsten (1997, p.91) 'the euro's rise may have to await a serious policy lapse by the United States'. Furthermore, Chinn and Frankel (2005) predicted that if the thirteen candidates and potential candidate countries join the EMU by 2020, the euro will be able to surpass the US dollar as a global reserve currency. In contrast, other studies argued that this is not likely to happen (Feldstein, 1997; Cohen, 2003). As it is said three years after the global financial and economic crisis the dollar's role as an international currency not only retained but also was reinforced (Cohen, 2009). After nearly thirteen years it can be said that none of the positive expectations was affirmed. Before we proceed to the evaluation of whether the euro can be a global reserve currency, a closer explanation of theoretical issues is needed. In general, each currency has three functions; it can be used either as medium of exchange, or as a unit of account, or as a store of value. In addition, the most prominent scholars acknowledge three main dimensions for the assessment and evaluation whether the euro will ever be a global reserve currency. These are the trajectory, the scope, and the domain. According to Cohen (2009) there are two levels of analysis: the private market and the public policy (official sector) in which role of the euro can be analyzed. The analysis of the euro as a reserve currency mainly belongs at the level of public policy under which the euro has two functions as a medium of exchange and as a store of value. However, the euro as a unit of account in its

public policy sector is related with exchange rate decisions as an anchor currency. Table 1 below shows the roles of an international currency.

Table 1: Roles of an international currency

Role	Private use	Official use
Medium of exchange	Vehicle currency (in foreign exchange markets)	Foreign exchange intervention
Store of value	Banking	Reserve accumulation
Unit of account	Invoicing (for trade or financial transactions)	Monetary anchor

Source: Galati and Wooldridge (2009).

A global reserve currency is the currency that is controlled by the monetary public authorities (official sector) for the implementation of three main targets. It can be used to maintain either the exchange rate capabilities, or to mediate in foreign exchange markets, and/or to guarantee wealth (Galati and Wooldridge, 2009). Moreover, there are four main elements that affect the formation of a global reserve currency. Namely, these are the size of the economy and the global share in output and trade (Eichengreen, 1998; Bergsten, 1997), the macroeconomic stability (Hartmann and Issing, 2002) and macroeconomic fundamentals (Alogoskoufis and Portes, 1997), the creation, size and liquidity of foreign exchange financial markets (Eichengreen, 1998; Cooper, 2000) and the network externalities (Rey, 2001). In addition it can be said that the institutional structure is a key factor that influence the creation of a global reserve currency (Eichengreen, 1998). In this sense, not only the rejection of the UK to be a member of the Eurozone reduced euro's ability as a global reserve currency but also its impediments in the euro bond markets (Portes and Rey, 1998).

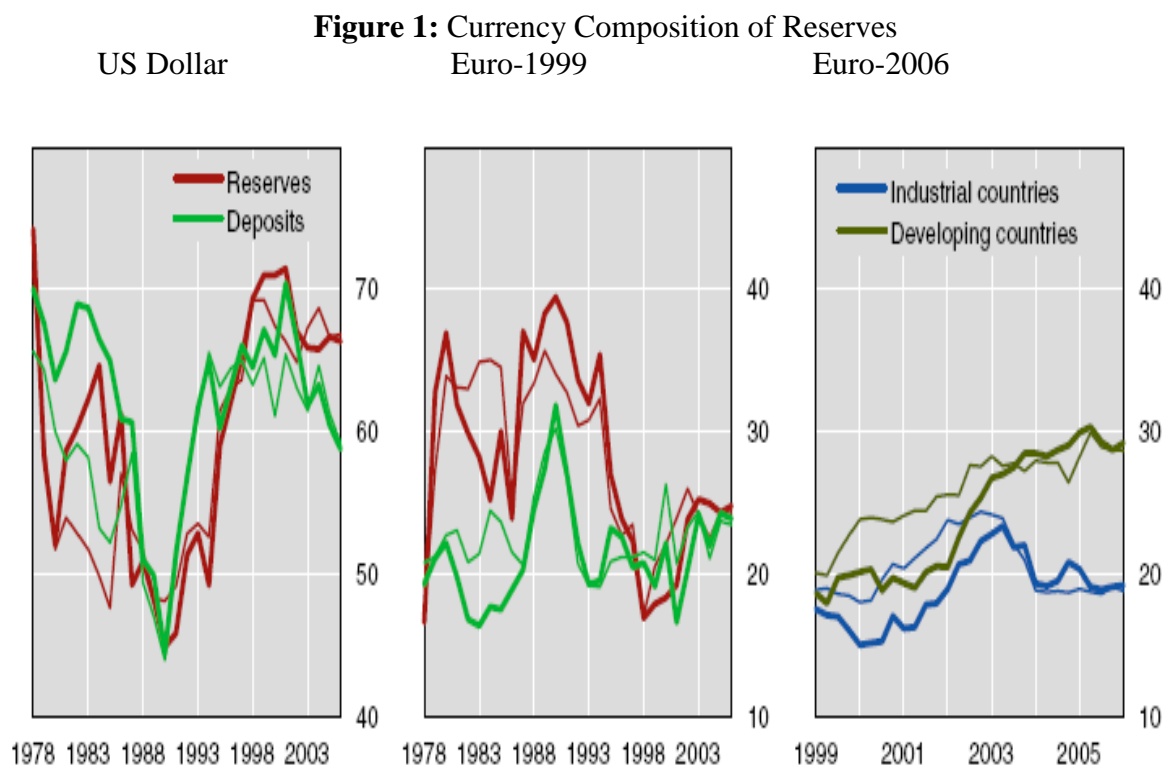
Under the aforementioned conditions it could be said that there exist many factors that could undermine the US dollar's role as a leading global reserve currency. Among of these are the macroeconomic fundamentals, like the net external debt of the US or the EMU's function (Eichengreen, 2005; Flandreau and Jobst, 2006). As Portes and Rey (1998b, p. 308) state 'Given the euro's fundamentals-the EU's economic size, the liberalization and integration of its financial markets, and confidence in its international creditor status and stability oriented monetary policy- we find that the most likely outcome is that the dollar will have to share the number one position'. However, as Cohen (2009, p.742) believes 'the real issue is not price but use: the extent to which the euro is being adopted by actors outside EMU for the standard functions of a medium of exchange, unit of account or store of value'. Under these conditions the US dollar has sustained not only its international role but also its role as a global reserve currency. It seems that the greater size of dollar financial markets and the inertia in the use of international currencies have helped to this respect ****.

**** According to the Cohen (2003) the euro does not provide significant advantages over the dollar in order to overcome inertia.

3. The Role of Economics

3.1. Composition of official reserves

As Galati and Wooldridge (2009, p.4) state ‘the euro’s share of reserves is higher today than it was immediately prior to monetary union, but it is still well below the US dollar’s share and below even the share of euro legacy currencies in the 1980s and early 1990s’. This is clear in Figure 1 that shows the currency composition of reserves as a percentage of total allocated foreign currency holdings for the US dollar, the euro legacy currencies until 1999 and the euro until 2006 respectively.



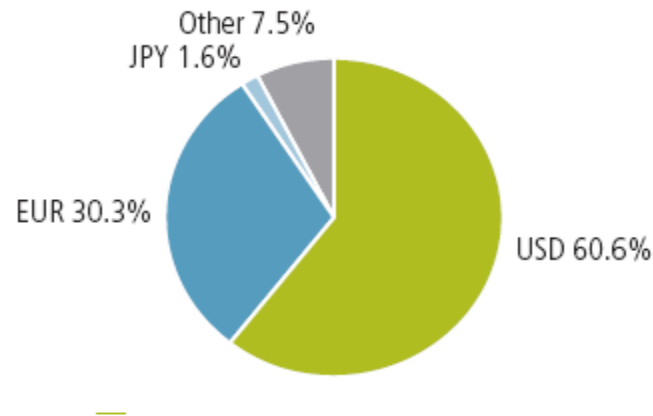
Source: Galati and Wooldridge (2009).

As it can be observed from Figure 1 the minimum point for the US reserves and deposits was in 1990 with 45% and the maximum point was in 2001 with a share of 70% in global reserves and deposits. It could be said that this supports Cohen’s (2009) argument that during crises the dollar’s role as an international currency is reinforced. Furthermore, it is clear that in 2004, five years after the creation of EMU, there was a significant difference between the euro and the dollar in reserves and deposits, although the dollar has decreased to 66% and 59% of reserves and deposits respectively.

Moreover, as it can be observed from the Figure 2 the vast majority of official reserves in emerging markets are still concentrated in the US dollar (Alexandraki, 2009). In addition, it can also be said that after 1999 the euro’s total share in industrial and developing countries increased but this improvement was geographically limited (Lim, 2006). The aforementioned

arguments shows that indeed, the euro not only is by far the second currency in official reserves in developed and in developing world but also that it seems to be only a regional currency.

Figure 2: Emerging Markets Official Reserves

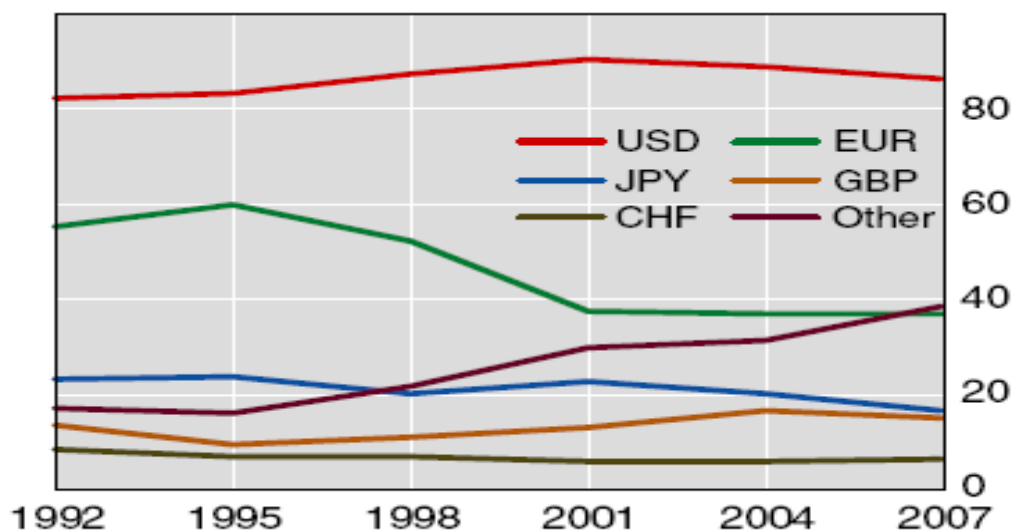


Source: Alexandraki 2009.

3.2 Medium of Exchange

In order to analyze whether the euro can ever be a global reserve currency, when it is used as a medium of exchange, one should focus on liquidity conditions in foreign exchange markets and in money and government securities markets. First, it is ambiguous if the liquidity of the euro challenges the dollar's liquidity in foreign exchange markets. It is clear in Figure 3 that the dollar's percentage in foreign exchange markets changed only slightly from 1992 to 2007 (Galati and Wooldridge 2009).

Figure 3: Foreign Exchange Markets Turnover



Source: Galati and Wooldridge (2009)

Moreover, as it can be observed from Table 2 which shows the currency distribution of foreign exchange market turnover from 1989 to 2007, the dollar is the sovereign currency,

and no other currency can overcome its dominance. In this sense, as Cohen (2009) believes not only the euro in contrast with the dollar is not equally distributed across the regions but also the euro is not functions as a vehicle currency globally. Consequently, as he states ‘outside the European region, the use of the currency for trade with EMU economies remains limited; in transactions between third countries, where neither counterparty is an EMU member, it is practically non-existent’ (2009, p.751). It is clear that as one can observe from Table 3 which shows the currency shares on foreign exchange market transactions in Asia, the leading dollar’s role is unambiguous as a vehicle currency. As a result, it can be argued that the dominant role of the dollar in world trade cannot be challenged by the euro (Kamps, 2006; Henning, 2009).

Table 2: Currency Distribution of Foreign –Exchange Market Turnover

	1989	1992	1995	1998	2001	2004	2007
Dollar	90	82	83.3	87.3	90.3	88.7	86.3
Euro	–	–	–	–	37.6	37.2	37
Deutsche Mark	27	39.6	36.1	30.1	–	–	–
French Franc	n/a	3.8	7.9	5.1	–	–	–
Other EMU currencies	n/a	11.8	15.7	17.3	–	–	–
All other currencies	n/a	62.8	57	60.2	72.1	74.1	76.7

Source: *Bank of International Settlements (2008).*

Table 3: Currency Shares on Foreign Exchange Market Transactions

Country	Total ^a	Currency shares (percent) ^b				
		US dollar	Euro	Yen	Pound sterling	Other ^c
China	9.3	98.5	0.7	0.7	1.1	98.9
Hong Kong	174.6	96.1	12.8	10.4	7.4	73.2
Indonesia	2.8	93.0	11.2	8.3	2.6	84.9
Japan	238.4	84.6	18.3	71.1	6.9	19.1
Korea	33.4	92.0	6.1	11.6	4.4	85.9
Malaysia	3.4	97.1	5.9	7.0	4.9	85.1
Philippines	2.3	99.2	2.3	2.3	1.9	94.4
Singapore	230.6	88.3	27.2	25.1	13.2	46.3
Taiwan	14.6	94.6	14.5	23.7	7.5	59.6
Thailand	6.2	94.4	8.8	15.2	2.2	79.3
East Asia	715.6	89.5	18.7	35.6	8.8	47.4
Australia	169.5	91.3	17.5	10.7	7.7	72.8
India	34.1	95.8	9.3	27.7	9.7	57.5
New Zealand	12.3	94.2	10.4	4.6	3.7	87.3
East, South Asia, and Oceania	931.4	90.1	18.0	30.3	8.6	52.9
World total	3,988.1	86.8	36.8	17.0	14.4	44.9

Source: *Henning (2009).*

Second, as Cohen (2009, p.752) states ‘the securities markets have proved to be, by far, the area of greatest success in the internationalization of the euro’. However, even though the EMU has developed the most significant alternative in government securities market at the end of 2005, as it can be noticed from Table 4, in 2005 the total outstanding stock of securities was 6,4 trillion for the yen, 4,7 trillion for the euro, and 4,2 trillion for the dollar, the magnitude is an inadequate standard for a judgment against the dollar (Galati and Wooldridge, 2009). In addition, ECB’s (2008) annual review of the international role of the euro points out that the euro’s share of international bank loans remains at the same level

since 1999 and in the case of international deposits stands lower. The primacy of the dollar in both cases is incomparable. As a result, it can be said that the dollar seems to possess important benefits against the euro like the wider bill market, the greater homogeneity and the higher credit quality of the treasury market, and the huge liquidity in US Treasury market.

Table 4: Government Securities Markets

USD bns	Total outstanding		Short-term debt securities				Credit rating ^c	
			Total ^b		Treasury bills		1995	2005
	1995	2005	1995	2005	1995	2005		
JPY	2073	6351	614	2153	324	1194	AA-	
USD	3292	4184	1267	1597	761	964	AAA	
EUR	2938	4658	720	910	474	410	AA+	
Italy	1039	1324	344	291	233	139	AA-	
France	526	1080	78	170	54	112	AAA	
Germany	449	832	45	203	0	41	AAA	
GBP	457	679	43	74	27	36	AAA	

Source: Galati and Wooldridge (2009)

Third, it can be observed from Table 5 that between 2001 and 2005 the outstanding value of repos increased from 3 to 4,7 trillion and from 3,4 to 6,1 trillion in the euro and dollar market respectively (Galati and Wooldridge, 2009). It is clear that from 2001 to 2005 the dollar's repos market has dominated the euro's repos market. The aforementioned denomination against the euro is also observable in the cases of overnight maturity, of tri-party agreements and in collateral transactions.

Table 5: Repos Market

	Total outstanding ^b (USD bns)		Overnight maturity ^{bc} (% of total)		Tri-party ^{bd} (% of total)		Main collateral ^{be} (% of total)	
	2001	2005	2001	2005	2001	2005	2001	2005
	USD ^f	3380	6141	39	44	...	26	60
EUR ^g	3011	4733	13	16	6	10	31	25

Source: Galati and Wooldridge (2009)

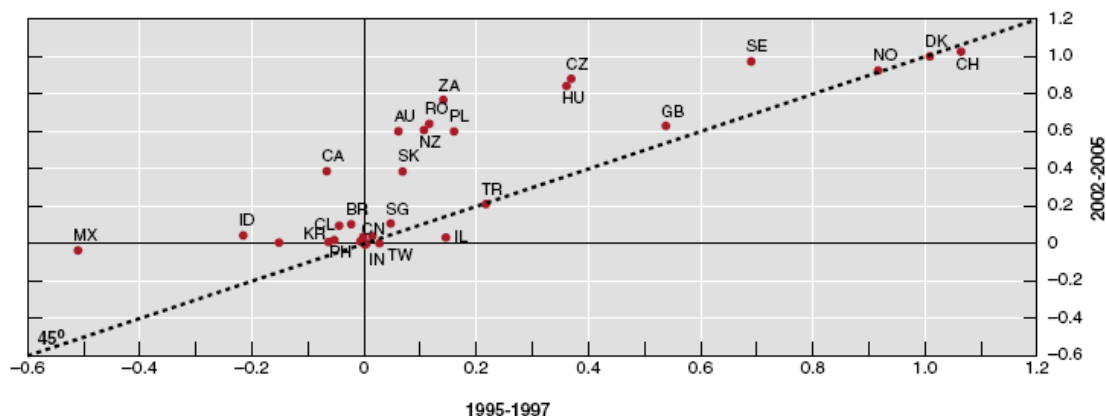
As a result, it can be argued that although the euro has, as a medium of exchange, increased its global role not only in foreign exchange markets but also in government securities and repo markets, it is not clear whether it could challenge the more widespread traded and more liquid US dollar.

3.3 Unit of account

As a unit of account the euro in public sector is used as a monetary anchor. In this context, it is important whether the euro has developed a significant gravitational role. According to Figure 4 it can be noticed that the euro the last decade has increased its global role but it is not again clear if this change could create a new global dominator in reserves. As Galati and Wooldridge (2009, p. 16) state 'Since 2002, the US dollar has depreciated against many currencies, and so the higher co-movement of currencies with the euro may reflect temporary dollar weakness rather than a long-term increase in the euro's influence'.

Furthermore, from the introduction of the euro it can be counted that nearly forty countries pegged their exchange rates with the euro but it is ambiguous whether this development represent a demonstration of the euro's greater international role or its regional character (Cohen, 2009). Moreover, it can also be said that the majority of the countries that have aligned their currencies with the euro are smaller as compared with the larger financial economies that have pegged their currencies with the dollar. As a result, as Cohen (2009, p.755) states 'If any currency is exerting increasing gravitational force, it would appears to be the greenback, not the euro'.

Figure 4: Exchange rate sensitivities with respect to dollar/euro rate changes

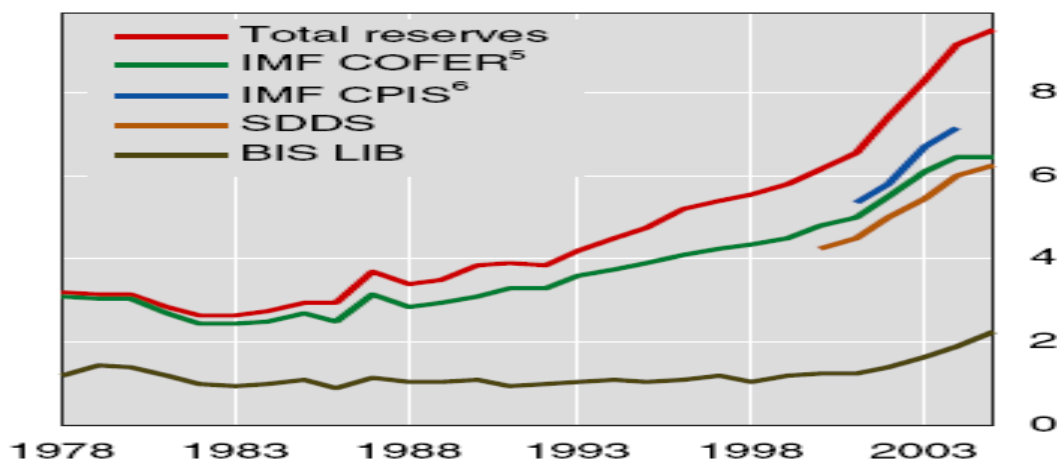


Source: Galati and Wooldridge (2009)

3.4 Store of value

As a store of value each currency can be used as a reserve of accumulation because every currency is related to purchasing power and macroeconomic stability. Moreover, Galati and Wooldridge (2009, p.16) state that 'the store of value function of an international currency is linked to the breadth and depth of financial markets'.

Figure 5: Total Reserves



Source: Galati and Wooldridge (2009)

In this case, as it can be observed from Figure 5 above the magnitude of total reserves increased from 1978 to 2005 more than 7%. In this respect, the monetary authorities like the

central banks not only use the total reserves for monetary targets more but also they have increased their importance as a monetary and intervention tool. It is clear from Table 6 that from 1999 to 2008 the euro share of official foreign exchange reserves increased from 17,9% to 25,5%. The same evolution can be observed also from Figure 6 which shows from 1995-2008 the development of the dollar and the euro as official reserve currency. However, according to the ECB the euro's share of global reserves is quite misleading because in constant exchange rates its share decreased (ECB, 2008). Indeed, it can be argued that the euro's trajectory after its fast start has remained stable (Cohen, 2009).

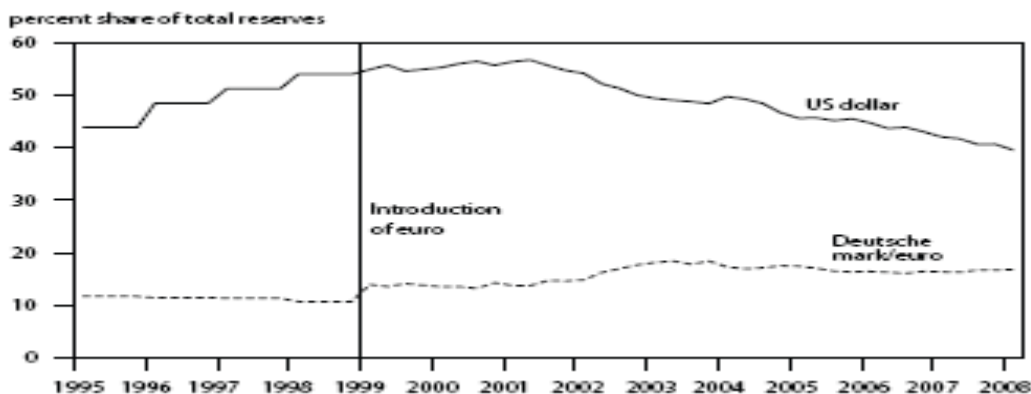
Furthermore, it can be argued that the introduction of the euro in 1999 created the second largest market after the US market in the world in terms of the euro securities markets and in credit quality and it has been noticed that in liquidity terms the pre-eminence of the US dollar is now declining (Galati and Wooldridge, 2009). Moreover, in terms of international bonds and notes it can be observed a substantial rise in the use of the euro (Cohen, 2009). However, as Cooper (2000) states the attractiveness of the US dollar as a reserve currency derived from the existence of a deeper and more liquid market in US treasury securities and in particular in treasury bills compared with euro markets. In this sense, this seems to become the core problem not only for the euro but also for the Eurozone. As Cohen (2008, p.44) argues 'the euro is condemned to remain at a disadvantage vis-à-vis the dollar as long as EMU is unable to offer a universal financial instrument that can match the US treasury bill for international investor liquidity and convenience'.

Table 6: Dollar and Euro Shares of Official Foreign Exchange Reserves

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a
Dollar	71	71.1	71.5	67.1	65.9	65.9	66.9	65.5	64.3	64.6
Euro	17.9	18.2	19.2	23.8	25.2	24.8	24	25.1	26.1	25.5

Source: Cohen (2009)

Figure 6: The Dollar and the Euro as Official Reserve Currency



Source: Mayer (2009).

4. The Role of Politics

In the case of political considerations one could say that there are many structural limitations and deficiencies that negatively influence the euro's role as a global reserve currency. Even though it can be argued that in economic output and trade the EU is in many cases in a better position than the US^{††††}, the EU today faces three main substantial imbalances on trade, on productivity and on budget deficit that affect its sustainability. Moreover, in the institutional domain, as Eichengreen (1998) argued, the institutional structure and the lack of supervisory and regulatory authority of the ECB are likely to have a negative impact on the euro's prospects as a global reserve currency. According to him, even the US dollar, during the conflict period among the sterling and the dollar, was not able to capture the primacy from the sterling because of the initial absence of the Federal Reserve.

As Benjamin Cohen (2003) has clearly observed from the early beginning, the EMU's ambiguous governance structure reveals uncertainties and confusion for its prospect primacy. It could be said that the aforementioned deficit is the most prominent of all. According to him the EU needs to solve three main issues on the governance of the ECB, the problem of the exchange rate policy, and the uncertainty about the political authority responsible for macroeconomic issues in the Eurozone. Under these conditions the Eurozone seems to be an artificial creation. In this sense, Cohen (2008, p.38) states that 'the euro is a currency without a country-the product of an interstate agreement, not the expression of a single sovereign power'. In addition, McNamara and Meunier (2002, p. 850) believe that 'as long as no single voice has the political authority to speak on behalf of the euro area, as the U.S. Secretary of the Treasury does for the American currency, the pre-eminence of the US in the international monetary matters, as in other realms, is likely to remain unchallenged'. For Cohen (2009, p.744) 'the euro's handicaps includes troubling ambiguities in EMU's governance structure-difficult to avoid when a single currency is jointly managed by more than one sovereign state-as well as a strong anti-bias built into the bloc's provisions for monetary and fiscal policy'. In this case, it can be said that the permanent limitations of the euro appear to have weighted on EMU's legitimacy and there is a need for other significant mechanisms of legitimization different than that of economic fundamentals^{††††} (Deroose, Hodson and Kuhlmann, 2007). For Hodson (2009) the EU has failed to produce a European vanguard because the decision-making lies on the national level.

It is also clear that even today two years after the Greek financial crisis the European Union's political leaders seem unable to solve the crisis because of the weak foundations and

^{††††} See for example Bergsten (1997).

^{††††} Hodson (2009) provides an overview of the challenges that EMU confronts.

architecture of the Economic and Monetary Union. The EMU is a unique example of transnational economic and political cooperation, but it is full of flaws and problems. From its early beginnings the political leaders accepted in many countries that in fact couldn't be competitive within the Eurozone. There are two important economic laws that affect their sustainability negatively. The first law is the transformation of comparative advantage to absolute advantage within the Eurozone. This means that within the Eurozone only the most competitive enterprises can survive. Thus, the states stand unable to help the industries and the entrepreneurs. The second law argues that it is impossible to have a symmetric and balanced economic growth within the whole area of the Eurozone. In this way, we can explain the occurrence of two major different areas of economic growth within the EU, namely the core countries and the peripheral countries. Under these conditions, many countries of the European periphery that have been unable to remain competitive in the Eurozone joined the EU only because of political priorities and decisions. These actions are also highly responsible for the euro's inability to surpass the US dollar.

Moreover, the system of European economic governance is not a well-rounded system that can help all its diverse countries in remaining competitive. The European Central Bank (ECB), although it is a highly credible institution, does not function as the American Federal Reserve. Thus, because the European economic integration is uneven, when the ECB takes a monetary decision, e.g. changing the interest rates or the money supply, the outcome of this decision does not have the same effect on all European countries. In this regard, the ECB cannot help Greece or countries similar to Greece. Furthermore, the Stability and Growth Pact (SGP) has also many omissions and we can't forget that France and Germany were the first two countries that failed to comply with its targets. Furthermore, the EMU suffers from asymmetric and adverse economic shocks, inflexible labour markets, rigid wages, centralization of economic activity to specific areas, incomplete trade integration, and uncoordinated monetary and fiscal policies. Together with its major institutional weaknesses and the fact that a European political union is not regarded as feasible and the European sense of solidarity is inexistent, the result is ruinous both for the European project and for its member states. In fact, Greece and many other largely peripheral countries remain trapped within the Eurozone. They cannot use either their monetary or fiscal policies to regain their competitive advantage. This is also an important lesson that the New Member States (NMS) must learn. Living within the Eurozone is not as simple as it looks. Accordingly, the European Economic Governance is not only responsible for the Greek crisis but also for the euro's inability to suppress the US dollar as the global reserve currency.

Furthermore, it can be said that the EU's political influence is considerably decreased beyond its neighborhood (Posen, 2008). As Posen (2006, p. 11) argues 'recent developments obscure the reality that the euro is at a temporary peak of influence, and the dollar will continue to benefit from the geopolitical sources of its global role which the euro cannot yet or soon, if ever, match'. In this context, Momani (2008) believes that even though it can be found a global currency as an alternative to dollar, no state can be found to replace the US security umbrella. Adam Posen (2009, p.99) clearly points out that 'because the euro area is not offering to the states behind potentially associated currencies a broader range of security relationships in general, it will not attract as many adherents as the economic factors would seem to suggest would come'.

As a result, it can be said that not only the euro has significant institutional and political obstacles to overcome but also it is almost unlikely for the EU to defeat the preeminence of the US in political affairs. It seems that it is unlikely for the euro to overcome the dollar's primacy. As Mundell (1993, p.10) states 'Great powers have great currencies' and in this case in contrast to the US neither the EU's currency nor its global political influence is significant. In this context, Frieden (1998, p.38) was right for his argument that 'political realities of today's EU will define the future of the euro'.

5. Conclusion

In conclusion, it is clear from the aforementioned analysis that the euro's global leading role is vague. The euro not only as medium of exchange, as a store of value, and as a unit of account has an unambiguous international position, but also it suffers from important institutional and political deficiencies and limitations that influence its role negatively. In this sense, it could be said that it is very difficult for the euro to overcome the dollar's dominance as a global reserve currency. The euro could be the second global reserve currency but not the leading currency. Even though Eichengreen (2009) believes that the euro is the only reasonably major opponent, it could be said that the decision for a currency to become a global reserve currency is not influenced only from economic but also from political and institutional factors. However, it can also be said that as Eichengreen (2009, p.67) argues the dollar 'it will not be as dominant as in the past, for the same reasons that the United states will not be as dominant economically as it once was'. In this case, the euro will be able to earn only a small part of the dollar's dominance but not the primacy. It could be said, that many other political and economic factors could affect the future not only for the euro but also for

the dollar. In this context, one could focus on the role of the China as the main catalytic factor for the road ahead (Bowles and Wang, 2008).

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Cooperation and community-based development: notes on the Hungarian case

Abstract:

This exploratory paper puts forward some evidence and hypotheses on the capacities of the Third sector to play a role in the transformation of 'loosing' communities into active player in the processes of economic development and democratization. The first section reviews some recent studies on the economic dualism in Hungary and the national and EU policies for local development. The second refers to investigations on the restructuring of co-ops, whose number is still quite high, especially in the agricultural sector. The research issues addressed are the following: How do these programs work? What kinds of organizations are being created? What is their degree of self-sustainability? What is the role of local communities? Is there a room for the organizations of the Third sector? Is the social economy able to attract resources and know-how largely dispersed in the informal economy? In the concluding section some hypotheses are advanced for further research on the role of co-ops and social enterprises in the process of community-based development in transitional societies.

Key words: Community local development, economic development, EU policies, transitional societies, Hungary

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1. Introduction

The countries of Central Eastern Europe (CEE) have shown a capacity to adapt to the asymmetric shocks brought about by the processes of economic globalization and accession to the EU. Such adaptation expressed itself in a variable combinations of growth of the private non industrial sector and policies aimed at attracting FDI. The social costs of the systemic transformation have been high everywhere in terms of economic marginalization of large sections of the working population, especially in the declining sectors and the stagnating 'Eastern peripheries.'

Such a situation has been addressed by a line of research which highlight the unsuccessful transfer of the European social model through the mechanism of the *Acquis communautaire*. In such approach, what has allegedly been transferred eastward is the hardcore of the model embedded in the human resource management of the MNCs subsidiaries in CEE countries. The effective transfer of the social dimensions then is seen as contingent on the capacity of local actors (unions, work councils) to assert their collective voice within the transnational social spaces and the system of industrial relation as a whole (Clark and Geppert 2006; Marginson and Meardi 2006; Meardi 2007). Indeed, the post-socialist transformation has resulted not so much in collective conflicts as in a great deal of individual exit (Meardi 2007). In other words, a huge number of salaried worker was thrown out from the industrial relation system and from the 'paradigm of decent work' and entered the variegated world of the irregular economy or choose to emigrate or tried to survive by getting back to the rural communities they left during the socialist industrialization (Mako and Symoni 1997; Tykkylainen 1999; Wallace 2002; Stenning 2005; Smith and Stenning 2006).

One can concur that the eastward extension of the European social model depends a lot on an institutional pull from below which up to now has been quite weak and scattered. Yet it is worth noting that the process of accession to the EU has been increasingly based also on program of local development and societal modernization targeted to the disadvantaged areas less able to attract FDIs. The research issues then are the following. How can these programs help overcoming socio-economic inequalities in CEE countries? How do managers and beneficiaries of these programs interact in different local contexts? What kind of organizations are being created? How do they work? What is their degree of self-sustainability? What is the role of the local community? Is there a room for the organizations of the Third sector? Is the social economy able to attract resource and know how now largely dispersed in the informal economy?

This exploratory paper put forward some evidence and hypotheses on the capacities of the Third sector to play a role in the transformation of ‘loosing’ communities into active player in the processes of economic development and democratization. The first section review some recent studies on the economic dualism in Hungary and the national and EU policies for local development. The second refer to investigations on the restructuring of co-ops in the agricultural sector. In the concluding sections some hypothesis are advances for further research on the role of co-ops and social enterprises in the process of community-based development in transitional societies.

2. Policies for cooperation and local development: national and European tools

The Europeanization process, for Hungary and the other CEE countries, also means regionalization and administrative decentralization. The crucial issue is that of creating local administrations with adequate capacities of managing development programs whose success also depends on the creation of trans-regional networks of cooperation between EU countries (Sóos 2002; Keune et.al. 2002; Palné-Kovács et. al. 2004; Kulcsar and Domokos 2005; Monasterolo 2007; Brown et. al. 2007; Cartwright et. al. 2007).

A first important act for the promotion of regional development is the law of 1996 which led to the establishment of seven regions and their elective councils. This means that the definition of regional entities did not passed through “a relatively long process of social reconciliation and consultation,” also because the interest at local level was centred not so much on the regional identity as on transparency and control of the inflow of national and EU funds. The outcome was that the principles of subsidiarity and partnership had little influence on the action of councils that actually worked as support agencies of the government in the implementation of regional policies (Cartwright 2007: 14).

Two more aspects are also to be borne in mind. First, the persistent dominance of sectoral policies and the ensuing results in terms of conflicts with the interests of local populations and, second, the increasing strength of the mechanisms of political clientelism at local level. These two factors led to the creation of the ‘statist conception of local management’. As a matter of fact, the European policies, aimed at fostering participation at local level, have brought about a re-centralization of the political process and the strengthening of the role of the state. Yet this does not imply the absence of incremental changes. The new institutions, created in the process of Europeanization, are not organically incorporated in the state administration. They remain islands in a sea of old style policies coming from the socialist –and even pre-socialist- era. An adaptation is taking place anyway

for local actors unanimously acknowledge that European norms may have their defects, but are more advanced than the national ones (Palné-Kovács et. al. 2004; Cartwright et. al. 2007).

The act of 1996 defines the competences on the matter of the ministries of environment and agriculture. These two ministries began to be fully operational at the end of the 1990s in order to be prepared to the management of European funds for social cohesion, the levelling of regional disparities, and the convergence among EU countries. Such funds are assigned through the Hungarian plan of national development according to four priorities: raising the competitiveness of the productive sector; developing employment and the human resource management; modernizing infrastructures and protecting the environment. The results are not so encouraging or, more precisely, they are good as far as the convergence of Hungary with the EU countries is concerned, also because the new entrants generated a favourable statistical effects in terms of GDP average level. The unintended result is instead the increased disparity between the 'winning' and the 'loosing' regions (Keune, Kiss and Toth 2004; Cartwright et. al. 2007; Brown et. al. 2007; Monasterolo 2007).

The county of Győr provides an example of winning region which was able to quickly recover from the crisis of the early 1990s. In this case there was a large influx of FDI in all branches of the local economy which today represent a successful model of re-industrialization well inserted into the global economy. This success does not mean that signs of difficulty are not there such as, for instance, the strains in the local labour market, the low content of R&D in foreign investments and the limited integration of local SMEs in global value chains.

The county government demonstrated a good innovation capacity in terms of training policies, creation of an industrial park and modernization of infrastructures. Such capacities stem from the emergence of two types of economic leadership: a group of former managers of privatized firms well connected with Western partners (mainly Austrian) and local authorities, on the one hand, and a group of new entrepreneurs on the other. The two groups put forward two distinct vision of local development: the first one based on FDI, and the second inspired by the Italian model of industrial districts based on SMEs. The first model is the one which would prevail insofar as the resources for the development of small enterprises are largely insufficient and these firms are not able to compete in global markets (Keune et. al. 2004)

The other case, opposed to the first one, is that of the Eastern peripheries, at the border with Ukraine, Romania and Slovakia. In such rural areas the structural legacies of socialist industrialization are still strong, and this explain the enduring stagnation of the local economy and the lack of FDI in the productive sectors till the late 1990s. Even today the fact remain

that only a fourth of the working population is engaged in the official economy. The majority of people survive thanks to welfare policies, subsistence agriculture, various activities in the informal economy and the petty trades at the border with more backward post-socialist countries (Keune et. al. 2004: 594).

Even in such cases, local authorities somewhat managed to promote development processes. On the one hand, they tried to innovate by imitation, that is, by trying to attract FDI promoting the region as a potential gateway toward eastern markets, on the other they looked for government support to the creation of new industrial zones. Such a strategy proved quite unsuccessful both for the scarce attraction of privatized enterprises to foreign investors, and the persistent economic stagnation of the countries at the eastern borders. Other factors which may explain the failure are the scarcity of qualified labour force and the inadequacy of infrastructures and the system of education.

The limited inflow of FDI left these areas largely deprived of resource for development. Yet the lobbying capacities of local authorities got an improvement during the last decade when the region begins to benefit of the funds of the PHARE program and the extant co-financing of the central government (Keune 2004; Monasterolo 2007). The strategy of strengthening the political clout may also display unintended effect, though, for it may led to neglect the need of building relations with local economic actors, which is important for attracting FDI (Galli 2001).

A significant step ahead is taken thanks to the new generation of European programs and the higher degree of complexity of the government policies, as it appears in the second national development plan whose implementation began in 2007. An example of 'complex plan' is that on the reviving of rural areas whose innovative features stem from the debate on social capital as a base of economic development. Examples of actions to undertake are the involvement of educated young people in programs for the community they came from or the building of 'multifunctional community spaces,' new forms of social economy or investments in infrastructures. On the whole this new national plan refers to the LEADER approach which is aimed at enhancing participation, building new human capital and forms of horizontal partnership between local governments, civil society, and inter-territorial and transnational partners. A program that, the initial difficulties notwithstanding, created 14 groups of local action which supported 272 projects of training, urban renewal and local development (Cartwright 2007: 16).

3. Cooperation and community-based development: recent changes

The restructuring of the former collective farming began soon after the regime change with a reform policy aimed at creating efficient and competitive agricultural enterprises. The basic idea was that of linking the property principle with that of productive use of land. What in practice would prevailed was the principle of restitution of land to the former owners or their heirs. The results turned out to be not satisfactory in terms of efficiency and productivity of labour for the average size of the new farms does not exceed 1,8 hectares (Gardner and Lerman 2006).

All these new micro-enterprises acquired denominations similar to those in use in the market economy, that of 'cooperative' included, because the possibility it offers of getting fiscal and administrative benefits. It is then not so easy to distinguish co-ops from the other firms. However the advocates of a 'genuine cooperation' are also there, and try to organize themselves according the classical principles of mutuality (Couture et. al. 2002).

As for the perspective of the cooperative movement in Hungary, 2007 marks a turning point. The new law of December 2006 in fact defines the co-ops as non profit organization, but allows them to also include external investors, even if they must be less than 10% of the membership. The co-ops may also enjoy fiscal benefits and may be granted funds for supporting social and cultural activities in the community.

The basic changes of the post-socialist transformation of co operatives may be summarized as follows. The law on restitution, which came into force in 1992, obliged the external shareholders to sell their shares to the co-op or to add such shares to its investment capital. In a situation in which many co-ops where undercapitalized and dependent from state subsidies, the operation could not be effected, and the outcome was that a number of co-ops ceased or changed their activity. The aggregate results of this reorganization may be highlighted through a comparison between the situation in 1970 and that in 2000. At the beginning of the period, co-ops amounted to 75% of collective farms, and their share of arable land was two third of the total. In 1990 such a share rose to 80%, the co-op number to 1360, and the total membership to one million (half of them retired people). The turning point is 1992 for the outcomes of the new law is that in few years the number of co-ops dramatically decreases so that in the year 2000 their number is 800, the membership 135,000 while the cultivated land is no more than one third of the total. However, a new law is enacted in 1999 which favour the creation of new types of purchasing and marketing co-ops so that 500 of them are established in the subsequent year (Gardner and Lerner 2006).

Such a reorganization of cooperative firms in the last decade has been going along with a growing influx of both foreign capitals in the agricultural sector, and EU funds for the development of rural communities. Some case studies may convey an idea on the problems and prospects for co-ops, and the Third sector on the whole, within the post-socialist transformation.

The first of the two case studies of traditional co-ops ('Kapostaj') refers to firm which retain its cooperative form until 2000 despite the possibility of turning into a joint stock company allowed by the law of 1992. This firm displays one of the typical features of traditional co-ops: almost two third of the membership is made of retired people. The number of external actors, quite limited at the beginning, increasingly grows and overcome that of the members in 1999. The reasons why the co-op turns into a joint stock company in the successive year are the following: to provide a more sound foundation to the property rights; to put a more efficient management in place; to obtain a better access to investment capitals and to create a better image of the firm. The members' intention was that of increasing their returns through the changeover. As a matter of fact, the increased strength of outsider (half of new owner with 26% of shares) led to the liquidation of the co-op and its transformation in 'Investment Oriented Firm' (Szabo and Kiss 2004)

A different outcome materializes in the other traditional co-op ('Beke') which, through the 1990s would rapidly grow by extending the cultivated land from 73 ha. in 1955 to 7,000 ha. in 2000 (belonging to about 4000 owners) and by operating 26 production lines. In this case, the government purchased half of the shares which, due to the law of 2005, will be given back provided the firm keep working as a co-operative (Forgács 2008)

The other two cases refer to purchasing and service co-ops. The first one was founded in 1994 by 35 small owners as non profit association for the purchase of seeds and fertilizers. The success is noteworthy so that the membership grows up to 2000 people in the next five years. In 1995 a similar society is founded for the collective selling of fruits and vegetables which get close to 300 members in 2002. The co-op organises the buying of input materials and the working of selling outlets. To achieve competitiveness and better product quality, the co-op may also work on the basis of production contracts with individual producers and make efforts to purchase input materials of the same type. The surplus made annually is redistributed among members, in proportion to their turnover with the co-op, after the subtraction of deposits and cost (Szabo and Kiss 2004: 276). The second case refers to a co-ops which already existed in pre-socialist times and starts anew in 1993 as Haidú Gazdák Agricultural Association, and three years later as 'Farmers' Club' and finally, in 1999, as

‘Purchasing and marketing co-op of Gazdák’ (PMCHG). The new association focused on: gathering and spreading information, joint purchase of inputs and marketing of products. Also important was the function of accessing additional government support (Forgács 2008: 62-63).

Ten in-depth interviews have been conducted in two of these co-ops in order to assess the role of social capital and leadership in determining the degree of success of such organizational model. The results may be summarized as follows.

➤ *Trust and reciprocity.* Both components of social capital were seen as important for the development of the cooperative model. Yet in the traditional co-op (Beke) members trusted mainly national and European institutions while in the member of the new generation co-op (PMCHG) trusted first of all their business partners .

➤ *Communication and information.* Beke members were inclined to seek information from the organizational leadership and national media while PMCHG members gathered information mainly among community leaders. In both cases a good flow of information was pointed out, even though to a lesser degree for investment decisions (especially in the PMCHG). The common opinion was that the management of information was a prerogative of the organizational leadership, and that the communication with external actors was not so much a source of power for leaders as a way for obtaining further help for the co-op.

➤ *Community, social networks and informal institutions.* The motivation to help the community was strong in both co-ops, even if the help was conceived of in terms of time e not money. Concerning the mediation of internal conflicts, the general indication was that they can be solved by the involvement of the organizational leadership or by convening a general meeting of the co-op members. In the new co-op there was no mention of internal cliques; in Beke two people mentioned that issue.

➤ *Institutional environment and cooperation.* The attitude toward the principle of mutuality has changed with the introduction of radical reforms. The common opinion is that the law on restitution of 1992 was ill conceived and badly implemented. The level of trust among members dropped in the following years: people become more reserved and less inclined to engage in cooperative activity. Almost all interviewees declared a lessening in their trust in the government in charge, especially in PMCHG. A disappointment was also apparent on the policies adopted for the preparation to EU accession.

In short, what emerges from the interviews is that the members of the new type of coops started from their experience as individual owner, thus they motivated the decision to associate with the reduction of transaction cost with supplier and customers. The members of

the traditional co-op recall instead the economic success reached at the outset (under the previous regime) to declare their support to the mutuality principle, and to recall the high levels of social capital that existed in the past. As for the role of organizational leadership, it emerged as a crucial element for keeping the traditional co-op alive while in the other case it was important for motivating individual farmers to associate.

4. Concluding remarks and hypothesis for further research

The literature examined shows that the development potential of cooperative enterprises in Hungary is quite significant. Yet such a potential is to be evaluated with reference to the typical management problems often highlighted by the research on the co-operative phenomenon (Borzaga and Spears 2004). Indeed, high differences in efficiency and productivity emerge, even among co-ops in the same region. The differences are also significant among firms of the same dimension or the same type of production. Thus the debate dimension-efficiency appears a too narrow framework for understanding the management problems of co-ops in transitional economies. It is not just structural factors that matters (type of soil, production, property rights, etc.). Subjective factors are also crucial: the 'missing variable' of social capital is to be included into the picture (Gorton and Davidova 2004; Grazhdaninova and Lerman 2005; Zeuli and Delle 2007). However, the evidence on the role of social capital in community development in transitional societies is still quite fragmentary, and that poses a set of questions for future research.

The four cases highlight how, in the transformation of co-ops in post-socialism, the market logic is intertwined with that of non profit often within community-based development processes supported by national and European institutions. In such a framework co-ops, and the Third Sector on the whole, are providing collective goods that other kind of organizations do not provide, especially in a market economy whose maturity is highly differentiated among regions. What needs to be better understood is the relevance of the Third sector and its socio-economic impact in losing regions which are nonetheless forging ahead.

The experiences of co-operatives and social entrepreneurship in Hungary (and other transitional societies) call for a more integrated approach such as that of community-based enterprises which has been applied both to developed and emerging market economies (Borzaga and Defourny 2001; Provasi 2004; Peredo and Chrisman 2006; Borzaga and Janes 2006; Smallbone 2007; Borzaga and Fazzi 2008). Admittedly, an interest for the social dimension of economic development is emerging in this country. Many organizations of the Third sector are actively involved in the implementation of local development programs. At

the same time, the 'post-socialist growth machine' is getting stronger at local level with its ways of working not always consonant with those advocated by the activists of community-based development. The growth machine is a power elite model in which "the public administrative elite, the 'big entrepreneurs', the local media and even leading intellectuals of a community are incorporated in (...) pro-growth coalitions (...) whose activities are likely to be driven by political rather than strictly economic interests," (Kulcsar and Domokos 2005: 551). The implication is that one should not neglect, in future research, the local dynamic of power accumulation in a capitalism with a strong socialist legacy whereby the only forces that can put restraints on the growth machine and its political networks are only two key external players: MNCs and the nation state (Kulcsar and Domokos 2004: 561).

As for the networks, it is worth noting that they may be of help in pursuing various kind of opportunities not just in the official economy: informal networks may well be developing to pursue opportunities in the informal economy which thrives especially in the eastern peripheries. The point then is that the social economy is somewhat growing within the process of systemic transformation. Yet the resources of human and social capital that would stimulate its further development are finding a better remuneration in the market economy or are dispersed in the irregular economy. The Third sector is increasingly involved in local partnership for development, but the drivers of the growth machine seem to be quite hesitant in fostering such involvement. The hesitation may stem from the still scarce capacities of the Third sector to provide adequate answers to new social demands. However, at the roots of the problem there also seems to be a persistent ambiguity on the real meaning of partnership for local development which, at least in part, reflects the incoherencies of the Europeanization process. In other words, the European programs seem sometimes to be managed in ways that have been graphically described like this: "Plan but don't co-ordinate, regionalise but centralise in the short run, work in enclaves, impose rather than exchange." (Cartwright et. al. 2007: 20).

As for the disadvantaged Eastern peripheries, one can notice many of the typical difficulties of development programs in poor countries: closeness of the structures of political power, inadequacy of the legislation, cultural prejudices, deficiencies of welfare provisions, unemployment, and a mushrooming of activities in the subsistence economy. Admittedly, the development of the Third sector is hampered by cultural barriers such as, for instance, the perception of co-ops as a legacy of the communist regime or, at least, as enterprises unable to compete with private firms in a modern market economy. Another similarity with the situation in developing countries is the excessive dependence of NGO from European and

international donors, which means that such organizations may sometimes be genuine expression of associationism, but also be the by-product of the availability of funds. Another brake to the development of the non profit sector also is the widespread perception that the real domain of solidarity is that of family and friendship, not the community (Vercseg 2005).

All these obstacles notwithstanding, the potential for the assertion of various forms of social economy in the postcommunist transformation are far from negligible. A couple of problems remain though in the path towards social integration and a community-based development. The first one is the cultural legacy of social participation left by the socialist regime. In fact, the differences with western countries lies today not so much in the citizens' participation in cultural, social and recreational activities. Rather the differences seem to lie in the citizens' involvement in the management of public matters, in working for the common good, which is the basic precondition for a community-based (or –driven) development. The second problem is that such a legacy creates a disjuncture between the perception of citizens' rights among the ONG activists and that which prevails in the local population. In short, the key issue is to turn democracy into a daily practice, and the ways to fill the gap are seen in : long lasting development programs, adult education accessible to all, and training of professional that provide qualified programs to such programs (Vercseg 2005)

The training of 'professional for the community development' is really a crucial issue insofar as it would help overcoming the dilemmas of collective action that are surfacing in the attempts to stimulate social participation. An hypothesis for further research may be that kinds of 'community development enterprises' (CDE) are beginning to emerge also in the post-socialist context thanks both to the influx of FDI, and the funding of local development programs by the national government and the EU. Forms of CDE do exist in western countries (especially in the USA), which are social enterprises with a well defined strategy, an effective governance and a set of stakeholder than can guarantee the mobilization of various kind of resources and the circulation of technical and market information (Provasi 2004). In other words, even in the context under examination forms of community-based social enterprises may materialize which could find a balanced way of gathering and using resources that originate in the public, private and associational spheres. CDE-type organizations would reduce the scarce mobilization of local resource, their misallocation, and their dispersion in the informal economy.

Admittedly, the more favourable condition for the establishment of CDE do exist in winning regions. It is indeed in these areas of the country that more possibilities exists for the restructuring processes to result in 'regional system of innovation.' It is here in fact that the

presence of strong network organizers such as MNCs, banks or even public administrations may led to an alignment of local networks (not oriented to the status quo) with those of foreign investors and the key actors in the process of European integration (Radossevic 2002). Yet network organizers may be also be found in more disadvantaged regions. The case studies referred to above revealed the presence of local leader able to trigger the formation of ‘bridging ‘ forms of social capital that foster organizational development. (Murray et. al. 2008; Forgács 2008). These are indeed instances in which social entrepreneurs may emerge who may put their prestige into use to convince other key actors of the importance of their project (Provasi 2004). It seems then reasonable to think that also in the post-socialist context the formation of social capital may be triggered by the resources of prestige and the investments in reputation of social entrepreneurs.

This hypothesis should however go along with a reassessment of assumptions concerning social participation. In other words, one should not idealize the transformational capacities of participation for the empirical research on community development brought to light at least two basic problems. First, the exercise of ‘voice and choice’ may be a costly exercise for individual in terms of time, energy and money and, second, participation per se hardly can transform attitudes and management styles of local political and administrative elites (Mansuri and Rao 2004: 6).

To conclude, future investigations on community-based development should aim at improving our understanding of the working of post-socialist growth machines in winning and losing areas, the alignment (or the lack of it) of the network of local key actors with those of external actors. Also important, though, is to avoid an underestimation of the role primary groups may play in local development, even if such a role is largely being played in the sphere of the informal economy which is larger than that of the social economy.

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Book Reviews

Book Presentations



Regionalisation, Growth and Economic Integration

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European regional policy faces intensive challenges, globalisation and rapid technological change, in order to provide the economic opportunities and quality jobs needed in less favoured regions. The sources of wealth and economic growth in the modern global economy are Information and Communication Technology (ICT) and knowledge, rather than the efficiency of natural resources and physical labour, as competitive factors. Today, within European Union, the R&TDI gap is nearly twice as great as the cohesion gap. Many of the causes of disparities among regions can be traced to disparities in productivity and competitiveness. Education, research, technological development and innovation are vital components of regional competitiveness. European Union is increasingly becoming a knowledge-based economy, with the development of knowledge having a direct effect on competitiveness and employment, as well as on the society in general. Regionalization is a common feature of the changing territorial organization of European states today. Regionalization alone, however, cannot produce any of the benefits we attribute to it without looking into the conditions in which it occurs.

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