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Competitiveness Assessment and Growth Opportunities of the Romanian Tourism Industry

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In an increasingly dynamic market, with complex consumer behavior and product attributes, the fundamental task for destination management is understanding what are the new tourism developments and trends, the new techniques and approaches required to handle them effectively, the new business models that generate major impacts for tourism and its competitive positioning strategies, as well as how tourism destination competitiveness can be sustained and enhanced. Tourism has become a fiercely competitive business for destinations the world over. Competitive advantage is no longer natural, but increasingly man-made, driven by information technology and innovation. As such, it is not simply the stock of natural resources of Romania that will determine its share in the tourism market, but rather how these resources are managed and integrated with other competences to create a competitive advantage.
The objective of this paper is to identify the elements of a new paradigm, specific to Romania, which would help it become and remain competitive within the international tourism industry. In the paper we argue that one of the best ways to do this is to identify and integrate the critical success factors that could boost competitive advantage and achieve sustainable growth over the longer term.

Keywords: *tourism industry, tourism policy, Romania, destination competitiveness, competitive advantage, Porter's diamond.*

I. Background of the study

Tourism has become a fiercely competitive business for destinations the world over. Competitive advantage is no longer natural, but increasingly man-made, driven by science, technology information and innovation. As such, it is not simply the stock of natural resources of Romania that will determine its share on the tourism market, but rather how these resources are managed and integrated with other competences to create a competitive advantage.

To ensure that the benefits from increasing globalization and integration are shared, countries need to make certain that they have the necessary level of competitiveness. As the WTTC recently stated, "maintaining competitiveness has become an increasing challenge for destinations" (WTTC 2001).

In the tourism sector, traditional models fail to give responses to questions such as: why countries that are characterized by an abundance of natural tourism attractions like sea, sun and beach, as well as cultural resources are losing competitiveness? Or, why many destinations in developing countries, characterized by an abundance of resources and cost advantages, are not able to create wealth and prosperity in tourism? The failure to provide responses to these questions advocates the need to set out a new competitive framework for tourism management. The implications of this new conceptualization regard structures, approaches, competitive resources and strategic actions.

The constantly growing number of travel destinations and the enhanced quality of existing ones are putting great pressure on those responsible for a given destination to find better ways to compete in the tourism marketplace and to do so in a sustainable manner. The first step in achieving this goal is to better understand those forces and success factors that determine the competitiveness of major tourism destinations. Success factors of a specific destination can then be identified and integrated to ensure sustainable growth for the destination within a competitive environment.

The competitiveness of Romania as a tourism destination has been insufficiently analyzed and the limited results have not been used so far for the design of an efficient economic tourism policy. Therefore, Romanian tourism can be considered potentially stronger in non-produced attractiveness than in its management's capability to add value.

The aim of this paper is to present an analysis on the competitiveness of Romania as a tourist destination. The article is constructed as follows: first, an overview of the tourism industry in Romania is presented; second, the theoretical background of destination competitiveness is examined, together with the methodological framework for its assessment. In the third part, empirical results of Romania's tourism competitiveness analysis are revealed and article concludes with a review of the Romanian tourism potential.

II. Overview of the Romanian tourism industry

Development of the tourism industry in Romania was initially based on a large domestic demand, on an influx of incoming tourists from the former Soviet bloc countries and on a small number of budget tourists from Western Europe.

Following the turning point of 1989, the Romanian tourism sector experienced a severe decline, due to a dramatic drop in the purchasing power of tourists from the socialist countries, the lifting of restrictions on travel outside the eastern bloc and a paradoxical rise and continuous growth in the outbound demand. Suddenly, Romania was forced to compete with tourism destinations outside the Eastern bloc and it quickly became a net importer of tourism services.

After years of declining visitor numbers and under-investment in development and modernization, Romania's Travel & Tourism industry is slowly regaining profile and pace. As Romania's accession to the European Union (EU) became certain and as it advances in its way to develop the infrastructure and improve its governance and legal systems, the Travel & Tourism sector is supposed to play an ever increasing role, particularly in creating sustainable jobs for the country's important rural population. If managed effectively, Travel & Tourism can be an important catalyst for the development of other economic sectors in Romania, such as manufacturing, construction and other services. It can also help to preserve the country's primary assets, namely its natural and cultural environment.

Travel & Tourism industry is already an important contributor to Romanian's GDP and employment. By the end of 2006, the wider Travel & Tourism Economy is expected to contribute by 4.8 per cent to the country's GDP and should account for 485,000 jobs, representing 5.8 per cent of total employment (WTTC 2006). Furthermore, over the next ten years, Travel & Tourism in Romania is forecasted to achieve an annualized real growth rate of 6.7 per cent, taking the GDP's share of Travel & Tourism to 5.8 per cent in 2016. There is also a positive outlook for Visitor Exports, which are forecasted to grow at 8.5 per cent per year, over the next ten years, ranking Romania the fourth in the world.

Statistical Data on Romanian International Tourism

In 2005, Romania received 5,839,374 foreign visitors, distributed as follows (National Institute of Statistics 2006): 26.07% from Hungary, 24.58% from the Republic of Moldova, 6.67% from Bulgaria, 6.06% from Germany, 5.62% from Ukraine, 4.64% from Italy, 3.44% from Turkey, 2.53% from Serbia and Montenegro, 2.21% from Austria and 2.05% from the US. France ranks the 11th, with only 1.88% of arrivals, Spain the 21st (0.5%), Switzerland the 26th (0.28%). The share of the Asian countries is insignificant.

For the same year, international tourist arrivals in all accommodation facilities were of only 1,429,911, representing 24.63% of total arrivals (National Institute of Statistics 2006), out of which 81.99% from European countries, 8.44% from Asia and 7.66% from North America.

Data on international tourist arrivals by market share offer a different structure by country of origin (WTTC 2006): Italy is on the top with 13.62%, followed very close by Germany (13.41%), then by France (8.04%), Hungary (6.31%), United Kingdom

(5.78%), Israel (5.09%), Austria (3.73%), Netherlands (2.93%), Spain (2.89%) and Turkey (2.23%).

International tourist arrivals in all accommodation facilities have been steadily increasing for several years: 5.22% more foreign tourists in 2005 in comparison with 2004 and 56.28% more in comparison with 2001. Hotels received 89.44% of the total international tourist arrivals, followed by urban guest-houses (3.27%), motels (1.55%), villas (1.54%) and rural guest-houses (1.23%).

It is encouraging that, after eleven years of negative tourism balance, with a diminishing deficit trend after 2001 (-97 million Euro in 2001, -74 million Euro in 2002, -27 million Euro in 2003, -28 million Euro in 2004), the tourism balance became slightly positive in 2005 (Romanian National Bank 2006).

Romania benefits from a quite extensive hospitality network. The accommodation sector is now all but fully privatized, with 3,873 accommodation units in 2005, representing a growth of 11.29% compared to 2004. The total number of hotels was 969 in 2005, out of which: 8 were five-star hotels, 67, four-star hotels, 260, three-star hotels, 446, two-star hotels and 188 – one-star hotels. 65.43% of the hotel stock is at the lower-end of the market, meaning one- and two-stars hotels.

For a total of 161,223 beds in 2005, the distribution of tourist arrivals by location was: Bucharest and other cities – 71.3%, other urban accommodation –10.5%, mountain resorts – 7.9%, Seaside – 6.2%, Spas – 2.5%, Danube Delta, including the town of Tulcea – 1.6%. The general occupancy rate was 33.4% in 2005 and the hotel occupancy rate was 41.10%, the seasonality being still an important issue for Romania.

III. Nature and framework of destination competitiveness

Perspectives on Competitiveness

The literature reveals various approaches in defining, understanding and measuring competitiveness. Perspectives in various disciplines reveal that competitiveness is a multi-faceted concept. Dwyer (2001: 44) regards the notion of competitiveness as associated with four major groups of thought. These are:

- a comparative advantage and/or price competitiveness perspective;
- a broad scheme and empirical studies;
- a strategy and management perspective;
- a historical and socio-cultural perspective.

While economists have placed emphasis on price and the country-specific economic characteristics of competitiveness, the management and strategy authors have focused on the firm-specific characteristics, while the focus of sociologists and political theorists has been on various social, political and cultural characteristics underlying the notion of competitiveness. Moreover, each group has suggested different indicators to explain or measure competitiveness (Dwyer 2001: 45).

The definitions offered in the literature provide both a micro and a macro connotation for the term competitiveness.

From a macro perspective, competitiveness is a national concern and its ultimate goal is to improve the real income of its citizens. It is a very broad construct, encompassing all social, cultural and economic variables affecting the performance of a nation in international markets (Dwyer 2001: 45 and Yoon 2002: 32).

On the other hand, from a micro perspective it is seen as an organization level phenomenon; organization-specific behaviors determine competitiveness. To be competitive, any organization must provide products and services for which customers or clients are willing to pay a fair return or price. In the long run and in a free enterprise system, competitiveness is measured by the ability of the organization to stay in business and to protect the organization's investments, to earn a return on those investments, and to ensure jobs for the future (Porter 1980: 113 and Dwyer 2001:45).

Comparative and Competitive Advantages in Tourism

The discussion of competitiveness in the general literature has tended to stress competitive advantage (resulting from value-added activities by firms and organizations), while de-emphasizing comparative advantage as a source of international competitiveness (Dwyer 2001: 48). For a tourism destination, comparative advantage would relate to inherited or endowed sources such as climate, scenery, flora and fauna, while competitive advantage would relate to a destination's ability to use these resources over the long-term such as quality of management, skills of workers, service levels, and government policy (Crouch & Ritchie 1999: 142). The importance of these two pillars of international destination competitiveness will be shortly discussed.

a) Comparative advantages

Comparative advantages concern a destination's factor endowments, both naturally occurring as well as created. They are close to primary tourism supply (natural, cultural and social attractiveness) and can never be reproduced with the same attractiveness. Porter (1990: 20), Crouch and Ritchie, (1999: 42), and Hill (2000: 130) identify five broad categories of endowments: human resources, physical resources, knowledge resources, capital resources and infrastructure. In a tourism context, it seems appropriate to add historical and cultural resources as an additional resource strategy and to expand the infrastructure category to include tourism superstructure (Crouch & Ritchie 1999: 142). Crouch and Ritchie (1999: 143) argue that a country's natural resources are an important source of comparative advantage in tourism.

b) Competitive advantages

Where comparative advantages constitute resources available to a destination, competitive advantages relate to a destination's ability to use these resources effectively over the long-term (Hamel and Prahalad 1993: 56; Thompson 1997: 23 and Crouch & Ritchie 1999: 143).

Competitive factors refer to secondary tourism supply. They can be produced and improved by tourist firms or government policy. A destination endowed with a wealth of resources may not be as competitive as a destination lacking in resources, because the latter might be utilizing the little it has much more effectively.

A destination that has a tourism vision, shares this vision among all stakeholders, understands both its strengths and weaknesses, develops a positioning strategy and implements it successfully may be more competitive because of its effective strategic approach. The most important is the ability of the tourism sector to add value to its products. The primary attractiveness can be a source for higher value added, but the value is only created through performing activities. It can happen that the comparative advantage is lost due to the un-competitive secondary tourism supply. The support of tourism stakeholders is essential for successful development and sustainability of tourism and could help to improve destination competitiveness. As a result, the tourism destination will receive many benefits from enhanced tourism destination competitiveness.

The competitiveness of tourism destinations is also determined by the ability of tourism companies to increase productivity (Keller 1995). A below average rate of productivity leaves companies little room for maneuver on prices when faced with international competition. It also makes them less competitive in the domestic factor markets. Productivity of tourism therefore, on national level as a contributor to growth, as well as on branch/industry level as driver of competitiveness is of imminent consequences on destination competitiveness. The labor–intensive services of the tourism sector suffer from cost sickness. They are less productive than other services and they have to compensate for productivity shortcomings by higher prices. Productivity differentials or limitations of productivity progress between destinations that are at different stages of development explain why countries with low wage levels are cheaper than those where wages are high. Productivity in tourism services depend very much on the average occupation rates and therefore on the ability to control the flow of travelers. Controlling the flow is increasingly a question of industrial techniques: standardization of the basic supply of products and services can lead to new ways to improve productivity.

Assessing destination competitiveness – the methodological framework

The most detailed work undertaken by tourism researchers on overall tourism competitiveness is that by Crouch and Ritchie, who claim that in absolute terms the most competitive destination is the one that brings about the greatest success, that is, the most well-being for its residents, on a sustainable basis. Crouch and Ritchie (2000) state that competitiveness is illusory without sustainability. Thus, the most competitive destination is the one that most effectively creates sustainable well-being for its residents. This view is supported by Hassen (2000: 113), who defines destination competitiveness as "the destination's ability to create and integrate value added products that sustain its resources, while maintaining market position relative to its competitors".

The systematic model of destination competitiveness proposed by Crouch and Ritchie (1999) points out that it is necessary to investigate and understand the relationships of interplay among the determinants of competitiveness. Furthermore, it has been suggested that a systematic analysis of the comparative and competitive advantages contributing to destination competitiveness is done.

The national competitiveness model and its four determinants, proposed by Porter (1990), can be used as a fundamental source for explaining the determinants of destination competitiveness (Ritchie & Crouch 1993). These determinants are factor conditions (e.g. skilled labor, infrastructures), demand conditions (e.g. basic tourism services), related and supporting industries, and firm strategy, structure and competition.

Porter's (1990) national "diamond" addresses competition in terms of the determinants of national advantage, in particular industries or industry segments. Whereas the five forces model could be applied at the level of the organization in the tourism industry, the national diamond model suggests the fundamental structure of competition among national tourism industries; that is, the nation as a tourist destination. According to various authors, for example, Crouch and Ritchie (1999: 141) and Grant (1995: 340), Porter's diamond model is the best model for evaluating competitive advantage at a national level and will, therefore, be used in this paper.

Fabricius (2001: 30) applied Porter's diamond to a tourism destination. He argues that various important qualities of the tourism industry need to be considered when applying Porter's diamond to tourism destinations and these are:

- the primary tourism product is an experience rather than a tangible product or service. Tourists travel to destinations to enjoy experiences and is, therefore, highly driven by the discretion, tastes and attitudes of the consumers;

- the product cannot be delivered to the market; rather, the market is confronted with a "virtual" proposal, often in the form of pictures, descriptions and perceptions based on media exposure and personal interactions;

- the tourism experience is not delivered to the consumer as a finished product; the consumer purchases various components of the experience, which are delivered at the destination as the experience unfolds. The comparative advantages of tourism are therefore mainly located in its factor conditions, i.e. its inherent attractiveness to specific market segments.

The components of Porter's Diamond will now be used to analyze and discuss the international competitiveness of Romania as a tourism destination.

IV. Diamond analysis of Romania as a tourism destination. Results of the empirical analysis

We are presenting below the results and interpretation of an analysis of the potential comparative and competitive advantage that Romanian tourism may have using Michael Porter's Diamond Analysis Model. As mentioned before, comparative advantage focuses on inherited factors of production, such as cheap labor or energy or natural resources, whereas competitive advantage is created through interlinked factors, which are often costly and difficult for other countries to duplicate.

The elements considered were:

- for factor conditions: geography, diverse tourist products, cheap labor, worn-out infrastructure, low number of training institutions for highly-skilled personnel, positive cultural attitude towards tourism;

- for demand conditions: large population, low purchasing power of domestic demand, falling demand for seaside resorts, increasing sophistication of domestic demand;

- for related and supporting industries: weak, but developing, distribution and promotion networks, low degree of coordination and clustering, IT industry support;

- for strategy, structure and competition: late privatization, low degree of competition outside major cities, focus either on the low-end or on the high end of the market, weak but improving promotion by the government, weak management and marketing skills.

Competitiveness Assessment

Romania's tourism market could have the potential to become competitive; however, large improvements in many parts of the industry are required in order to accomplish this.

Currently, Romania is not competitive in marketing tourism: it does not have enough skilled professionals with experience in marketing to a more educated tourism audience. Tourism management is also weak, both at a central level and at an industry level. Many of the persons operating SMEs in the tourism sector have little or no tourism experience; they also lack skills in management practices. The availability of personnel willing to work for low wages means there is not much pressure to increase operational efficiency. Additionally, access to market information by Romanian tour operators is hampered by the low computer usage rate and weak internet usage in the industry.

The low use of technology is another factor that makes Romanian tourism less competitive. Outside of the capital, computer usage and access to the internet is patchy. Without a more reliable and sophisticated group of tour operators and small hotel owners with access to computers and the internet, the ability to take advantage of growth in online reservations and promotions will not be captured.

Financing is generally considered inadequate in the sector. Many SMEs are unable to get financing to refurbish their accommodations and make other capital improvements. High collateral demands are often one of the barriers to receipt of such financing.

While linkages and networks are becoming stronger, they are still relatively weak compared to countries like Hungary and the Czech Republic. Many foreign tour operators are simply unaware of the Romanian market. The Romanian government has not invested adequately to insure that Romanian products are promoted. For example, in 2004, the Romanian government tourist promotion budget was US$20 million. While this is high for Romanian standards, compared with government promotion budgets in Turkey of US$75 million and in Greece of US$150 million it is insufficient.

Foreign tour operators, who control a large part of the flow of tourists are either unaware of Romania or have a poor opinion of the country. Image problems cut into Romania's competitiveness. Even if tour operators and tourists are aware of Romania, they may only associate it with Dracula/Transylvania. Most tour operators are unfamiliar with Romania, or they consider that Romania is a destination only for very budget conscious tourists. Currently, the international perception of Romania as a tourist destination is low.

V. Opportunities for growth

Product Development Strategy

The tourism industry has recognized the need to innovate in order to develop. The conversion of traditional Romanian tourism products (mass tourism – sun & sand and skiing) into more sophisticated products (spa, MICE, cultural and heritage tourism, urban tourism, countryside, wine and culinary tourism, eco-, geo- and active tourism) and, at the same time, the improvement of the actual infrastructure base should be the two axes of the tourism industry product strategy. The new or improved tourism products could be designed by developing the traditional ones, such as:

Spa tourism, that is one of the most important products of specialized tourism in Romania, based on niche markets and oriented to senior high-income consumers. Currently, there are over 70 health resorts in Romania. The main reasons for the development of such products are: the demand of an ageing European population, the opportunity to increase the average length of stay of tourists as well as tourism receipts.

Romania, already an EU member, with many conference and business centers, with modern accommodation facilities in Bucharest as well as other towns, has a growing potential to develop the meetings, incentives, conferences and exhibitions (MICE) sector. Conference facilities are available, albeit in short supply, as there are only 48 such facilities around the entire country. According to the Romanian Convention Bureau (RCB), some 900 conferences and events are held each year in the capital, MICE representing another important form of specialized tourism.

Often internationally labeled "agrotourism", rural tourism is present in many regions of Romania but its major concentration is in the mountainous regions, the Black Sea coast and the Danube Delta. At present, there are 4,000 tourist boarding houses throughout Romania, mainly for the domestic demand. The value of the rural tourism products could be enhanced with gastronomic, wine, handicrafts attractions. The initiative requires partnership and industrial links in each main region, in order to develop and promote each destination and community and co-operation among stakeholders on a chain of projects with shared information (cluster relationships).

Cultural tourism is centered on four main locations: the painted monasteries of the Bucovina region, the castles, fortresses and churches in the Maramures region and in Transylvania, the art galleries and historical and contemporary sites in cities such as Bucharest, Brasov, Constanta, Sibiu, the latter having a special significance, being the European Capital of Culture 2007.

Eco-, geo- and adventure tourism is specific for the mountains, hills, along the Danube River and in the Danube Delta.

Realizing the Potential

By strategically targeting the key products, which have potential for export, the tourism industry could realize its potential. Some of the key target markets for these products are first: Italy, Germany and France, and second: the U.K. and the United States. Currently, the market share of Italian tourists is of 13.6%, followed by Germany with 13.4%.

The first tier markets are already importing tourism from Romania. All of these countries have the ability to send considerable numbers of tourists with the buying power to purchase accommodations and vacation packages classified as 3 stars and above. With adequate promotion, interest from the second tier markets is expected to grow, especially based on business interests and language affinities.

Romania has significant tourism potential, which should be put to better use by stimulating investment in the sector (including FDI), upgrading its facilities and addressing higher-income segments. Romania should continue to develop its private tourism sector (including rural tourism) and should try to widen the breadth of its international markets, while increasing its share on its traditional markets and potentially large new markets such as Germany, Great Britain, the Scandinavian countries, France, and Italy. Also, efforts should be made to promote products that will reduce the dependence of the tourism sector on the summer season, especially through the promotion of conference tourism and more sophisticated all-inclusive packages.

The Romanian Tourism Strategy

In order to achieve its goals, the National Tourism Authority recognizes, for the promotion of Romania as a tourism destination, the role of improvements in the quality of tourism infrastructure and services and in the tourism educational system, the importance of research and development, of communication and IT systems, of international co-operation, of monitoring the tourism competitiveness and price/quality ratio, of sustaining a cluster-based development strategy and of promoting sustainable development.

An important part of the strategy is the <u>development of the infrastructure</u>. Although basic Travel & Tourism infrastructure in Romania is adequate, Romanian being crossed by three pan-European corridors, significant amount of modernization and upgrading is necessary to sustain growth and allow Romania to compete at global level. As the vast majority of Romania's visitors arrive by road, considerable funds have been allocated for the upgrading of the country's highways, including EU structural funds. In order to facilitate and increase visitor arrivals, the liberalization of the aviation sector will be pursued. The low-cost carriers have impelled the inbound tourism, but a negative impact on the tourism balance is that the outbound tourism has been spurred as well. Romania also benefits from extensive accommodation facilities, but there is a need for the standardization of the sector. As the MICE tourism has a great potential for growth, the promotion of this market has become one of the priorities of Romanian tourism.

As regards the strategy of sustainable development, the main directions followed by Romania were established by UN's Agenda 21. The Rio Declaration on Environment and Development, the Statement of Principles for the Sustainable Management of Forests and the Declaration of Quebec from 2002 were also in the attention of Romanian authorities on this purpose. As a member of EU, Romania will also become part of NATURA 2000, the EU network of protected areas and the principal instrument of ecological protection in the EU countries. Also, Romania ratified the Kyoto Protocol in 2001 and, in September 2005, Romania has become the 3rd country in the world to sign a Geo-Tourism Charter with National Geographic.

For the most part, widespread Internet usage has remained limited in the tourism sector. However, since 1998, an Internet-based reservation system has been in place, to serve the best hotels in the top sea and mountain locations. Romania has been included in the European Tourism Portal, which contributes to the increase of its international awareness as a tourism destination. The National Tourism Authority has also been improving its own online presence. Development of high-tech networks in the rural areas and the training of rural agents is a problem that can be tackled only in the long run. The leading international providers of electronic global distribution services have entered the Romanian market. In the period 2003-2005, the total number of e-bookings increased by 12% yearly in Romania.

Human resources play a crucial role in the quality of tourism services. In Romania, Travel & Tourism accounts for 5.8 per cent of the country's workforce. This amounts to some 485,000 jobs. Even if the sector becomes more sophisticated, growth of the T & T Industry in Romania will generate the creation of many lower-skilled jobs. There is still a need for improvement of the tourism educational system, in order to develop management and marketing skills of employers and employees. However, Travel & Tourism in Romania is seen as 'last resort' when it comes to a career choice, situation which reflects the low levels of motivation offered by the industry. There is a stringent need to develop the motivation system both in the private sector and in the government one, in order to attract highly-skilled professionals.

VI. Instead of conclusion

Looking forward

Opportunity	Method
1. Competitive Positioning	Examine destinations within Romania that incorporate its most engaging products and match these to markets, human resources, capacity limitations and investment requirements. Develop a strategy to brand an authentic "Old Europe" experience for some Romanian destinations. Expand services to meet higher value consumers.
2. Customer Focus	Develop better understanding of market trends and current and potential customers' requirements and develop a comprehensive strategy and common cluster actions for attracting them. Ensure that the necessary supporting factors are in place to support marketing to niche markets.
3. Innovation	Offer a greater mix of products including those that speak to particular niche market groups. Study market trends and employ cultural, historic and natural resources to access new market groups. Enhance the marketing of Bucharest and other big cities as a vacation gateway and business destinations. Develop themed packages based on cultural activities and regional tour routes.
4. Human Capital Investment	Work with training institutions to incorporate more updated and diverse curriculum offerings, especially in the area of hospitality training. Upgrade management training programs to modernize skills. Assist in the penetration of IT training and usage.
5. Cluster Cooperation	Stimulate greater inter-cluster cooperation, not only with supporting industries but also among direct partners, such as tour operators, trainers, etc. Stimulate regional cooperation among neighboring countries. Cultivate common interests among competitors.
6. Forward Integration	Work more closely with business partners and clients to clearly identify and effectively respond to their requirements. Provide new services based on customer requirements.
7. Strategies and Attitudes	Expand cluster advertising efforts for the entire industry. Take responsibility for the development of strategies and the search for investment opportunities. Focus on provision of higher end/value products and services.

In this paper, we analyzed the competitiveness of Romania as a tourist destination. Following the reference literature, we established four main groups of variables. On the basis of obtained empirical results, we revealed areas where improvements should be made to Romania as a tourist destination. The presented research represents only one single step in the analysis of the competitiveness of Romania as a tourist destination. We have listed some of the main dimensions and indicators only. There is a need to explore in more detail the importance of different attributes of destination competitiveness, in order to improve and maintain Romania's competitive position as a tourism destination on the international market.

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Mathematical formalism and significance in economics: a review of criticism

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The mainstream economics in both its micro and macro search for relevance in respect to people, organizations', and countries' behavior lays its analytical foundations on a rigorous set of methodological requirements.
It is the purpose of this contribution to enlist the main lines of attack against that widespread belief, as well as to provide a substantial discussion as to the extent of the use of mathematical formalism distorts the significance of economic facts. To that end, this material has made recourse to the existing literature and has organized it around two dominant points of argumentation. A first cluster of arguments has been gathered along the history of economic thought with regards to the quantitative adoption of formalism from the point the view of its economic relevance. A second view tackles the issue of alternative perspectives in order to find a way out toward economic relevance.
The reader is advised not to take this material as an exercise in refuting mathematical formalism in economics. Instead, its added value should reside in identifying the limits of formalism under those circumstances when the significance of economic analysis either becomes of no practical importance or assumes doubtful theoretical constructions.

Key words: *Formalism; Economic significance; Economic method; Modeling*

Introduction

The methodological debate in economics has never been deprived of radical attitudes from that of Samuel Bailey who argued that no economic phenomenon is conserved through time, and therefore scientific analysis is impossible (Mirowski, 1989, p. 399) at one extreme, to that of Paul Samuelson (1994) who said that "nothing would impede great leaps forward but some economists' poor knowledge in mathematics" at the other. A more moderate stance has been however embraced by those who see in the particularities of the every-day life the ferment or substance of the economic phenomena. By the 1880s, for instance, the German historicism held all economic generalizations to be relative judgments and, correspondingly, argued that each economic problem must be approached *de novo*. This recourse to realism finds its support in a long tradition of understanding economic life through its diversity rather than unifying correlations. This paper seeks to appropriately nestle the debate on formalism among those different views and find methodological arguments for the proper use of mathematics in revealing the relevant part of economic phenomena.

The current orthodox program in economics has been raised in piecemeal fashion on the building blocks of the marginalist revolution. Listening to its fathers would suffice to leave aside any scepticism. Take for instance the credo of W.S. Jevons (1871, *The Theory of Political Economy*): "Economics, if it is to be a science at all, must be a mathematical science…Our science must be mathematical, simply because it deals with quantities."; similarly, Walras (1900, *Elements of Pure Economics*) exposed its contempt for non-mathematical economics in clear-cut fashion: "As for those economists who do not know any mathematics, who do not even know what is meant by mathematics…let them go their way…They will always have to face the alternative of either of steering clear of this discipline…or of tackling the problems of pure economics without the necessary equipment, thus producing not only very bad pure economics but also very bad mathematics." (Both quotations come from Fullbrook, 2004: pp. 188, 209)

This self assurance has been preserved remarkably accurate in time (see Samuleson's position). Its assertiveness notwithstanding, a widespread criticism gets ever more consistent and visible. A failure to separate statistical significance from plausible explanation has been increasingly shown to produce from hilarious to pernicious effects. The Economist (2004) reports examples of both: "In medieval Holland, it was noted that there was a correlation between the number of storks living on the roof of a house and the number of children born within it. The relationship was so striking that, according to the rules of maths that govern such things, you could say with great confidence that the results were very unlikely to be merely random. Such a relationship is said to be 'statistically significant'. But the Dutch folklore of the time that storks somehow increased human fertility was clearly wrong. More recently and tragically, British mothers have felt the harsh effects of statistical abuse. An expert witness frequently called to give evidence in the trials of mothers accused of murdering their children argued that the odds of more than one cot death in a family were statistically so slim that three such deaths amounted to murder. On this erroneous evidence, hundreds of parents have been separated from their children and many others have been sent to prison."

The following arguments attempt to deconstruct this "cult of statistical significance" and distinguish between exaggeration and necessity in economic formalism. The mainstream economics in both its micro and macro search for relevance in respect to people, organizations', and countries' behaviour lays its analytical foundations on a rigorous set of methodological requirements. It has thus evolved not only as a quantitative science, but as an "exemplar of rationality" next only to physics (Mirowski, 2004: p. 170). It is the purpose of this contribution to enlist the main lines of attack against that widespread belief, as well as to provide a substantial discussion as to the extent of the use of mathematical formalism distorts the significance of economic facts. To that end, this material has made recourse to the existing literature and has organized it around two dominant points of argumentation. A first cluster of arguments has been gathered along the history of economic thought with regards to the quantitative adoption of formalism from the point the view of its economic relevance. A second view tackles the issue of alternative perspectives in order to find a way out toward economic relevance.

Another theme of criticism stems from outright flawed mathematics that is used to quantitatively underpin the economic modelling. From the monumental elaboration of Mirowski (1989) who shows the fatal mistakes in generating the equilibrium conditions to recent observations of outright mathematical errors which persist in economic analysis (Keen 2004) the economist is warned that the economics he is being taught may be not the one which he ought to become familiar with by means of a scientific method proper. However, this author is a non-mathematical economist who does not venture in discussing incorrect mathematics. There is still a wealth of evidence left to prove the point.

The problem of significance

A first hint comes from the scepticism which the very outstanding exponents of quantitative economics expressed at some point along their career, usually after being recognized for their prominent stature within the economics realm. The most notorious examples are John Hicks, John Maynard Keynes, Georgescu-Roegen or Joseph Stiglitz. A different blend of scientists is represented by those econometricians (Neyman, Pearson, Leamer) who always were aware of the limits to which formalism can be of any help to social sciences in general. All these intellectuals' recurrent theme sheds light on the meaninglessness which the modelling of economic phenomena bears for understanding of economic evolutions.

The discussion is timely as flawed causation among elementary economic variables virtually sets the scene for the basis of standard micro and macroeconomics. There are disparate observations which speak for serious, fundamental shortcomings of the conventional method of economics. Noteworthy remarks were uttered from the beginning of economic theory by outspoken economists like William Thomas Thornton who insisted that there were no such things as "laws of supply and demand" (Mirowski, 2004: p. 278) or Oskar Morgenstern who argued that "current theory possesses no methods that allow the construction of aggregate demand curves when the various constituent individual demand curves are not independent of each other" (Fullbrook, 2004: p. 75). In the same vein, modern economic literature witnesses incongruent discussions on fundamental themes of economic interest (Cojanu, 2003).

Several pioneering statisticians like Venn, Neyman, or Pearson long ago warned about the improper use of *statistical* significance of economic correlations for addressing issues of *economic* (substantive) significance. In statistical terms, significance arises when a characteristic of the population under observation may be taken for real (permanent) or is just attributable to chance variation. To put it differently, the significance level the economist chooses for his analysis is a matter of technical nature, of mathematics or statistics alone and may or may not have any policy relevance at all. It is so to be expected that statistical significance still be treated to be the same as economic significance. According to McCloskey and Ziliak (1996), the topic is still discarded by most leading readings in econometrics and worse still the distinction is not yet considered a topic of interest by several authoritative texts in statistics.

In spite of self-confident remarks as the one of Gerard Debreu in 1986 ("the development of mathematical economics was an irresistible current of thought"; quoted by Mirowski, 1991), it is interesting to note that juxtaposing *relevance* and *formalism* has not always seemed so "irresistible". There may indeed be observed a continuous line of mathematical expression in economics beginning with the works of Daniel Bernoulli (1738), but al least until the Second World War it seemed more controversial than evident that formalism dominance is the right methodological approach. As Mirowski (1991) remarked, the mathematical discourse from 1887 to 1924 as reflected in prestigious journals (*Revue d'Economie Politique*, *Economic Journal*, *Quarterly Journal of Economics*, and *Journal of Political Economy*) rarely devoted more than 5% of their pages to mathematical discourse. This may be due to a series of unrelated events which marked the emergence of economics as science[1].

First, doubts about the methodological validity persisted from the very beginning. Precursors in mathematical economics looked to the physics of motion, referred to as "rational mechanics" in the 18th century, to provide them with the analogies needed to guide them in their conceptualization of value. This brutal transfer of physics concepts resulted in the admission that the analogy between rational mechanics and the price system was flawed. That was the case, for instance, with Canard's (1801) attempt to assimilate market exchange to D'Alembert's Principle and the equilibrium of the lever. Similarly, William Whewell in 1831 admitted that his formalization of supply and demand bore a distant resemblance of the state of things produced by the perpetual conflict of such principles with variable circumstances, a theme which resonates from Cournot to contemporary writers with the same ardour.

Second, by the 1920s, few economists placed much credence in the concept of utility, "many mocked it openly" as the American Institutionalist School for example. Historians like Witold Kula (1986) were prompt to infer from observational data that standardized commodity measurements are a relatively recent phenomenon, becoming instituted long after market relations were prevalent. Measures did not exhibit the invariance required to constitute algebra as we know it; in many situations the money price was held invariant in order to carry out calculations, while the various physical measures of the commodities were altered in reaction to alterations in supply.

Third, in contrast to their precursors (e.g. Cournot), most of the second generation of neoclassical theorists were not as well-versed in mathematics or physics. "Bad

[1] The following historical accounts heavily draw on Mirowski (1991).

mathematics", it seems, is not such a rare occurrence in the body of the accepted body of economics. Keen (2004), Mirowski (1989) among others dedicate volumes to dismantle large parts of the accepted theory.

The late 19th century however set out "a state of cumulative self-assured internal development" of formalism in economics which never lost its pre-eminence from 1950s onwards anymore. After 1870, a critical mass of theorists trained specifically in physics, among them William Stanley Jevons, Léon Walras, Francis Ysidro Edgeworth, Irving Fisher, Vilfredo Pareto, each independently or not adopted the same mathematical metaphor – the equilibrium in the field of force – which equated potential energy with "utility" or "rareté" or "ophelimity". As documented by Mirowski (1989), the miraculous emergence of the neo-classical theory from so many independent contemporary economic writers cannot but be explained by the fact that they copied the physical mathematics literally term for term and dubbed the result *mathematical economics*. An even more substantial wave of trained scientists and engineers into economics – Ragnar Frisch, Tjalling Koopmans, Jan Tinbergen, Maurice Allais, Kenneth Arrow – fundamentally paved the way for what has come to be known as *standard economics*. Moreover, noted mathematicians such as John von Neumann, Griffith Evans, Harold Thayer Davis, Edwin Bidwell Wilson "were induced" to turn their attention to economics. They discovered that the corpus of neoclassical theory consisted largely of the formal models which they has already mastered in their earlier training in physics, with "the only difference being that the vintage of the model was clearly that of the later 19th century". Koopmans (1979), for example, explains: "Why did I leave physics at the end of 1933? Because of my reading block, I chose problems that, by their nature, or because of the mathematical tools required, have similarity with physics…What held me back was the completely different, mostly verbal, and to me almost indigestible style of writing in the social sciences." (quoted in Mirowski, 1991)

The new economists however distinguished themselves first and foremost in their familiarity with a new blend of formalism; one based on more up-to-date mathematical techniques such as stochastic mathematics, mathematics of vector fields and phase spaces, linear algebra and constrained optimization. Gerard Debreu in 1984 made the suggestive remark that "the fact that commodity space has the structure of a real vector space is a basic reason for the success of the mathematicization of economic theory" (quoted by Mirowski, 1991). Undoubtedly, as some authors (e.g. Piermartini and Teh) remark, an additional factor which underpins the present dominance of formalism consist of the increased computational and data processing power of computers that have only eased the way the exercises in quantification may be further pursued, but only sticking to the same methodological vulnerabilities. Unless one unnecessarily blurs the distinction between formalism and relevance, it is convenient to pick up two broad directions of mathematical formalism – statistics and modelling – that correspond to the logical foundations of the conventional way of thinking, inductive and deductive reasoning, respectively. The remaining of this section discusses them in turn.

F.Y. Edgeworth in 1885 and John Venn in 1888 are mentioned (McCloskey and Ziliak, 1996; Ziliak, 2004) to have coined first the term "statistical significance" by referring to the division between errors in sampling and what matters form the point of view of economic facts. "Significance" in a statistical context was thus understood in the sense "that we may be tolerably confident that if we took another similar batch we should find a similar difference." In 1933, Neyman and Pearson wrote about the consequence of error in terms of type I and II errors. In their view, mathematical theory show how the risk of errors may be controlled and minimized in a purely technical investigation. This latter qualification was especially introduced for a discussion on the use of these statistical tools in social context. "To convict an innocent man or to acquit a guilty" just hangs on the investigator's perception.

Karl Popper in his *Logic of Scientific Research* added a new element embedded in the principle of *verifiability* to this methodological discourse. The researcher should be prepared to see proofs that dismiss her beliefs (King, 2005: p. 258), to get through the opportunity to deny a systematic relation given that there will always be practically impossible to test all cases. "Is there a pattern or is it just random?" are the interrogative questions of what come to be known as inferential statistics. The scientific character of economics depends on this *inferential* argument (Harberger, 1993) whose absence deprives disciplines such as accounting or lay of any scientific component. The inferential logic allows us to ascertain that the result is significant only if we show that rejecting it is statistically highly improbable (King, 2005: p. 271). The formalization of error so began in the early 20th century by being absorbed in the theory of probability (Mirowski, 2004: 170) and further conceptualized within the discipline of statistics.

Though this distinction leaves things unchanged from a practical point of view (it does not require any recourse to or supplementary treatment of observational data), it imposes a definitive reference to think of differences between sample and population as statistically significant or insignificant. The literature (e.g. Cooper and Schindler, 1998: p. 467; Mirowski, 2004: p. 331) emphasizes two dominant accounts of the treatment of error: the theory of Neyman-Pearson hypothesis testing and the Bayesian theory of subjectivist probability assignment. The first in known as classical statistics or sampling-theory approach: decision making rests totally on an analysis of available sampling data; a hypothesis is established (the null hypothesis), it is rejected and its alternative is accepted or fails to be rejected, based on the sample data collected. Bayesian statistics go beyond sampling data and consider all other available information (subjective probability estimates stated in terms of degrees of belief, based on general experience). The latter usually receives less consideration in economic research because of both its more intricate mathematics and stronger assumptions (in the Bayesian tradition everyone must form identical probability assignments to be 'rational').

A difference has statistical significance if there is good reason to believe the difference does not represent random sampling fluctuations only. Has it any practical significance? The statisticians answer in two steps. First, one has to choose a certain "level of confidence" to distinguish randomness from significant. Ronald Aylmer Fisher (1890-

1962) wrote in 1925 about the first test of significance in his *Statistical Methods for Research Workers* which is now known as "the rule of 2". He explained: "the value for which P=.05, or 1 in 20, is 1.96 or nearly 2; it is convenient to take this point as a limit in judging whether a deviation is to be considered significant or not. Deviations exceeding twice the standard deviation are thus formally regarded as significant." (quoted in Ziliak, 2004) So, if a false indication appears only once in 22 trials one has a "standard of convenience" to verify the hypothesis. The most common level of significance is 5% (95% certainty), although 1% is also widely used, and is largely determined by how much risk one is willing to accept. For instance, the US State Supreme Courts have a standard measure of confidence of a 5% level [of Type I error] for justice cases (Ziliak, 2004).

A second step is to associate a level of risk with errors. There are two potential sources of mistakes (Yeomans, 1968: pp. 69-70), which may be based on relative monetary costs: Type I error is an error of commission; it occurs when action is taken incorrectly or unnecessarily. The null hypothesis actually holds true, but the study says otherwise. Type II error is an error of omission; it occurs when one fails to take some necessary course of action. The null hypothesis does not hold true, but the study rejects the alternative hypothesis. The researcher's task should be "to balance [the risk level associated with a type error] so that they reflect the consequences of the two wrong decisions". Ideally, the best situation is where $\alpha = \beta = 0$.

Accepting the null hypothesis may be reasonable or unreasonable, but it depends on economic context as the two anecdotes extremely show. King (2005: pp. 279-80) warns against taking "statistically significant" for true but if the result seems unreasonable advises to specify a better model. Few econometrics textbooks in fact distinguish economic significance from statistical significance. The only kind of uncertainty the test of significance deals with is the sampling error. "Low uncertainty" stands for "significant" but it does not answer the question how important the variable is. As McCloskey and Ziliak (1996) note, when the *t*-tests first reached the masses between 1975 and 1979 separating statistical significance from other kinds of significance was almost inexistent in the papers authored by Ph.D.'s conferred by that time and few changed in the meantime. According to the evidence they gather, in the 1980s and the 1990s between 70% and 80% of the empirical papers in the *American Economic Review* did not distinguish statistical significance from economic, policy, or scientific significance. They relied too much on numbers, and too little on economic reasoning. 72% of them did not ask "How large is large?" that is, after setting on an estimate of a coefficient, 72% did not consider what other authors had found; they did not ask what standards other authors have used to determine "importance".

A different mix of mathematical formalism emerges from efforts to apply general laws of behaviour like market models to economic phenomena. Here the discourse gets more sophisticated for a non-mathematical economist because the frequency of *incorrect* modeling seems more plausible. However, one cannot help observing the obvious. Keen (2004), for instance, following Anwar Shaikh, discusses the Cobb-Douglas production, function a tenet of neoclassical economists and remarks that the function is simply a transformation of the national income identity according to the following comparison, under conditions of relatively constant income shares and where Q, Production, L, Labour, K, Capital, A, α, β positive parameters.

The national income identity	The Cobb-Douglas production function
$Income = Wages + Profits$	$Q = A\, K^{\alpha}\, L^{\beta}$

The deceptively obvious consists in showing a powerful model of economic growth only because it is a correlation of X with approximately X.

However, the most frequent problem of modelling remains its strong underlying assumptions which deprives the analysis of any significance. Rational behaviour seems a particularly strong assumption. Derivation of demand curve, for example, implies similar preferences irrespective of income category. Under these circumstances, there is an inherent difficulty in expressing in mathematical terms the context of choice. In a discussion of what are known as the 'Sonnenshein-Mantel-Debreu' conditions, Keen (2001) notes that a number of 'conditions' which economists impose upon their models are actually 'proofs by contradiction' that their theories contain errors. Microeconomics foundation says that, in order to be able to aggregate the individual utility which different consumers derive from consuming different commodities: (a) all consumers' indifference curves must have the same slope; and (b) the slope must be such that spending doesn't change with income. But condition (a) means that all consumers must be identical—so that there is really only one consumer. Condition (b) means that all commodities must be identical—so that there is really only one commodity. This means that utility *can't* be aggregated across different consumers and different commodities—it is a 'proof by contradiction' that what economists are trying to do is impossible. As Mirowski (2004: p. 330) comments, "if Walrasian general equilibrium cannot guarantee uniqueness and stability of equilibrium except under unrealistic circumstances, then these economic laws don't operate in general the way their neoclassical advocates suggest."

In this case, significance or lack of is visible in the series of numerical computation for policy practitioners. The computation appears in the form of a general or partial equilibrium analysis and accounts for all or part of the links between sectors of an economy - households, firms, governments and countries. It imposes a set of constraints on these sectors so that expenditures do not exceed income and income, in turn, is determined by what factors of production earn. These constraints establish a direct link between what factors of production earn and what households can spend. For partial models, it is further assumed that the impact of that sector on the rest of the economy and vice versa is either non-existent or small.

Some unrealistic representations of economic life are encapsulated by the very construction of the model: the puzzling absence of "finance" in an increasingly global world; the high level of aggregation required to be able to use comparable and consistent data; or the difficulties in the specification of parameters and functional forms in the model.

It should be so no surprise that the results significantly diverge from representing a true understanding of economic phenomena. Piermartini and The (2005) admit that "the numbers that come out of the simulations should only be used to give a sense of the order of magnitude that a change in policy can mean for economic welfare of trade." Even by this modest yardstick, the results are hardly relevant. They survey various applications of analytical techniques of Computable General Equilibrium (CGE) and gravity models and find controversial results. Some papers generate simulations which show welfare losses from agriculture liberalization; one other paper shows that trade reform can have quite opposite welfare effects on developed and developing countries; in three other simulations, agriculture is the sector where the greatest welfare gains are derived. These results suggest again that differences in assumptions, in this case about market structure and the presence of scale economies, reflect a huge discrepancy between the impersonal world of models and conditions of actual human and social behaviour (see also Rodrik, 2005).

Alternative views to formalism

In light of these vulnerabilities, there have lately been many attempts to rescue formalism from its demise. A clear awareness of its irrelevance has only worsened its status. Harberger (1993) favours an approach between science and prescription, "one foot planted in science, the other in the practice of that science" in contrast to the methodological discipline of pure sciences like chemistry or physics. His perception is based on a large educational survey applied to American population that signals worries only muted so far in the orthodox economics:

- Both faculty and recent Ph.D. respondents believed mathematical and statistical tools were overemphasized;

- Only 14% of faculty members could say that by the time students completed their comprehensive examinations, most of them or all of them were good at applying theory to the real world;

- About 80% of faculty respondents call for less theory and technique, the most frequently suggested changes include more emphasis on the links between theory and real-world connections and applications.

In his view, the implication is that probably 90% of policy practitioners have to be able "to think on their feet, to know simple tools and how to use them well." The reality a policy practitioner should perceive appears like "more or less OK", "caution" or "danger". The method of economic analysis should give a sense of "the nature and source of the trouble", of "what is normal and what is not". A suggestion consists in collecting data for a large number of countries, going back where feasible for about 30 years on a vast array of subjects such as monetary and banking institutions and magnitudes, national income and product accounts, trade and the balance of payments, prices, wages, interest rates, and exchange rates. Though a definitive split with the orthodox methodology is hardly recognizable, Haberger insists that "formalism should be taught as a 'door-opener', to be followed by a demonstration of its massive failure to explain the facts of the last century or so, to be followed in turn by an explanation of some of the more plausible reasons for this massive failure."

This sort of methodological intervention is better known as the principle of minimalism: methodological simplicity, not methodological overstatement. It is in fact an interchange between two types of researchers, A and B: A introducing a more complicated methodology which appears to be needed in order to accomplish the objective at hand, and B responding that A missed a particular trick and showing that A's task could still be performed in a very simple framework.

This approach is not singular. In a different form but similar mindset, McCloskey and Ziliak (1996) try to understand the link between economic relevance and scientific success, or in their words, between statistically significant coefficients and clever common sense, elegant theorems, new policies, sagacious economic reasoning, historical perspective, relevant accounting.

Some other authors explore a modern symbiosis between mathematical formalism and some sort of instrumental institutionalism. For instance, Mirowski (1991, 2002) begins from the understanding that algebra is necessary to describe modern market activity because the market structures have historically evolved to the point where its formalism patterns reify the impersonal character of appropriation. He explains: "this has absolutely nothing to do with 'equilibrium' or any other metaphor borrowed from physics…Prices conform to specific algebraic structures, but they are not the *a priori* products of nature or of the individual mind, rather, they are provisional invariances imposed upon the motley variety of human perception by various conventions and social structures."

Concluding comments

The formalism of orthodox economics seeks event-regularities *per se* in an effort to resemble (pure) science. It proposes a unifying framework of economic endowments and constraints that is amenable by its very quantitative nature to mathematical treatment. This material argues that in doing so the current orthodoxy escapes for its large part the economic significance of the phenomena under observation. The identification of the underlying mechanisms especially where correlations are not to be found remains the unresolved methodological problem in economic analysis.

The normal line of criticism follows the problem of juxtaposing the issue of *practical* significance with the one of *theoretical* validity. It is recognized here that this treatment is much less elaborated and laborious work is still needed in order to validate the analytical treatment of causation in economics.

The reader is advised not to take this material as an exercise in refuting mathematical formalism in economics. Instead, its added value should reside in identifying the limits of formalism under those circumstances when the significance of economic analysis either becomes of no practical importance or assumes doubtful theoretical constructions.

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International Tourism and Oil

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Although oil prices rose rapidly in the last years and continued into 2006, a UNWTO study concluded that the impact on tourism was limited. Firstly, when the increase is analyzed in light of previous oil crises in constant US dollars or constant euros, it suggests that oil prices are catching up with inflation, rather than speeding ahead of other price indices. Secondly, the rise in oil prices has had limited impact on tourism prices. In 2004, 2005 and further in 2006, increases in the prices of tourism products and services have not been significant enough to influence consumer behavior. It seems that airlines absorbed the extra burden and did not pass on the full increase in cost to passengers for fear of losing customers in a very competitive market.

The rise in oil prices, accelerated considerably in 2005, has come in a context of multiple crises and uncertainty, with the wars in Afghanistan and Iraq, the rise of terrorism (e.g. the recent attacks in London and Bali), natural disasters (Hurricane Katrina and the earthquake in Pakistan), and the threat of a bird flu epidemic. In such a context, these risks could accumulate and create an economic and political climate of a nature to jeopardize a number of advances made in world tourism development, and in particular continued growth in international tourism demand. In view of these uncertainties, it is fundamental to assemble the capacity to analyze and diagnostically assess the current impact of rising oil prices on tourism with a view to proposing measures to consolidate the basis for current growth in tourism flows and contend with the consequences of successive oil price increases and the recent proliferation of crises.

The price of oil reached the historic level of US$ 70.85 per barrel in New York on 30 August 2005 (the average price was only US$ 13.11 in 1998). In view of this accelerating trend, questions have been raised about the current and future effects of very high oil prices on international tourism and on one of its major components, air transport.

Statistical analysis of oil price increases in nominal and real terms

Every oil shock has two contradictory effects: inflationary (on the supply side by raising business costs, particularly for transport); and deflationary. Tourism is right in the middle of these competing forces. Oil shocks have until now resulted from market tensions between strong demand and political crises in the Middle East, which can momentarily interrupt supplies. The economic consequences of these distortions can be considerable: the first two oil shocks in the 1970s and 1980s led to severe inflation followed by a rapid rise in interest rates and a collapse in growth rates for crude oil importing countries.

The current situation is very different, for two reasons:

• First, the recent rise in demand is not a temporary phenomenon. It mainly reflects economic growth in the emerging countries –starting with China, whose annual growth rate of more than 9 per cent accounts for more than 40 per cent of the increase in world oil production and sales. China has become the world's second largest importer of oil, after the United States. Certain forecasts to the contrary, China's economic growth has not weakened (the IMF's latest growth forecasts have just been raised from 8.5% to 9%) and has been accompanied by strong growth in South-East and South Asia. In the latter region, India has substantially increased its imports of oil products. It is also emblematic of this trend that Indonesia, a major producer, became a net importer of oil in 2005.

• Second, on the supply side, oil supplies from the Middle East have not been interrupted.

On the other hand, instability in Iraq, recurrent tensions in Nigeria, and certain exogenous shocks –such as Hurricanes Katrina and Rita, which damaged production and refining facilities in Louisiana– have fuelled speculation in the markets. As a result, growth in supply could prove chronically inadequate to meet increases in demand –particularly considering the countries that once exported oil and that now have become importers– and the fact that reserve estimates for the world's largest producer and exporter, Saudi Arabia, could be revised downward.

Under these conditions, according to the Centre for Global Energy Study (CGES), the chances of a significant rollback in prices during the next two years are minimal. Additional pressure is expected to come from decisions by oil consuming countries to replenish, and by China to create, strategic reserves. For these reasons, the impact of rising oil prices on international tourism should be analyzed in terms of a scenario of high prices for the near and even medium term. This price increase, however, cannot be fully understood in terms of current dollars or euros alone. When we look at the rise in current prices, we have to distinguish between what amounts to a form of "catch-up" –particularly relative to inflation rates– and increases directly attributable to tensions in the oil markets. To appreciate the effects of rising oil prices on tourism flows, it is therefore useful to compare movements in current dollars and constant or real dollars. It is also important to compare movements in constant dollars with movements in constant euros. Hence, the following sections will cover:

• Oil price movements in current dollars.

• Oil price movements in constant dollars.

• Oil price movements in constant euros.

Oil price movements in current dollars

The price of oil has increased more than six times in six years. The price per barrel barrel.., which averaged US$ 9.40 in December 1998, rose to US$ 60 in October 2005. These crude prices have well surpassed the record levels of the Gulf War or the second oil shock, when crude prices momentarily pierced the US$ 30-per-barrel level.

Unlike the other oil shocks, however, this increase in prices has been more gradual, and above all, more lasting:

An analysis of oil price movements in current dollars shows that the rise has extended over a longer period of time than during the two earlier most comparable shocks. In addition, the downward price correction observed following earlier shocks has failed to materialize; just the opposite: prices have held at a new plateau, well above US$ 50 per barrel.

Comparison with earlier oil shocks

A comparison with earlier oil shocks shows that the latter have thus far done very little to

affect continuing growth in world tourism. Where tourism has been affected negatively by the shocks, however, has been in terms of what inflation, high interest rates, and slower economic growth have done to diminish purchasing power.

Today, the effects of oil shocks on tourism are more indirect than direct.

World tourism flows are more directly affected by declining economic growth rates in the importing countries, as a result of increased oil prices. Slower economic growth is accompanied by reduced purchasing power, which in turn dampens consumption, including the consumption of tourism products.

That was the case in 1982, when international tourist arrivals stagnated (-0.5%) and receipts declined (-2.3%, local currencies, constant prices). Similarly, when economic growth faltered in 1993, particularly in Europe, growth in world tourist arrivals as well as receipts declined significantly.

Today, in certain "mature" generating countries the consumption of tourism products, relative to income is somehow, incompressible. Consumers prefer to reduce some items of expenditure such as clothing or more durable goods as furniture, rather than forego their planned tourism trips. Consequently, a sharp decline in international tourism demand is very unlikely. However, transfers among countries as well as regions tend to develop.

It is particularly interesting to note that from 1990, the year of the oil shock, to 1993, international tourist arrivals increased by more than 12 per cent. The region benefiting most from this increase was Asia and the Pacific.

Analysis of short-term effects 2000-2005

Unlike the earlier oil shocks, the rise in oil prices from 2000 to 2005 was not abrupt but gradual, coming in stages spread over the entire period. On the other hand, a "ratchet effect" was observed: prices rose in successive stages without ever actually decreasing. Most importantly, all indications suggest that this trend will not be significantly reversed: oil prices should remain high over the medium term because demand in America and Europe is still so great, and demand in countries like China and India, now major consumers as well, is growing so rapidly.

Analyzing the short-term effects, and taking into account the new trends in tourism demand in different regions (particularly to and from the Middle East), we see that international tourism flows do not appear thus far to have been affected by oil price increases. One of the reasons for this unusual situation is the limited impact of higher crude prices on other links in the tourism chain (apart from transport), particularly in terms of hotels and other forms of accommodation, including cruise ships.

Impact from the present increase in oil prices has come in three distinct phases:

The lasting effects of this new oil shock can be analyzed in terms of the aforementioned three phases –2000-2003 (phase I), 2004 (phase II) and 2005 (phase III)– as follows:

Phase I – 2000-2003: moderate rise in oil prices and slowed growth in tourism flows

A number of circumstances distinguished this phase from the earlier oil shocks: Between

2000 and 2003, the increase in oil prices was moderate and highly irregular: from US$ 25.20 in 2000 to US$ 28.60 in 2003. During the same period, there was a clear slowdown in international tourist arrivals, with growth of only 1.1 per cent between 2000 and 2003 resulting, in particular, from the economic situation and the consequences of SARS in Asia, the war in Iraq, and the heat wave in Europe during the summer of 2003.

Indicators 2000, 2002, 2003

Indicators		2000	2002	2003
OIL:	Price per barrel (US$)* Variation (%)	25.2 +3.4%	26.7 +5.9%	28.6 +7.3%
TOURISM:	Arrivals (millions)** Variation (%)	689.1 + 7.4 %	708.9 + 3.0 %	696.6 - 1.7 %

Source: *Price in December: IRAC Refiner Acquisition Cost of Imported Crude Oil, US Energy Information Administration. **International tourist arrivals, World Tourism Organization (UNWTO).

An analysis of trends in international tourist arrivals reveals that:

• The Middle East is the only region where international tourist rivals have continued to increase rapidly from 2001 to 2003, with an increase of nearly 20 per cent in three years. In 2000, the region's good performance results in part from celebration of the Holy Land Millennium. The positive effect ended with the start of the new *Intifada* in September. The growth since 2001 can be attributed to increasing intraregional flows, which in turn resulted from two factors: an increase in purchasing power for consumers in the region, owing precisely to the rise in oil prices; and the increased difficulty for Middle Eastern residents of traveling long distances, owing to the obstacles (visa requirements, etc.) put in place notably by the United States, which have discouraged travel outside their own region.

• In Europe and Africa, tourist arrivals stagnated from 2001 to 2003, before recovering in 2004.

• The Americas and Asia and the Pacific saw a slight decrease in tourist arrivals from 2001 to 2003, following the drop in economic growth rates in 2001 (only 0.7 per cent for the OECD countries), followed by strong recovery (with 3 per cent growth) in 2004. Arrivals during this period were also seriously affected by September 11 and the SARS epidemic in 2003.

Thus far, Asia and the Pacific and the Middle East appear to be the main beneficiaries of the evolving international tourism demand.

Trends in world tourism 2001-2004

International arrivals (millions)

Regions	2001	2002	2003	2004
World	*688.5*	*708.9*	*696.6*	*766.1*
Africa	28.9	29.5	30.7	33.3
Americas	122.2	116.7	113.1	125.8
Asia-Pacific	116.6	126.1	114.2	145.4
Europe	395.8	407.4	408.6	425.6
Middle East	25.0	29.2	30.0	35.9

Source: World Tourism Organization (UNWTO)

Phase II – 2004: accelerated rise in oil prices and strong recovery of growth in world tourism. In 2004, the rise in oil prices accelerated significantly, reaching US$ 34.30 in December 2004. On the other hand, the stagnation in world tourism flows gave way to a brisk recovery, with growth of nearly 11 per cent for 2004.

Indicators		2004
OIL:	Price per barrel (US$)* Variation 2003/04 (%)	34.32 +19.8%
TOURISM:	Arrivals (millions)** Variation (%)	766.1 +10%

Source: *Price in December: IRAC Refiner Acquisition Cost of Imported Crude Oil, US Energy Information Administration. **International tourist arrivals, World Tourism Organization (UNWTO).

From the standpoint of regional trends, Asia and the Pacific, with the SARS episode behind it, experienced strong growth in 2004, with 31 million additional tourist arrivals, accounting for nearly half of worldwide growth that year. The rise in oil prices, therefore, in did not prevent a strong recovery in world tourist flows thanks in particular to strong growth throughout Asia, not only in China.

Phase III – 2005: a new and apparently lasting oil shock, increased air fares and

uncertainties about future tourism flows

The earlier oil shocks created inflationary tensions, a rise in interest rates, and a drop in

economic growth rates. This time the situation has been different.

The latest oil shock, marked by accelerating price increases in 2005, comes in a more favourable microeconomic context, which has tended to limit its adverse effects.

• ***From the standpoint of inflation,*** the spike in oil prices has not created inflationary tensions in the OECD countries, as it did 25 years ago when prices rose in most European countries by more than 10 per cent per year. The first troubling signs of returning inflation, however, have already been observed in the United States, where consumer prices surged by 1.2 per cent in September following hurricane Katrina, contributing to an annual inflation rate (from September 2004 to September 2005) of 4.7 per cent. According to the US Department of Labor, some 90 per cent of this increase is attributable to oil and gas prices, which rose by 54.8 per cent in one year.

These inflationary tensions are particularly acute in a number of emerging countries.

Under these conditions, the current oil shock appears to be affecting economies differently, and especially the old vs. the new industrial countries. The impact on international tourism flows is obvious, notably in Asia, where intra-regional demand is key to growth in tourism flows. And yet, the competitive pressures of globalization do not allow companies to set prices so as to recover all of their increased energy and raw material costs.

Historical and projected economic growth rates 2005-2006

According to the latest IMF estimates, the negative impact of rising oil prices on economic growth should be limited in 2005 to only -0.2 per cent to -0.3 per cent for the European Union and -0.8 per cent to -1.1 per cent for the NIC in Asia, where growth is more dependent on oil. Given these data, which underlie the current economic growth, it is not surprising that the trend in 2005 has been continued growth of roughly 5 per cent in international tourism flows. According to the UNWTO World Tourism Barometer, tourism demand grew during 2005 at an annual rate of 5.9 per cent, on pace –even with the slowdown expected late in the year– to surpass the record level of 800 million international tourists worldwide, almost certainly in 2006.

INDICATORS		2005
OIL:	Price per barrel (US$)* Variation 2004/05 (%)	56.4 +64.2%
TOURISM:	Arrivals (millions)** Variation (%)	800 / 825 +5% / +6%

Source: *Price at 18 November 2005, WIT, New York. **Estimate based on the 5.9 per cent increase recorded for the first half of 2005 (UNWTO World Tourism Barometer, October 2005

As a result, the consequences of the oil shock of 2005 on tourism have thus far been very

different from those recorded following earlier oil shocks. This time, the world economy has been relatively unaffected by, and has become more independent of, energy price increases, which in real terms have served largely to catch up to the rate of inflation.. From this point of view, the tourism sector should not be adversely affected so long as the world economy continues to grow by more than 4 per cent per year. This does not mean, however, that certain components of the tourism sector, starting with air transport, have not been severely affected already.

Evaluation of the impact on air transport

Transport, and air transport in particular, is currently the link in the chain of tourism products most perceptively affected by rising oil prices. IATA's latest statistics indicate that the impact of rising fuel prices has already been significant in 2005, but the organization's forecasts through 2007 are relatively optimistic.

Although it is not taxed, kerosene has become the airlines' highest operating cost, now accounting for 20 per cent of all direct and indirect operating costs (having generally accounted for 10-12 per cent in the recent past). Under these conditions, the impact of oil

price increases on air transport is highly significant, with four main consequences:

• The establishment of strategies for coverage and the introduction of oil surcharges.

• Further deterioration in the situation of major US airlines.

• Particularly adverse effects in the developing countries.

• Possibly continued fragility in the growth of low-cost airlines.

Hedging strategies and the introduction of oil surcharges

The major airlines have adopted a two-pronged strategy for contending with oil prices in purchasing kerosene: hedging or forward transactions to provide cover against anticipated

fuel price increases; and wider use of oil surcharges on current air fares according to changes in price. For such European airlines as Air France/KLM and Lufthansa, surcharge coupons have been used in amounts of about US$ 10 for short-haul carriage and more than US$ 40 for long-haul carriage.

It should also be noted that airlines receive a significant share of their income in euros, whose exchange rate against the dollar has until now been rather favorable. Tour operators, which through charter companies also act as air transport operators, tend to adjust their package prices to reflect surcharges on the air transport component of their operations.

The large US air carriers: from bad to worse

In early September, at a time when two major airlines, United and US Air, were already in bankruptcy proceedings, Delta and Northwest Airlines also entered into default and sought protection under Chapter 11 (bankruptcy law). The situation is directly attributable to the rise in oil prices. Delta's and Northwest's fuel bills, having ballooned by more than 50 per cent in one year, account for more than 20 per cent of their operating costs, leaving both companies unable to service their debts (US$ 29 billion in the case of Delta and US$ 18 billion for Northwest). The impact of rising oil prices has been much greater on American than on European and Asian companies because of their inadequate hedging cover and rigid salary costs, which for Delta account for up to 45 per cent of all costs. These companies had also suffered the full brunt of collapsing domestic and international demand for air transport in the wake of September 11, 2001. In addition to this initial handicap, one of the main immediate consequences of the current oil shock has been to make the major American carriers extremely vulnerable, with potentially major implications for the tourism sector should some of them disappear. It should be recalled that Delta is currently the leading air carrier over the North Atlantic and plays an essential role in tourism flows between Europe and the United States. Delta's difficulties could also have consequences for its partnership in Skyteam with Air France and KLM.

The impact on independent air carriers in the developing countries

In view of their cost structures, a certain number of airlines in the developing countries are virtually unable to continue operating. In September 2005, for instance, companies like Djibouti Airlines saw their fuel costs rise to more than 40 per cent of their total operating costs, compared with the usual ratio of 12 per cent or 15 per cent. A company as dynamic as Qatar Airways is no longer making profits. Accordingly, any new increase in kerosene prices must automatically be passed on to fares if flights are to remain financially viable. The result has been a significant increase in airfares that has directly affected the prices of tourism products, penalizing long-haul carriage while favoring domestic and regional tourism in the developed countries.

One of the short-term risks created with the increase in oil prices is that the frequency of tourist visits to some of the developing countries, and in particular the Least Developed Countries (LDC), will decline as the price increases, making their tourism products less competitive with other destinations geographically closer to the major generating markets.

Continued, possibly more fragile growth for low-cost airlines

It should be noted that most low-cost airline have decided not to apply the surcharge, even though they suffer the effects of rising fuel prices more than the major airlines, which tend to benefit from forward market transactions. And yet, the growth of low-cost airlines, unlike that of most of the traditional carriers, does not appear to have been affected by the increase in fuel costs. For example, their market share in Spain, one of the major tourism markets for air transport, grew by 33 per cent in one year, with 14 million passengers and 29.2 per cent of the total traffic in 2004. During the same period, regular carriers suffered a decline of -1 per cent. The situation may appear surprising in that fuel represents one of the few costs that low-cost airlines cannot do much about, other than using a new generation of more fuel-efficient aircraft. Indeed, fuel represents a costlier item within their cost structures than those of the regular carriers, which have been unable to reduce their structural, administrative and commercial costs to the extent that the low-cost airlines have. *Thus, many of the smaller low-cost airlines could be significantly affected by increased oil prices, although a small number of them have sufficient capital and market share to resist the current rise in oil prices: Southwest, in the United States; Air Asia, in Asia; Ryanair, in Europe. Ryanair's share capital, for instance, largely exceeds that of Air France/KLM or Lufthansa – with less than one-tenth of their annual sales.*

An analysis of regional scenarios indicates that rising oil prices have not had a negative impact in certain countries, where surplus purchasing power has permitted strong growth in tourism activity:

The Middle East benefits directly in terms of greatly enhanced purchasing power as a result of increased oil export receipts. A new element in the international tourism panorama is the expansion of intraregional tourism and air transport, especially in the Gulf region. Tourism demand originating in Saudi Arabia, Kuwait, and the Emirates, is for travel to Jordan, Dubai, Sharm-el-Sheikh, Cairo, or Istanbul. With a rise of 7.8 per cent in tourist arrivals during the first seven months of 2006, growth in the United Arab Emirates, and Dubai in particular, exceeded the world average. The figure for Egypt was 13.1 per cent. In addition, the mechanisms for recycling petrodollars have changed, such that more of the additional receipts generated by rising oil prices tend to remain in the region, as leisure-oriented real estate investments (tourism and hotel complex construction projects, such as the artificial islands in Dubai and Qatar).

Europe benefits to some extent from growth in domestic and intraregional tourism. The oil surcharge for air transport is already perceptible and tends to favor short-haul travel. Some of the Mediterranean destinations, moreover, are benefiting from new customers with increased purchasing power from Eastern Europe, and in particular the Russian Federation.

This is the case for Turkey, where international tourist arrivals increased at an average annual rate of 23.2 per cent during the first seven months of 2006. Growth is strong in Croatia (7.9%) and Spain (6%), as well. The Eastern European countries have also benefited from continued growth in tourism as a result of EU expansion to 25 member countries and the future membership of Bulgaria and Romania. Mediterranean Europe, and Italy in particular, have suffered from the Euro zone's weak economy and the lifeless tourism generating market in Germany.

Africa Many African countries, and particularly the more advanced, oil-importing countries, bear the full brunt of rising oil prices. Thus far, however, growth in the main tourism receiving countries in Africa has remained strong, thanks in particular to cooperative behavior from the euro, given the region's fundamental dependence on West European generating markets. From January to July 2006, the annualized growth rate for international tourist arrivals was 9.9 per cent in Tunisia, 7.2 per cent in South Africa, and 6.2 per cent in Morocco. The chilling effect of the attacks in Djerba and Casablanca appears now to have been forgotten.

The Americas and the Caribbean islands in particular, enjoy the benefits of proximity to US and Canadian markets, but their greater distance from European markets has become a handicap, partially offset by a strong euro. The region has been helped by its largest economies (Brazil, Argentina, Venezuela), which are now performing well, having stabilized politically and maintained strong raw material export levels. Accordingly, the region as a whole has thus far not suffered significant detriment from the oil price increases. Growth in international tourist arrivals has been particularly strong in the United States, the region's leading destination, at 7.8 per cent, thanks in particular to a favourable euro/dollar exchange rate, which has partially offset the oil surcharge on trans-Atlantic air travel.

Asia and the Pacific Pacific, now the world's second-largest tourism region, has seen continuing growth still well above the world average: 8.7 per cent on average for the first seven months of 2006. The countries of northeast and southeast Asia in particular have been less vulnerable to oil price increases because they have diversified the composition of their international tourist clientele, including regional as well as intercontinental travelers. These destinations could therefore benefit from increased clientele from distant markets (Europe, North America), as well as from regional (NIC, Japan) and domestic markets (particularly in such cases as China, India, Indonesia, and Thailand).

May. The growth rate in Oceania (5.9%) has been considerably lower than in the Asian countries. Given their greater geographic distance from such major generating markets as Japan and the Republic of Korea, the Oceanic countries have borne more of the brunt of rising fuel prices.

In conclusion, the analysis of the current and potential impact of rising oil prices on international tourism flows suggests that certain segments of the tourism and transport sectors are suffering more than others. The airlines, cruise lines, and tour operators specialized in long-haul travel are suffering more from repeated oil price increases than business travel domestic tourism, cultural tourism, sports and health activities, short-stay tourism, rural tourism, or some of the cruise lines. The available information indicates that some of the trends observed after the attacks of September 11 and the climate of insecurity that ensued should be accentuated by the impact of current oil shocks on world tourism. This refers in particular to a wide range of technological innovations and new patterns of tourism consumption behavior, designed to "offset" the increased cost of travel and tourist stays.

The following trends in particular should continue if not accelerate:

• *Reduced duration of business travel* and the development of meeting and seminar facilities in airports.

• *Greater use of the Internet* for the organization of personal and business travel.

• *Proliferation of last-minute sales* as well as discounts and promotional fares.

• *An increase in short distance travel* by surface transport for weekend stays, accentuating the fragmentation of annual holidays.

• *Development of trips centred on ecotourism* and discovery of the natural environment (hiking trails, VTT, cycling excursions) as well as pilgrimages on foot (the St. James Way).

• *"Do-it-yourself", independent travel*, with tourists assembling their own travel packages.

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World Tourism Organization „Market Intelligence and Promotion”, Special Report number 26/ 2006

IMF: Statistics

What Knowledge-based Society in Europe?

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By its conceptual construction, Europe is the best environment for the proliferation of knowledge and technology based communities and individuals. Creating the appropriate economic and institutional framework that provides incentives for the efficient use of local and global knowledge, that fosters technological entrepreneurship, and that permits rapid adaptation in firms, institutions and markets is a daunting challenge for any country, and particularly so for the new EU member countries. Knowledge, innovation, technology and the new economy became for same time the new issues of the European policies. The purpose of his paper is to present some aspects regarding the state of knowledge society creation in EU member states and to highlight the challenges for the new member states and accession countries.

Keywords: *knowledge society, knowledge economy, innovation.*

Knowledge is information with meaning and information that acts, according to Mihai Drăgănescu[1]. That is why the knowledge society can only be based on the information society, but it is much more than it due to the new role of the information, that becomes knowledge in the society. The features of the knowledge society, proposed by the same author:

- Expansion and deepening of the scientific knowledge;
- Management and usage of the existing knowledge in the form of technological and organisational knowledge;
- Producing new technological knowledge by innovation;
- Extensive dissemination of knowledge using new means (Internet, e-books) and usage of electronic learning methods;
- A new economy in which innovation is paramount; the influence of the Internet as a market and acknowledging the intangible assets value importance, especially knowledge are characteristics of the new knowledge economy;

[1] Drăgănescu Mihai, „Societatea informaţională şi a cunoaşterii. Vectorii societăţii cunoaşterii." (Informational and Knowledge-based Society. Vectors of the and Knowledge-based Society), http://www.academiaromana.ro/pro_pri/doc/st_a01a.doc

- Is global and a factor of the globalisation;
- Is essential in ensuring an ecologically sustainable society.

The Lisbon strategy, which states that EU will become "the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment by 2010"[1], was adopted by the European Council in 2000.

Although some progress was made on innovating Europe's economy, there is growing concern that the reform process is not going fast enough and that the ambitious targets will not be reached (the Kok Report in November 2004). After the recent global economic downturn, governments seem to have been reluctant to push through difficult and unpopular economic reforms or to focus on increasing their national budgets for research and innovation. Many economists claim that, as a result, the EU has lost valuable ground on its main competitors, the US and Japan[2].

In July 2005, the Commission presented a 'Community Lisbon programme', a list of fifty measures grouped under eight "key measures with a high European value-added"[3]: supporting knowledge and innovation; reform of state aid policy; simplification of the regulatory framework; completion of the internal market for services; global agreement on the Doha round; removal to obstacles to physical, labour and academic mobility; developing a common approach to economic integration; supporting efforts to deal with the social effects [e.g. job losses] of economic restructuring.

In its January 2006 first annual progress report[4] on the Lisbon strategy, the Commission has defined four priority areas where more action is needed: more investment in education and research, more support for SMEs and higher employment rates and the new idea, which was up to now not part of the Lisbon strategy, the need to define a common EU energy policy.

The Commission publishes every year a European Innovation Scoreboard (EIS). The 2004 report covers the 25 EU member states, Bulgaria, Romania and Turkey, the associated countries Iceland, Norway and Switzerland, as well as the US and Japan.

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[1] "Relaunch of the Lisbon strategy", (2004), http://www.euractiv.com/en/innovation/relaunch-lisbon-strategy/article-131891

[2] "Lisbon Agenda", (2004), http://www.euractiv.com/en/agenda2004/lisbon-agenda/article-117510

[3] "Relaunch of the Lisbon strategy", (2004), http://www.euractiv.com/en/innovation/relaunch-lisbon-strategy/article-131891

[4] EU Progress Report, 2006, http://ec.europa.eu/growthandjobs/annual-report_en.htm.

The 2004 annual scoreboard shows some interesting results[1]:

- On average, EU member states are less innovative than the US and Japan and the gap is expanding further, especially in the areas of patenting, working population with tertiary education and public R&D expenditure;
- However, the Nordic countries are outperforming the US and Japan on several indicators and also Germany is a high performer amongst EU countries;
- Portugal, Cyprus, Ireland, Latvia and Slovakia are the countries with the best recent progress in innovation but they started from low starting points;
- The correlation between innovation performance and GDP is not always very strong and may point to the need for differentiated policy strategies to translate innovation into economic growth;
- The non-technical dimension of innovation (changes in management or work organisation) plays an essential role in explaining the advance of the US over Europe on productivity growth. "Non-technical innovation may well be the 'missing link' that prevents Europe from taking full advantage of new technological opportunities";
- There are large differences in the innovativeness of specific sectors: the electrical and optical equipment sector is the EU's most innovative one, where textiles is the least innovative sector.

In a 2006 report prepared for the 2007 EU Spring Council[2] the authors identify two trends of the future of the innovation policy in Europe:

- Europe has developed knowledge based industries comparable in employment terms with the US but has failed to make the underpinning knowledge investment in areas such as R&D, ICT software and higher education;

- R&D must be increased, but targets must be realistic and have a clear justification.

Since the concept of information society is an important building block of the knowledge society, it is important to assess to level of former s development in the EU candidate countries and new member states. The eEurope+ Action Plan (launched in 2001 at the Göteborg European Summit), part of the Lisbon strategy, aims to help accelerate reform and modernisation of the economies in the EU candidate countries, en-

[1] "Innovation gap between EU and US still growing", (2004), http://www.euractiv.com/en/innovation/innovation-gap-eu-us-growing/article-132730

[2] Brinkley, I. and Lee, N., "The Knowledge Economy in Europe", October 2006, http://www.theworkfoundation.com/Assets/PDFs/KE_Europe.pdf

courage capacity and institution building, improve overall competitiveness, and enhance social cohesion.

The results presented in the first progress report (presented in 2002) on the implementation of the eEurope+ Action Plan show that the information society is already very present in EU candidate countries and it is the subject of considerable political interest due to its potential for the economies and societies in the countries. These are some of the initial policy conclusions:

a) All candidate countries have undertaken a clear and tangible political commitment to progress the implementation of the Information Society with the aim to make use of its full potential to modernise their economies and societies and reduce the digital divide. However, substantial work remains as the Information Society is a fast-moving, complex target to achieve and constant and focussed political attention is essential.

b) Over the last years, the candidate countries have made great strides in basic access to communications: the average percentage of households that have fixed telephony service is closing in on the EU average, mobile penetration rates are very high and often substantially higher than fixed line penetration.

c) However, there remain substantial problems in the potential use of these technologies for access to Internet.

d) With a few exceptions, there is still a low penetration of computers in schools. In addition, there is substantial divergence between the countries for all three levels (primary, secondary, and tertiary). It seems that about half of the computers in the schools are connected to Internet, in some countries with a very high-speed connection via national research networks.

e) Significant progress is made in the provision of public on-line services through eGovernment actions in all of the candidate countries. In this way, local and federal government plays an important role as a major provider of services, boosting local, multi-lingual content, providing important impetus to eCommerce transactions because of eProcurement initiatives. In a next phase, candidate countries should also give consideration to the possibility for citizens, enterprises and administrations to have access, where appropriate, to the pan-European e-services of any European public administration in a seamless way.

Furthermore, important issues for the next phase of the eEurope+ action plan are: the completion of the implementation of the EU acquis relevant to the Information Society, in particular in relation to eCommerce as a pre-condition in creating trust and confidence in the use of Internet-based transactions; the introduction of alternative Internet access technologies; the provision of computers to schools and their connection to Internet, accompanied by appropriate curricula and training of teachers; increasing the number of public access points to ensure greater participation for all; and the further development of eGovernment services and of local content; and tackling the new challenges in the area of cyber crime and network and information security.[1]

Some of the trends associated with the knowledge society concept include[2]:

- The ongoing evolution of the information society and its related shift towards networked computing power, compared to earlier generations of stand-alone and one-to-one computing;

- The increasing importance of innovation as a source of competitiveness and as an instrument for increasing the efficiency and effectiveness of organisations of all types. Innovation can be defined as the widespread application of knowledge to establish new ways of doing things;

- The development of service economies, a notion at the heart of 'post-industrialist' theories, which tended to stress the role of service sectors in delivering intangible products to specific clients (especially information processing and human interaction);

- Social learning – a concept that involves substantial investment in improving education and training, and in determining what type of skills and knowledge are socially and economically important. At a policy level, the idea of 'lifelong learning' has been widely recognised as a key priority, with particular emphasis on enabling people to become adaptable and to acquire new skills and knowledge, making them more informed workers, citizens, and consumers;

- Challenges associated with globalisation, which stimulate the above trends and which further reinforce the trend towards globalisation.

In ranking the countries according to how well they accomplished the Lisbon strategy targets the results showed that on top are the Nordic countries, the UK and the Netherlands, in the middle group are the main continental countries, and in the least advanced country group, the Mediterranean countries. The new Member States were not involved in the study[3].

[1] "Progress Report eEurope+ 2003", (2002), http://ec.europa.eu/information_society/eeurope/plus/doc/progress_report.pdf

[2] "The puzzle of the knowledge society"(2004),

http://www.eurofound.eu.int/pubdocs/2005/134/en/1/ef05134en.pdf

[3] "The puzzle of the knowledge society"(2004),

http://www.eurofound.eu.int/pubdocs/2005/134/en/1/ef05134en.pdf

Among the countries examined, Finland was selected to represent the forerunner countries, Germany the average countries and Greece the least advanced countries. In addition to group and individual differences, there were differences in national perceptions, which were summarised as follows:

- In the Nordic European countries, the knowledge society was very much related to the welfare society and to equal opportunities. The knowledge society was seen in a positive light and as a source of opportunities.

- In the middle European countries, the knowledge society was associated with economic growth and discussed in a practical and technically oriented way, although not as future-oriented as in the Nordic countries.

- In the southern European countries, the knowledge society was much more related to people's relationships with each other, friends and family. In this sense, it was seen in quite a negative light, as something that would destroy old traditions and structures and that would demand increased modernisation.

Swot of Finnish knowledge society model[1]	**Swot of German knowledge society model**[2]	**Swot of Greek knowledge society model**[3]
Strengths ▪ new media tradition; ▪ good training possibilities; ▪ high innovation ability; ▪ high standard of living; ▪ flexible labour market; ▪ high educational level; ▪ strong efforts to make all citizens ICT literate; ▪ high equality (regional,	**Strengths** ▪ innovation ability; ▪ great willingness to engage in self-directed learning; ▪ flexible work forms appreciated by many; ▪ good broadband access.	**Strengths** ▪ high growth rates; ▪ 'EU-optimists', flexible, open to trying out new things, easily adjust to new circumstances and are able to survive under difficult conditions; ▪ highly trained scientific and technological workforce;

[1] "The knowledge society in Finland" (2004),

http://www.eurofound.eu.int/pubdocs/2004/11/en/1/ef0411en.pdf

[2] "The knowledge society in Germany", (2004),

http://www.eurofound.eu.int/pubdocs/2004/12/en/1/ef0412en.pdf

[3] "The knowledge society in Greece", (2004),

http://www.eurofound.eu.int/pubdocs/2004/13/en/1/ef0413en.pdf

gender, social groups)		▪ expenditure on education is relatively high; ▪ the use of new technologies is considered important.
Weaknesses ▪ high unemployment rate; ▪ low entrepreneurship level; ▪ low PC availability in schools; ▪ low level of business education and apprenticeship training; ▪ stressful working life; early retirement and sick leave increasing.	**Weaknesses** ▪ education system lagging behind: ▪ electronic media insufficiently included in education; ▪ rising unemployment.	**Weaknesses** ▪ not clear if the preconditions exist to ensure development or is the country just sporadically reacting to external pressures; ▪ the quality of life concept is not integrated in people's everyday lives; ▪ the social dialogue, communication, coordination ad collaboration between the actors involved is only effective to a certain extent; ▪ not flexible labour market; ▪ high unemployment rate.
Opportunities ▪ investment in R&D; ▪ innovative and highly educated workforce; ▪ social innovations may lead to a future innovative business cluster; ▪ immigration and emigration increase mobility of workforce and multicultural life; ▪ welfare society discourages social exclusion and polarisation, enabling Finland to utilise all its potential social capital; ▪ government willing to accomplish tax and social security reforms to maintain competitiveness; ▪ user-friendlier ICT might ease daily work and prevent special groups from being excluded from the knowledge society;	**Opportunities** ▪ flexible, innovative and well-trained workforce manages shift towards service industry; ▪ little income disparities; ▪ good quality of life.	**Opportunities** • new well-designed policies for education and training, the information society, employment, research and equal opportunities; • the use of new technologies is on the increase in the public and private sectors, as is private research and innovation.

▪ strong indication that knowledge society aspects will have to be taken into account in every field in the near future.		
Threats ▪ risk of rising social exclusion if unemployment rate does not drop; ▪ increasing labour shortage as baby boom generation retires; ▪ lack of innovativeness; ▪ competitiveness based on ICT production; ▪ risk of welfare society crashing, if tax and social security reforms are not accomplished; ▪ productivity increase mainly in the hands of the ICT sector; ▪ rising risk of vulnerability due to increasing use of technology. ▪ continuous investment in updating ICT may become very expensive for Finnish society.	**Threats** ▪ poorly educated new generation of workers reduces Germany's innovation ability; ▪ high unemployment prevents the necessary economic boost; ▪ R&D threatened by sluggish economy and budget consolidation.	**Threats** ▪ a gap between the knowledge and skills provided and those required by the market; ▪ not sufficient willingness to take risks; ▪ conservative organizational culture of Greek enterprises and public institutions.

These results may partly explain the reason for different speeds and levels of advancement of the knowledge society within the EU-15.

Concerning Romania's level of development of the knowledge society the following SWOT analysis was based on the insight of Filip et. al 2001 study[1]:

[1] Filip, F. Gh., Dragomirescu, H., Predescu, R., Ilie, R., "Vision for the Knowledge Society – The Experience with a Romanian Foresight Exercise", 2001, http://fistera.jrc.es/pages/books/content%20bucharest%20book/Art%2011.pdf

Strengths
▪ Relatively high skilled and low cost workforce; ▪ Increasing ICT usage in schools, firms and social life; ▪ Information Society Technologies' sector is very dynamic; ▪ Increasing growth of RDI expenditure; ▪ Economic growth recorded during the past 5 years and the optimistic medium term forecasts.
Weaknesses
▪ Increasing need to improve the quality of education and correct the mismatch between the skills that the education system produces and the labour market demand; ▪ Accelerated brain-drain of highly-skilled graduates; ▪ Low participation rates in secondary and tertiary education and in adult learning in rural areas; ▪ Investment in telecommunication infrastructure is still insufficient; ▪ RDI expenditure is far below EU average.
Opportunities
▪ Increase of competition and larger foreign investments brought by the Romania's accession to the EU; ▪ e-Learning services have been developing in Romania at a swift pace; ▪ Promoting e-governmental services.
Threats
▪ Current economic competitiveness of ICT sector in Romania is rather determined by low wages than by innovation; ▪ Lack of a consistent policy to promote an innovative culture; ▪ Negative trends for business R&D expenditure; ▪ Lack of cooperation between research institutes and industry.

Conclusions

The knowledge economy has most commonly been defined[1] in terms of technology and knowledge based industries reflecting R&D intensities, high ICT usage, and the deployment of large numbers of graduates and professional and associate professional workers. Building the four pillars of the knowledge economy: education and training – an educated and skilled population, a dynamic information infrastructure, economic incentive and institutional regime – enables the free flow of knowledge, supports investment in information and communications technology, and encourages entrepreneurship,

[1] Brinkley, I. and Lee, N., "The Knowledge Economy in Europe", October 2006, http://www.theworkfoundation.com/Assets/PDFs/KE_Europe.pdf

innovation systems – viable networks of research centres, universities, think tanks, private enterprises and community groups[1] proves challenging.

In building the knowledge based economies the accession countries and the new EU members must first get the fundamentals right. Coherent, consistent, and predictable legal, regulatory and policy frameworks are essential to creating an environment for innovation, foreign investment, and growth of a vibrant private sector, the key driver of a competitive knowledge-based economy. Equally important is finding the proper balance between the role of the government and private sector initiative in driving innovation and creating new economic opportunities. Its role is to create the conditions for fair competition, investment and trade; to promote sound macroeconomic and fiscal policies; and to address, in partnership with the private sector, key structural constraints on economic growth, including issues of infrastructure and human capital. The most competitive countries are those that create favourable conditions for continuous, market-driven and private sector-led innovation.

The knowledge society is still an elusive concept and an emerging reality. The EU-15 members' experience showed that there is not one viable model but several and that specific country conditions may prove to be assets or liabilities in the new context.

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Integrating Sustainable Development & Corporate Social Responsibility

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Sustainable Development (SD) and Corporate Social Responsibility (CSR) have to be among the most important concepts that companies apply and/or promote through specific programmes. As some analyses show, SD and CSR programmes are becoming a constant part of corporate actions, either as part of the company's PR strategy or as an element of the company's operational system. The following article offers an overview of the sustainable development and corporate social responsibility concepts, emphasising the importance they have gained at corporate level and pointing out a few aspects that international organisations view as being essential for the future of SD and CSR.

1. Sustainable development

The term sustainable development (SD) was launched in 1987 within a UNCTAD report – Our Common Future, also known as the Brundtland report. The report stated that poverty was the main cause of environment destruction and proposed that resources should be generated by economic increase (activated by international trade).

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."[1]

Lately, the terms most associated with the definition of sustainability are people, planet, profit or the three pillars of sustainability. This phrase originates in the terms that WBCSD - World Business Council for Sustainable Development used when defining the operational aspect of sustainability (people welfare, natural support and economic growth)

The Brundtland definition addresses all the parties it referred to: from common people or society, to environmentalist organisations and companies. Although defined in simple terms, sustainable development became a complex matter, which companies started to integrate more often with their programmes or daily activities. The reasons for getting involved in such matters and making them public are numerous and derive from

[1] http://www.lca-net.com/products/sustainable.asp

the importance of SD.

Forum for the Future, one of the most important charitable organisations in Great Britain, whose main purpose is to promote the sustainable development concept, presents the following factors, as being essential to understanding the importance of sustainable development[1]:

- over the last 10 years, ecological disasters have generated losses of USD 600 bn – more than losses recorded in the last 40 years due to the same causes;

- if fossil fuels are burned at the same pace, greenhouse gases will increase by 50% in the next 5 years;

- over 100 million Europeans and North Americans live in cities with extremely high pollution level;

- a growing number of the world population is affected by the lack of drinkable water or food and by floods or draughts.

The same organisation draws attention to the fact that such problems, although not typical of developed countries, are emerging in economic environments where the level of welfare is much above the global average. The basis of this problem is the ignorance with which people treat the environment and the lack of understanding that any human activity is dependent on it. Fortunately, a higher number of organisations and persons try to contribute by coming with new methods of solving altogether, the economic, social and environment problems which society is dealing with, either through sustainable development or through what is known nowadays as social responsibility.

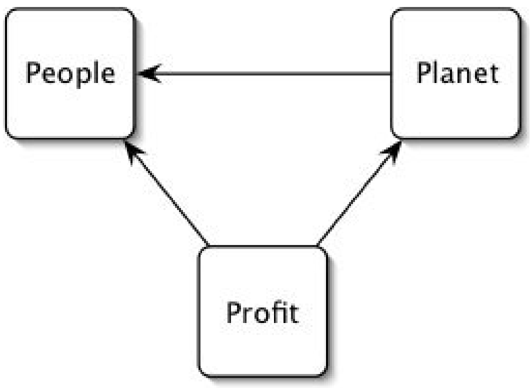

Fig. 1. "The three pillars of sustainability".

Sustainable development as well as social responsibility can be applied by any type of organisation – from small and medium enterprises or foundations to state governments. For example, the sustainable development strategy of Great Britain in 1999 ad-

[1] www.forumforthefuture.com

dresses the following matters[1]:

- social progress which recognises everyone's needs;
- effective protection of the environment;
- prudent use of natural resources;
- maintenance of high and stable levels of economic growth and employment.

Companies will certainly have different approaches towards sustainable development programmes. However, since the general lines are respected, this helps to make an efficient link of economic, social and environmental aspects. Starting from the three pillars of SD, we can state that the main principle of sustainable development is that the right of a company to function in society should not come only from satisfying stakeholders, but also from the increase of social and environmental performances.

One of the main advantages of launching SD programmes is the reduction of operational costs. This benefit is most evident with companies that adopt ecological initiatives so as to reduce water, recycle materials, preserve water and electricity.

For example, Cisco Systems designed and built its San Jose headquarters so as to conserve an average of 49.5 million kilowatt-hours per year. By doing this, Cisco not only lowers costs and lessens environmental impacts, but also takes advantage of the incentives offered by the energy supplier, Pacific Gas & Electric (PG&E). Therefore, it is expected to save about $4.5 million per year in operating costs that qualify the company for $5.7 million in PG&E rebates when construction is completed. According to the Cisco case study presented on the company's website, the environmental benefits of Cisco's energy conservation at its San Jose headquarters could power 5,500 homes. In addition, almost 50 million fewer pounds of carbon dioxide are produced per year and 14,300 fewer pounds of nitrogen oxide. This is the equivalent of removing 1,000 cars from the road.

By analysing the value of the reduction in operational costs we may understand better why sustainable development has crossed the boundaries of theory and entered the area of practical measures taken or that are to be taken by companies. If applied properly, it is, obviously, a concept that may generate profit to all "the three pillars of sustainability".

[1] http://www.sustainable-development.gov.uk/publications/pdf/strategy/SecFut_complete.pdf - Securing the Future, pg. 16

2. Corporate social responsibility

The history of social and environmental concern about business is traced by some economists „as old as trade and business itself"[1]. However, the impacts of business on society and the environment assumed a new dimension once the economy entered the industrialisation period. In time, as concerns about large corporations and their power grew in importance, **Corporate Social Responsibility (CSR)** became a debate-generating principle.

Business started long centuries before the dawn of history, but business as we now know it is new - new in its broadening scope, new in its social significance. Business has not learned how to handle these changes, nor does it recognize the magnitude of its responsibilities for the future of civilization.[2]

Corporate social responsibility is a principle that depends on a complex of economic, cultural and political factors, therefore companies do not apply it to the same extent. However, recent reports and analysis of the market show that companies make efforts to include CSR either as strategy or adopt it as corporate value, indifferent of the economic sector they perform in. In numerous cases, companies apply CSR rather to align to market tendencies than to express a true interest towards society. Even so, the growing interest for CSR is evident and its influence on the international business environment and society as a whole is more powerful than before.

Corporate social responsibility is a commitment to improve community well-being through discretionary business practices and contributions of corporate resources.[3]

Philip Kotler, Nancy Lee - Corporate Social Responsibility (2005)

In recent years, the support granted to social causes has become a constant action in the corporate environment. Without being associated to a specific economic sector, CSR activities are promoted through various communication channels. Companies make use of their official websites, annual reports or other promotional materials in order to publicly show that the implication in the community's life and sustaining social causes are among the most significant activities that they perform.

This is partly due to the multiple requests for supporting social causes received from non-profit organisations, government agencies, interest groups, potential investors, politicians etc. Matters for which support is required varies from issues such as health, education and public safety to community development, animal rights protection or the

[1] www.brass.cf.ac.uk/uploads/History_L3.pdf - History of Corporate Social Responsibility and Sustainability

[2] www.brass.cf.ac.uk/uploads/History_L3.pdf - comment within an address delivered at NorthWestern University in 1929 by the Dean of Harvard Business School, Wallace B. Donham

[3] Philip Kotler, Nancy Lee, Corporate Social Responsibility, John Wiley & Sons, Inc, 2005, pg. 3

environment. Companies respond to these "pressures" strategically by choosing to support both economic and social causes, to take actions that are beneficial to both the company and the cause itself.

The multitude of cases supported through CSR programmes determined a constant development of the concept, reaching a stage where it can now be associated to a great number of matters. Starting with ethics and human rights to corporate governance and the environment, the causes promoted by CSR programmes have been at the origin of specific company policies or have been inserted among corporate values.

A report released in 2004 by the Centre of Urban Planning and Environmental Development (University of Hong Kong) analysed the incidence of CSR policies at a global level. The paper is based on a survey that asks 450 companies whether they had written policies on each of the 20 aspects of CSR policies. Out of the 49% of companies that responded, 47.7% North American companies reported to have made policies on CSR/sustainability, as compared to 60.4% in Europe and 33.3% in Asia[1]. Richard Welford, the deputy director of the Corporate Environmental Governance Programme (CEGP – University of Hong Kong) has stressed the fact that the existence of a policy does not guarantee that it is implemented, and conversely, the absence of a policy does not mean that a certain CSR aspect is not practiced.

In conclusion, corporate social responsibility is a concept that business absorbed fast, at a pace imposed by stakeholders and society as well.

3. The future of sustainable development and corporate social responsibility

In its strategic planning document, "ISO Horizon 2010 – Standards for a Sustainable world," the ISO Central Secretariat identifies, as a key driver, "the urgency of a responsible approach to sustainable development, covering economic, social and environmental aspects, where all actors in society have a role to play and all companies and organizations have new commitments to make."[2]

This is consistent with evolving international sustainable development policy, which highlights the role of voluntary, market-based tools to promote sustainable development. In Paragraph 17 of the World Summit on Sustainable Development (WSSD) Plan of Implementation, companies are urged to: enhance corporate environmental and social responsibility and accountability. This would include actions at all levels to encourage industry to improve social and environmental performance through voluntary

[1] http://web.hku.hk/~cegp/image/publications/report11.pdf - Corporate Social Responsibility in Europe, North America and Asia: 2004 Survey Results, Richard Welford, May 2004
[2] idem

initiatives, including environmental management systems, codes of conduct, certification and public reporting on environmental and social issues, taking into account such initiatives as the International Organization for Standardization (ISO) standards and Global Reporting Initiative guidelines on sustainability reporting, bearing in mind principle 11 of the Rio Declaration on Environment and Development.

With such strong recommendations, reiterated in many important documents, the two concepts discussed above have great chances to turn into principles of normal life. And, it is quite clear that, no matter how complex the process may be, it has to go on.

4. Conclusions

Sustainable development and corporate social responsibilty share the common belief that economic growth and development cannot continue unless the social aspect, in its global dimension, is taken into account. They both work in the direction of increasing the awareness of the social aspects of both governments and companies and to determine every member of the society to develop a sense of responsibility towards the future.

According to the International Institute for Sustainable Development (IISD), the social responsibility of an organization should define its contribution to the balanced promotion of all three pillars of sustainable development: economic growth, social development and environmental protection.

Altough the variety of CSR and SD programmes might be confusing in determining which concept comprises the other, it is clear that both social responsibility and sustainable development are interdependent. We could consider that for companies defining their programmes as purely CSR or SD programmes might not be very relevant. As long as the programme has a clearly defined purpose, which is attained at the end, debate on the CSR vs. SD-type of action should not be of great importance. But requests for standardasing CSR practices and policies are increasing.

As any beginning, the development of CSR/SD actions may not distinguish clearly from other actions a certain company usually takes. At the same time, as CSR/SD actions span over a variety of economic and social issues, it could be difficult to determine to what extent companies are socially responsible and whether their actions do have the promised effect. This is is still a test for many policy makers. Let us hope that all of them will pass it successfully as soon as possible.

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The Effects of Globalization on Young People

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This paper seeks to highlight the key policy recommendation arising out of young people, who are highly affected, but rarely considered. Accordingly, its perspective is necessarily broader than the detailed policy recommendations within the six cross-cutting themes which are privatization; global structure and financial architecture; representation, activism and human rights; inequitable relationships; education; and displacement. Clearly, this six issues are interrelated and overlap in many ways, as do the related human rights and solutions offered. Only by undertaking a holistic approach to the challenges of globalization that effective solutions can be found.

It has become a cliché to say that "globalization" is one of the defining characteristics of our time. Every generation feels that it is living in a time of great change and today is no exception.

Despite the fact that most academics, media commentators, economists and politicians, agree that the process of globalization exist, it remains a highly contested concept. Many celebrate the continued interconnectedness of national economies towards a single international economy, the increases in cultural homogeneity and the advances in communication technology that occur almost daily. However, others raise concerns about the direction of globalization, its impacts on the most vulnerable and the loss of local community. This level of concern raised by both high profile commentators like, international banker, George Souris and Joseph Stiglitz, the former chief economist of the World Bank, as well as the thousands of young people from every continent who have responded to the International Youth Parliament's Youth Commission into Globalization.

We can define globalization broadly; that is, it is the many economic, political, technological and social process, innovations and changes the are increasing the interconnectedness of our world. It can be thought of as the butterfly which flaps its wings in one part of the world only for the flow on to affect the weather patterns elsewhere. Likewise, we live in a time when a decision in New York (or London, Paris, Sydney, Jakarta) can affect the livelihoods of subsistence farmers in the Solomon Islands, or the viability of a small rural centre in Australia. This level of interconnectedness means that those who are making the decisions are further away from those who feel the consequences of them.

While there are many who debate the effects of globalization, few discuss one of the most *highly affected but rarely considered* segments of the international community – young people. Young people are at the sharp end of globalization. They can be amongst affected, but are also potentially the most adaptable to change. Young people are not the only vulnerable to the vast changes brought on by the processes of globalization, but can also be the key change agents. Despite this, young people are often ignored both in the literature and the sphere of political decision – making. In this way, young people must be considered key agents of change for globalization, as well as its potential victims.

Last four years were the culmination of a period work by the Youth Commission on Globalization, an International Youth Parliament (IYP) initiative. The conclusions of them are different in a number of ways. *Firstly*, ***young people are part of an international network*** that has been developed over a number of years. So, these young people have not only undertaken research into the identified issues as part of IYP Youth Commission. *Second reason*, ***young people as "agents of change"***. There are action items and policy recommendations of governments, multilateral institutions, non – government organizations (NGOs), corporations and individuals. There is a sophisticated analysis of the key – themes identified and a multi-level response presented which is within a rights – based framework. In essence, the position of us, as humans, have a number of inalienable rights. Ultimately, the processes of globalization must be managed from its perspective. The rights – based framework provides a lens with which to consider the processes of globalization.

The *third addition*, the process of globalization means ***"new voices of the young people".*** While the expertise offered by many academics, world leaders and media commentation is valuable, there are few opportunities for the voices of young people to be heard.

What globalization means to the young people and what is the impact of it has had on their lives? International Labour Office , University of Washington and UNICEF identified 11 key issues as relevant areas where globalization is most significantly affecting young people. These ***key issues*** are:

1. Access to and privatization of education
2. HIV/AIDS prevention, treatment and care for youth
3. Export oriented manufacturing industries and young workers
4. Trafficking of young women
5. Indigenous youth
6. Vulnerability of agricultural youth
7. Violence and young people's security

8. Globalization of youth activism and human rights

9. Young people access to technology

10. Young people access to water

11. Global youth culture and youth identity

While each of these issues focus on a particular one, the integrated nature of the themes will present will become clear. It is not possible to discuss any one of these issues without in some way also considering the others. It raises questions about farming practices, consumption patterns, food security, government trade and economic policy, international trade agreements and demands on agricultural lands. As a result, a number of **overarching themes** have emerged for young people.

- ***Access to and privatization of education***

Internationally, more than 10,000 state – owned companies were privatized in the ten years between 1998 and 1998. (Nash, 1999). The arguments for privatization include efficiency improvements and the removal of "unnatural" government monopolies that restrain trade (Barker and Mander, 2001). However, for low – income nations, and often the more wealthy nations too, the results are very different. The experience has led to declining employment, increasing corruption and environmental degradation.

For young people, privatization policies affect all aspects of their lives. From access to education, to employment opportunities, the decision by governments (with the advice of multilateral institutions) to private means that choices once existed may well disappear.

- ***Global structure and financial architecture***

While multilateral institutions were once considered remote and intangible, there is no denying that young people are more aware than ever that this institutions play an increasingly important role in their lives. Each of the 11 issues have identified the role and impact of the various multilateral institutions. It is noted that it is within these very institutions that there is hope for a version of globalization that is more positive, not only for young people, but for all. There remain a great need for reform however.

For example, The World Bank and International Monetary Fund (IMF) have often been blamed for bad advice that has lead to negative economic, social and environmental consequences. Despite this, it is within these institutions, along with a more active United Nations, that we see the potential to promote greater democracy, environmental sustainability and human rights.

- ***Representation, activism and human rights***

This theme is the issue of representation and the need to provide a platform for the voices of young people. It is clear that most of young people have very few opportunities to be heard, and this is a source of ongoing frustration for them. For those formal institutions that do offer a voice, it is often within stringent boundaries that offer little flexibility.

For the North, the result is the continues fall in voter turn out apathy towards formal politics. For both the North and South, such trends should be of growing concern as young people may well decide that the solutions to today's local, national , regional and global problems are not available through formal structures.

Young people believe that they have much to offer in overcoming the challenges evident in the world today. However, the formal structures of decision – making act to frustrate rather than promote youth participation.

- ***Inequitable relationships***

The growing interrelationship between economies has often cemented an uneven interconnectedness which allows agencies in one region to exercise power through decisions, actions, or inaction that can have significant consequences for nations, communities and households of other regions (Held , D., 1999). According to Goodman (Goodman, 2000) , such power differentials are fundamental attribute of economic globalization.

Young people at the sharp end of globalization have found that while opportunities may well increase, more often, however, inequitable relationship institutionalize poverty by concentrating resources and wealth amongst economically dominant nations, corporations and sections of the community. The past decade has proven that the convergence predicted from global markets has only resulted in an "increasing concentration of income… and wealth among people, corporations and countries" of the North (UNDP, 2001). Young people see this every day.

- ***Education***

Investment in education plays an important role in equitable development and large – scale reduction in poverty. However, 130 million primary school age children in developing countries have no access to basic education (Oxfam, 2005). Exclusion from education deprives young people of the skills necessary to gain employment and undermines the productive capacities of impoverished households. For many, globalization stands as an obstacle to accessing education. Yet education is absolutely essential to one's capacity to participate in the processes of globalization. For many governments, the ability to provide basic education is being greatly diminished by the demands of servicing foreign debts overseen by IMF and World Bank. It many heavily indebted countries , debt – servicing payments account for more than twice the amount devoted to education.

- ***Displacement***

Displacement refers to the forced removal people from their homes. From the environmental consequences of globalization and changes in agricultural patterns that affect agricultural livelihoods, to the threat of conflict over 'resource' wars, the consequences of displacement are felt on many different levels.

While economic prosperity may offer increased opportunities for some, the benefits are not available to all. Focusing on environmental displacement we find that despite the many commitment made by the large number of governments since the Rio Earth Summit in 1992 and the more recent World Summit on Sustainable Development, including a declared focus on 'sustainable development', little appears to have changed.

The systemic nature of the impacts of globalization means that these environmental challenges cannot be separated from those of poverty, debt and other social issues.

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Testing for seasonal anomalies in the Romanian Stock Market

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This paper investigates seasonal anomalies in stock returns on Bucharest Stock Exchange. The anomalies studied are two of the most common security price anomalies detected on international stock markets, the day-of-the-week effect and the month-of-the-year effect. The empirical research is conducted using daily logarithmic returns of the Romanian composite index, BET-C, over a six years period (January 2000- December 2005). A regression model using dummy variables is run to test the presence of these seasonal effects, but the results provide no support for the existence of these calendar effects on the Romanian stock market.

Keywords: *pattern, seasonal anomalies, dummy variable, multiple regressions.*

JEL Classifications: *G10, G14*

For many years, financial analysts have been concerned about seasonality in stock returns.

The most important calendar effects studied are the day-of-the-week effect (significantly different returns on some day of the week; usually higher Friday returns and lower Monday returns), the monthly or January effect (relatively higher January returns), the trading month effect (returns higher over the first fortnight of the month) and the holiday effect (returns higher on the days before holydays). These market anomalies, if detected, are proofs of market inefficiencies.

This paper is concerned with two of the most common anomalies found on different stock markets of the world, and tries to test the presence of the two most common calendar effects, day-of-the-week effect and January effect, on Bucharest Stock Exchange.

Since Fama (1965), a vast number of papers have been concerned with these stock price anomalies, known as calendar effects. For a survey of common security price anomalies see Thaler (1987).

In what the day of the week effect is concerned, French (1980), Gibson and Hess (1981), Lakonishok and Levi (1982), Rogalski (1984), Kato (1990), Keim and Stambaugh (1984) demonstrate the presence of this phenomenon on different markets. It is however observed that most of these seasonal anomalies tend to disappear, or at least to lose significantly in magnitude over time.

1) Testing for Day-of-the-Week Effect on Bucharest Stock Exchange

One of the most common seasonal anomalies is the day-of-the-week effect. This analysis is based on the hypothesis that the yields produced by each security are not independent of the day of the week.

Daily observations of the Bucharest Stock Exchange Composite Index (BET-C) are employed to investigate the day of the week effect in the Romanian stock market. We consider a six years period (2000-2005), or a total of 1447 daily observations, which will be further divided into two sub samples with an approximately equal number of observations, in order to find any possible change, or if in fact there was one. In this way, the first sub sample would have 730 daily observations, covering the period January 6th till December 19th 2002 (last trading day in 2002) and the second sample would contain the remaining 717 observations, or the period January 6th 2003 (first trading day of the year)- December 23th 2005.

The following regression model is run, first for the whole period, and then for the two equal sub periods, in order to test whether there is any statistically significant difference among index returns on different days of the week:

$$Rt = B0 + B1D1t + B2D2t + B3D3t + B4D4t + ut$$

Where:

Rt: is the daily logarithmic return of BET-C index

Djt: are dummy variables which take on the value 1 if the corresponding return for day t is a Monday, Tuesday, Wednesday or Thursday and 0 otherwise.

Bi: Each of the estimated OLS coefficients for the dummy variables shows the estimated difference between returns in that day and returns on Friday.

The intercept, b_o in our equation, measures the average log return of the index for Friday.

ut: is the error term.

The hypothesis to be tested is:

H0: B1 = B2 = B3 = B4 = 0

TABLE 1: Statistics for daily regression-all six years (2000 -2005)

Regression Statistics	
Multiple R	0,01510575
R Square	0,000228184
Adjusted R Square	-0,002545108
Standard Error	1,349271304
Observations	1447

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	4	0,599166	0,149791619	0,082279	0,987845
Residual	1442	2625,209	1,820533051		
Total	1446	2625,808			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	0,149684561	0,079784	1,876120548	0,060841	-0,00682	0,30619
X Variable 1	-0,034814827	0,11313	-0,307740788	0,758324	-0,25673	0,187103
X Variable 2	0,009390239	0,112539	0,083440205	0,933513	-0,21137	0,230147
X Variable 3	0,02295698	0,112251	0,204515387	0,83798	-0,19724	0,243149
X Variable 4	-0,018433132	0,111782	-0,164902337	0,869044	-0,23771	0,20084

We can see that our equation estimates that the average return on Friday is 0,15 percent. As mentioned before, each of the estimated coefficients for the dummy variables shows the estimated difference between returns in that day and Friday returns. For example, if we look at Table 1, we find that the estimated return for Monday is 0,03 percent lower than Friday, which gives us a Monday prediction of about 0,12 percent. Mondays and Thursday are actually the only two days with estimated predictions lower than Friday.

Looking at the regression coefficients we notice a very low value for R-squared, which may suggest that a day-of-the-week effect in BET-C return may not be very important in explaining the evolution of the index.

We can use the F-statistics to analyze the null hypothesis that daily dummy variables are all equal to 0.

We are testing for significant daily variation of the Romanian index. From the ANOVA table, we find that, for 4 degrees of freedom, the F-statistic to determine whether all the regression slope coefficients are jointly equal to 0 is 0,08. We must next look in a table with critical values for F-test. If we choose a significance level of 0,05, we see that for 4 degrees of freedom of the numerator, the critical value is 2,37 when the denominator has an infinity of degrees of freedom. In our case (1442 degrees of freedom), the critical value would have to be larger than 2,37. The value for F-statistic is 0,08, so we clearly cannot reject the null hypothesis that all the coefficients jointly are equal to 0, which in fact means that we have no day-of-the-week effect on BSE..

The p-value of 0,95 shown for the F-test in Table 3 means that the smallest level of significance at which we can reject the null hypothesis is 0,98, or 98% , which is way above the conventional level of 5 percent.

Among the 4 dummy variables, we find for each of them very large p-values, which means that we have no statistically significant t-statistics, so we cannot reject the null hypothesis that the returns are equal across the days based on the t-test.

The situation does not change when the daily observations are divided in two equal sub samples, both covering a period of three years (See Table 2 and Table 3). For both sub periods, the regression coefficients are not statistically significant; in neither case the null hypothesis cannot be rejected. So, we can state that there is no day-of-the-week effect on BSE composite index.

TABLE 2: Statistics for daily regression - first three years (2000-2002)

Regression Statistics	
Multiple R	0,026465
R Square	0,0007
Adjusted R Square	-0,00481
Standard Error	1,436709
Observations	730

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	4	1,04891	0,262227	0,12704	0,97265
Residual	725	1496,497	2,064134		
Total	729	1497,546			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	0,140275	0,119312	1,175696	0,240102	-0,09396	0,374513
X Variable 1	0,005648	0,169925	0,033239	0,973493	-0,32796	0,339253
X Variable 2	-0,05005	0,168444	-0,29716	0,766432	-0,38075	0,280641
X Variable 3	0,008627	0,168158	0,051306	0,959096	-0,32151	0,338762
X Variable 4	-0,08633	0,167048	-0,5168	0,605456	-0,41429	0,241626

TABLE 3: Statistics for daily regression- last three years (2003-2005)

Regression Statistics	
Multiple R	0,040957
R Square	0,001677
Adjusted R Square	-0,00393
Standard Error	1,25701
Observations	717

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	4	1,89032	0,47258	0,299087	0,878589
Residual	712	1125,013	1,580075		
Total	716	1126,903			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95,0%*
Intercept	0,159361	0,105859	1,505405	0,132664	-0,04847	0,367195
X Variable 1	-0,07533	0,149444	-0,50404	0,614387	-0,36873	0,218077
X Variable 2	0,070012	0,149183	0,469303	0,638997	-0,22288	0,362904
X Variable 3	0,037347	0,148672	0,251204	0,801729	-0,25454	0,329234
X Variable 4	0,051844	0,14842	0,349308	0,726962	-0,23955	0,343238

2) Month-of-the Year Effect on Bucharest Stock Exchange

As stated before, we employ daily log returns of the BET-C index covering a six years period, from January 2000 through the end of 2005. We estimate next a regression equation including an intercept and 11 dummy variables, one for each of the first eleven months of the year. The equation that we estimate is:

$$Return_t = b_0 + b_1 Jan_t + b_2 Feb_t + \ldots\ldots.+ b_{11} Nov_t + u_t$$

Where each month dummy variable has a value of 1 when the month occurs and a value of 0 for the other months. The intercept, b_o in our equation, measures the average log return of the index for December. Table 4 shows the results of the above regression.

The regression equation estimates that the average return in December is 3,19 percent. Like before, each of the estimated coefficients for the dummy variables shows the estimated difference between returns in that month and returns in December. For example, if we look at Table 4, we find that the estimated return for January is 7,95 percent higher than December, which gives us a January prediction of 11,14 percent. This is actually the highest value we find between all 11 variables, followed by variable 2 (February) and variable 6 (June), the only three months with estimated prediction above that of December.

If we look further at the regression coefficients we find, however, a low R-squared, which may suggest that a month-of-the-year effect in BET-C return may not be very important in explaining the evolution of the index.

We can use the F-statistics to analyze the null hypothesis that monthly dummy variables are all equal to 0.

$$H_0: b_1 = b_2 = b_3 = \ldots\ldots = b_{11} = 0$$

TABLE 4: Statistics for monthly regression (2000-2005)
SUMMARY OUTPUT

Regression Statistics	
Multiple R	0,417216
R Square	0,174069
Adjusted R Square	0,020082
Standard Error	7,985898
Observations	71

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	11	793,0075	72,09159	1,130413	0,355018
Residual	59	3762,7	63,77457		

Total	70	4555,707

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	3,196884	3,260229	0,98057	0,330809	-3,32683	9,720595
X Variable 1	7,954564	4,835702	1,644966	0,105295	-1,72166	17,63079
X Variable 2	0,524058	4,610661	0,113662	0,909891	-8,70186	9,749978
X Variable 3	-8,85561	4,610661	-1,92068	0,059609	-18,0815	0,370306
X Variable 4	-0,14709	4,610661	-0,0319	0,974657	-9,37301	9,078828
X Variable 5	-0,70607	4,610661	-0,15314	0,878811	-9,93199	8,519848
X Variable 6	0,201338	4,610661	0,043668	0,965317	-9,02458	9,427259
X Variable 7	-0,85541	4,610661	-0,18553	0,85345	-10,0813	8,370507
X Variable 8	-1,15225	4,610661	-0,24991	0,803526	-10,3782	8,073675
X Variable 9	-0,14757	4,610661	-0,03201	0,974575	-9,37349	9,078348
X Variable 10	-0,2432	4,610661	-0,05275	0,958111	-9,46912	8,98272
X Variable 11	-0,81037	4,610661	-0,17576	0,861084	-10,0363	8,415546

We are testing for significant monthly variation of the Romanian composite index. Looking at the ANOVA table, we find that, for 11 degrees of freedom, the F-statistic to determine whether all the regression slope coefficients are jointly equal to 0 is 1,13. We must next look in a table with critical values for F-test. If we choose a significance level of 0, 5, we see that for 11 degrees of freedom of the numerator, the critical value is 1,95 when the denominator has 60. In our case (59 degrees of freedom), the critical value would have to be larger than 1,95. The value for F-statistic is 1,13, so we clearly cannot reject the null hypothesis that all the coefficients jointly are equal to 0.

The p-value of 0,35 shown for the F-test in Table 3 means that the smallest level of significance at which we can reject the null hypothesis is 0,35, or 35% - above the conventional level of 5 percent.

Among the 11 dummy variables, we find no statistically significant value for t-statistic, so we cannot reject the null hypothesis that the returns are equal across the months based on the t-test. The only coefficient with a p-value close to the accepted level of 0,05 is variable 3, which represents the estimated return from March. In our case, this value is by far the smallest one found among all monthly coefficients (8,85 % smaller than the estimated return for December).

In conclusion, the higher return observed in January is not statistically significant, (nor are the other regression coefficients), which means the null hypothesis cannot be rejected and we do not encounter a month-of-the-year effect on Bucharest Stock Exchange.

As we saw earlier, we could not prove the presence of a day-of-the-week effect on BET-C index either. The results are quite surprising, as we expected to find some anomalies which could prove that Bucharest Stock Exchange is not an efficient market. Nevertheless, further investigation must be conducted and other seasonal anomalies tested before we could reject the hypothesis that calendar anomalies are present on BSE.

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The EU Common Foreign and Security Policy and the 2007 enlargement wave: threats and opportunities

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The Common Foreign and Security Policy is the newest and, certainly, the most ambitious project pertaining to the European construction. Following the integration theory, tackled by many authors[1]*, the political union is considered to be the final stage of the integration process.*
Along the years, the European construction has become extremely extrovert, and the integration process has influenced not only the internal aspects of the European Union, but also its relationships developed with the rest of the world. The European integration process has become more consistent, and CFSP has grown to be one of the main pillars of the European Union. EU is trying to define and consolidate its common foreign and security policy in a time of profound and dramatic international changes.
The present paper tries to identify aspects considered to be relevant in an analyze about CFSP and the relation between CFSP, as a vertical axis of the integration process and enlargement, as the horizontal one.

Key words: *security, CFSP, enlargement*

The concept of security has become more and more complex, going beyond the narrow meaning of military balance between two rival sides.

After 1991[2], the Copenhagen School had a major influence on the academic debates on the problem of security and even of the development of security policies. Barry Buzan, Ole Waever and other specialists from the Peace and Conflict Studies Centre of Copenhagen proposed an enlargement of the concept of European security, on the following *five dimensions*: *military, political, economic, societal and environmental.*

[1] Balassa offers a large analysis of theories and stages of integration in his work *Theory of Economic Integration*, Irwin Homewood, Illinois, 1961

[2] In 1991, Barry Buzan published at Harvester Wheatsheaf, London, the second edition of his book *People, States and Fear*. The first edition had been issued in 1983, but the international acknowledgement of the Copenhagen School came after the end of the Cold War.

The security of human communities is affected by several factors in five major sectors: military, political, economic, societal and environmental. *The military security* is concerned with the action on two levels: the offensive and defensive capabilities of states and the perception of states regarding everyone's views. *The political security* is connected with the organizational stability of states, of government systems and of the ideologies which legitimize them. *The economic security* is concerned with the access to resources, markets and capital, necessary to support acceptable levels of welfare and power of the state. *The societal security* involves sustainability, under acceptable evolutionary conditions related to traditional linguistic patterns, to culture and religion, as well as to national customs and identity. *The environmental security* is connected with the maintenance of local and global biosphere as an essential support on which all other human activities depend. These five sectors do not operate separately. Each of them defines a focal aspect of the security problem and a path to organize priorities, but they are all related through a powerful netwotk.[3]

The theoretical concerns related to defining CFSP[4] were influenced by the Cold War and the relationships which the EU had to develop with its allies (USA), its enemies (the Soviet Block) and the "Asian threat" (especially China). Furthermore, the EU desire to construct an entity and to become a global entity was facing difficulties related to the fact that it inherited (and we can say it still inherits) the outcome of the World War II: on a military level, Europe was identifying itself especially through NATO, in spite of France's wish to impose a "European (or a French) vision" of the alliance.

The complexity of the international relations after 1989 brought new necessary and important elements in the definition of CFSP. The first was the fall of communism and the disappearance of the communist threat. Instead of a communist block, sufficiently homogeneous from an ideological and political point of view, there appeared new sources of threat: the fragmenting of the Soviet Block and the menace coming from a little controllable space with access to varied weapons, the economic instability of the satellite countries of the former USSR, the division of the former Yugoslavia (maybe the most important element from the CFSP perspective, if we consider Bosnia as the first

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[3] Barry Buzan in Dr. Dan Dungaiu's *Integrarea euro-atlantica, securitatea regionala si romanii din jurul Romaniei,* www.studiidesecuritate.ro; Translation mine

[4] Hans-Georg Ehrhart achieved a very interesting study in which he mentions the theoretical approaches which define the CFSP model. Three models were proposed, namely: EU as a civilian power force, starting from the unique situation of the European construction and the values (pre-eminently civilian) it promotes, a model which was supported by theoreticians of the 70s as Fraçois Duchene, the model of the militant power (theoreticians like Hedly Bull in the 80s), which started from the fact that a possible abandonment of the NATO umbrella will leave Europe exposed in front of any type of threat, and the model of normative power : "a normative power is characterized by its ability to shape standards of common sense. These norms define the international identity of the EU. Starting from these approaches, Hans - Georg Ehrhart proposes the model of "cooperative security provider", which relies on normativism, appropriateness, inclusiveness, multilevel orientation, multilateralism (Hans - Georg Ehrhart – *What model for CFSP?*, Chaillot Papers, no. 55, oct. 2002, www.isse-eu.org)

failure of CFSP even before the birth of this common policy). To all these were added the challenges launched by the process of globalisation, which emphasized competition coming not only from the recently communist-free East, but mostly from Asia (China, the last bastion of communism, began considerable reforms which in less than a decade led this economy to the top of world nations from the viewpoint of its dynamism—the highest rate of growth) and, let's not forget, from the USA[5]. International terrorism represents another very important element that any security model must take into account, which proves once again that the difficulty in creating CFSP is real.

Europe has searched for answers to some of these problems. The fall of communism allowed the reunion of Germany and the opening toward East, which concluded with the extension without precedent of the European Union. The direction towards market economy of the ex-communist countries helped to the development of financial instruments which led to "a second Marshall Plan" for Central and Eastern Europe, transforming the European Union into the biggest donor of financial assistance in the world. Europe has not abandoned the vertical axis of integration: together with the enlargement, it introduced a unique currency and applied a common monetary policy, it defined the construction of the internal market and made important steps in establishing a common citizenship.

I The history of CFSP

If on an economic level the EU is a giant, we can't say the same thing about it as an entity on a political level. The development of a common foreign policy represented a delicate issue along the years, which was perceived over the decades as a way of renouncement of the member states to their sovereignty and independence attributes.

Although the Rome Treaty made no specific reference to a political union, the efforts to set up a common defence and foreign policy have existed ever since the beginnings of the European construction. We can assess that the development of a common policy concerning foreign politics and common security has known two major stages, namely: the European Political Cooperation (EPC) stage, which is characterized mostly by the Europeans' endeavours to shape a set of coherent principles that could define the new path of politics and security, in an uncertain period on an international level, dominated by the existence of the two ideological systems and the two military blocks on a political and military level; the second stage is the after-Maastricht stage, when the Common Foreign Security Policy was conceived as a second pillar of the EU.

[5] The USA registered in the 90s one of the longest periods of economic growth which led this nation to the worldwide economic top. The European reaction was pretty modest. Through the Lisbon strategy, the Europeans tried to establish extremely ambitious objectives, such as the one to become the most competitive economy of the world by 2005.

The main stages of the European Political Cooperation can be summarized as such:

- In 1950, the Pleven Plan[6] was proposing the creation of an integrated European army under common command. The plan was the subject of negotiation among the member states of CECO and led to the formation of the European Defence Community, which was not ratified by France and, thus, was never applied.

- In the 60s, two ambitious projects were aiming at a tighter political cooperation among the member states, a union of states and a common foreign and defence policy. It was also stipulated the establishment of an independent structure which would ensure the transposition into practice of these measures, as well as the approval of the vote with qualified majority in certain situations. Neither of these initiatives was accepted by the member states.

- The Davignon Report of 1970 created the European Political Cooperation to ensure the mutual understanding and to strengthen the solidarity among member states regarding international issues.

- Another important historical event was the Copenhagen European Council decision of 1973 which was aiming at establishing common approaches and applying a coherent diplomacy.

- The Stuttgart European Council decision of 1983 was advising the inclusion of the political and economic aspects of security in the EPC.

- Finally, the Unique European Act of 1986 included in the treaty the European cooperation in the field of foreign politics. During this stage, the foreign politics of West-European countries were subjected to a process of harmonization on the basis of some informal agreements, without permanent official structures.

The birth of CFSP dates since the European Union Treaty (the Maastricht Treaty), in force since 1993 mentions for the first time this policy as the second pillar of the European Union[7]. The following developments which have affected the CFSP could be summarized as such:

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[6] www.europa.eu.int

[7] Created with the entry into force of the Treaty on European Union (EU Treaty) in 1993, Title V replaced EPC with an intergovernmental pillar in the Community structure. Article 11 sets out its five main principles:

- to safeguard the common values and fundamental interests of the Union;
- to strengthen the security of the Union;
- to preserve peace and strengthen international security;
- to promote international cooperation;
- to develop democracy and the rule of law, including human rights.

➢ the Amsterdam Treaty of 1997 improved the construction of PESC by extending the number of common instruments and by developing the decision making procedures;

➢ the Helsinky European Council in 1999 made decisions which consolidated the common defence and security policy;

➢ Between 2000 and 2004, the European Council reunions developed the plan for the construction of European military and civilian capabilities to solve crises;

➢ Finally, in 2004, *The Treaty to Create a Constitution for Europe* comprises important articles regarding the development of both the political dimension and the defensive one of CFSP and EDP.

The CFSP is also mentioned in Article 2 of the common provisions of the EU Treaty, which stipulates that one of the Union's objectives is 'to assert its identity on the international scene, in particular through the implementation of a common foreign and security policy including the progressive framing of a common defence policy, which might lead to a common defence…'[3].

Title V constitutes a separate pillar of the European Union, since the way it operates and its intergovernmental nature distinguish it from the traditional pillars of the Community, such as the single market and trade policy. This difference is most striking in the decision-making procedures, which require Member State consensus, whereas in traditional Community areas a majority vote suffices. In addition, the instruments of the CFSP, like those of the third pillar, differ from those of the European Community. The Maastricht Treaty provides the CFSP with the following key instruments:

❖ common positions, which require the Member States to implement national policies that comply with the position defined by the Union on a particular issue. One example of coordination can be found in the fight against the illicit traffic in diamonds, as a contribution to prevention and settlement of conflicts which are centered on countries such as Liberia, Sierra Leone and Angola;

❖ joint actions, which are operational actions by the Member States under the auspices of the CFSP. One example is the support for the Palestinian Authority in its efforts to counter terrorist activities emanating from its territories .

The Union may express itself through decisions, the conclusion of international agreements, declarations and contacts with third countries.

Another difference in relation to the first pillar is the less important roles played by the Commission, the European Parliament and the Court of Justice, which is in stark contrast with their powers in spheres of Community competence. The Commission's role includes the right to submit legislative proposals and budget execution. It therefore has a certain degree of influence over the formulation and coordination of this 'inter-pillar policy'. The European Parliament may put questions and recommendations to the Council and it holds an extensive annual debate on the implementation of the CFSP.

It is important to note that although the policy is intergovernmental in nature, there are many actors involved in the process. These include the European Council, the Council of Foreign Affairs Ministers, the Political and Security Committee, European correspondents, the CFSP Working Group and CFSP counselors. To these may be added the aforementioned influence of the Commission and the European Parliament. (www.europa.eu.int)

Taking into account the complex nature of the EU, it is not surprising that, as Michael Smith[8] remarks, there are three levels intertwining in the CFSP:

- First of all, the level of the European Community, and, respectively, the economic dimension of the European foreign politics;

- Second, we can mention the level of the European Union which, until the Unique European Act of 1986, constituted the unofficial coordination of the foreign politics of the member states in the framework of the European Political Cooperation (EPC) process. This direction of development was afterwards made official and actualized by the Treaty regarding the European Union and its modifications, starting with 1992;

- The third level is the national one, namely the separate foreign politics of the member states which are more and more influenced by EU's institutionalized foreign policy.

II The economic and the political dimensions of the EU

On an economic level, the European Union has succeeded to impose itself as an entity. The biggest successes were achieved as far as trade is concerned, where, there is no doubt that the European Union is the strongest actor. The trade policy is a common policy which is not coordinated by the member states, but by a communitarian organism, the European Commission. The unique market is valid and the EU has a common monetary policy[9]. The progress at the economic level is extraordinary, which can be proved also with clear figures:

- The EU is the biggest trader of the world, owning almost 40% of the global trade. The European Union countries are, otherwise, among the first exporters and importers of the world (in 2004, the biggest exporter in the world was Germany, the European Union having six of its member states in the top ten worldwide exporters). At any rate, the commercial dimension of the EU policies is the most important achievement in the integration plan, considering that during the negotiations, the EU acts through a sin-

[8] Michael Smith, *Europe's Foreign and Security Policy: The Institutionalisation of Cooperation*, Cambridge, Cambridge University Press, 2004

[9] Even if only twelve countries of the twenty-five EU member states are part of the monetary union, there is no doubt that the Euro currency is one of the most powerful currencies in the world. Furthermore, the ten states that adhered in 2004 are already part of the monetary mechanisms meant to ensure the transition towards the unique currency.

gle voice, the one of the European Commission. Paraphrasing the famous statement of Henry Kissinger, the former American secretary of state, *if I want to talk to Europe on the phone, whom do I call*, on a commercial level the answer would be: the European Commission!

❖ The European market is the biggest market in the world, its importance being supported not only by the large number of consumers (over 450 million, in the schema of 25 states), but also by the very high purchase force (the average real GDP per capita in EU25 in 2005 was 24,100 USD).

❖ The European Union countries are among the biggest investors in the world and are also hosting some of the biggest international corporations.

❖ The EU is an important actor on the international political stage as well, even if it does not act "through a single voice". Two of the five permanent members of the UN Security Council are European countries (France and Great Britain), four of the G7 members are European countries, EU is the biggest donor of financial assistance and, as a recognition of the role it plays on the international stage, almost every country has diplomatic representatives for EU in Brussels, and EU has set up delegations in over 120 countries.

In terms of its economic dimension, the model that the European Union should follow in the CFSP plan is at the crossroad of two great confrontations: **the internal coercions** which the European construction faces (caused by a multitude of elements, such as: the great number of countries—soon to be 27, the diversity on all aspects—cultural, social, but especially economic, the complicated mechanisms at the level of the Union, which are perceived as more and more burdensome by the European citizens and which push them away from the European institutions, leading to a more and more concerning deficit of democracy) and **the foreign challenges**, related to the terrorist threat, the lagging behind the USA, the more and more aggressive Asian offensive (with China as its main representative). Between these two coercions the EU is trying to define its identity, which is meant to satisfy the member states' egos, but also to be strong enough to prove itself in front of the other partners.

The European identity in the CFSP plan is difficult enough to sketch, although, paradoxically, of all the "projects " aimed at deepening the integration, the one related to CFSP is the most approved of by the Europeans (especially the EU15). A reason for this attitude could be determined by the fact that this is the field where few steps have been made and CFSP has not yet achieved a certain level of development that could lead to reaching national sovereignty. Unanimity still represents a fundamental principle concerning the authorization of all actions of the common foreign security policy.

Since the foundation of CFSP, the EU has manifested many weaknesses regarding its foreign politics. An example is the Bosnia conflict, when the lack of reaction of the European leaders allowed the USA to take initiative and act under the auspices of NATO. We can also underline a series of unilateral actions inside the EU, such as Germany's decision to singly recognize Croatia's independence[10], or Greece's unilateral imposition of a blockade against Macedonia motivated by the fact that the latter were using Greek cultural values, or Great Britain's support of the USA position of threatening the Iraky regime unless they submit their weapons to be inspected by the United Nations[11]. But maybe the biggest "defeat" of the European Union at the level of its foreign policy was the Iraky War. The positions of the European leaders were very contradictory: on the one hand there was the group of countries led by France, which repeatedly strengthened their position against American intervention, on the other hand there was the group led by Great Britain, which supported unconditionally and participated with the USA at the formation of an international coalition against Sadam Hussein's regime.

III The enlargement of the EU and the challenges launched by CFSP

The extension in 2004 towards Eastern Europe presented EU with new challenges in its plan of foreign and security policy. The five dimensions of security, identified by the Copenhagen School, are more up-to-date than ever inside the European Union. Additionally, the European citizens seem to grant greater importance to the social and environmental dimensions than to the political and military ones. In a study completed in 2005[12], it was shown that the Europeans are more concerned with global warming than terrorism, which says a lot about the immediate interest related to, for example, the formation of a common security policy. Paradoxically, or maybe not, the rejection of the Constitutional Treaty, thought of as the most recent CFSP failure, is not related to the rejection of the European idea in general, but to the "old members' fear" of unemployment, immigration and economic crises. In this context, we can say that the Eastern extension has rather brought obstacles in the formation of CFSP. The new members are closer to NATO than the old ones, which entitle the citizens of the 15 countries to consider them as pro-American, rather than pro-European. Furthermore, as it is shown in the study mentioned above, the Europeans have a different understanding of the concept of super-power. According to most Europeans, the status of super-power must not necessarily involve the military dimension. There is a strong preference for the so-called "soft-power", which should be promoted by the EU and which should include the prevalence of the monitoring actions of elections to the prejudice of economic or military sanctions.

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[10] There have been voices at the time that considered Germany's recognition of Croatia's independence as a gesture of friendship between former allies.

[11] John McCormick, *Understanding the European Unuion – A concise introduction,* Pelgrave, 1999, p. 208

[12] Transatlantic trends 2005, www.transatlantictrends.org

The NATO affiliation of the new EU member states (from the 2004 extension, as well as the countries that will join the Union on 1st January 2007) creates a certain "dis-comfort" for Europeans. The present transatlantic relations can be described as being under a state of suspicion nourished by both parties. On the one hand, the United States, prevalent in the security issues and the hegemonic ruling of worldwide affairs, are complaining about the weak contribution of Europeans in NATO and about the fact that they are profiting from the benefits without a proportional effort. On the other hand, the USA are afraid not to be abandoned by the European allies with the construction of PESA, and the EU capacity to lead military actions is perceived as a reduction of the NATO role and as a decoupling from the ally strategy.

As far as the Europeans are concerned, who have traditionally been more reserved concerning the increasing of military expenses to efficiently contribute to the Western defence military capabilities, they wish to play a substantial role in achieving the Western security policy. From a larger perspective, we can notice that internal structural factors are to be blamed for this situation of relationships. The two allies have fragmented political systems in which governments can't control the internal media and in which divergent priorities are developing. There are also different perceptions of threats and risks, political preferences and different perspectives, as well as diverse definitions of national interests[13]. During the last three decades, the technological and military lag of the EU member states (except for Great Britain and France) behind the USA has grown. Starting from this, the American administration gradually adopted a more unilateral approach of military interventions, tending to engage in ad-hoc military coalitions. Additionally, the European Union still does not have, as an entity, the necessary political unity to construct a common armed force. In spite of its increasing global economic and financial power, the European Union cannot yet have a significant global military presence in the case of a conflict, even a diffuse one, such as the fight against terrorism, and even less probable in a war situation. At the same time, the European Union does not have the necessary material resources to form a military force capable of a fast intervention at a global level, simultaneously on several operating fields. At any rate, the EU defence expenses are significantly lower compared to the American ones: around 40% of the American level of expenses for military equipment, including research and development. The situation is identical for the operations led and for the maintenance of the operational forces.

[13] Ingo Peters, *ESDP as a Transatlantic Issue: Problems of Mutual Ambiguity*, International Studies Review, vol. 6, nr. 3, 2004.

IV Romania's adhesion and CFSP

The European Union extension after 2007 will lead to the re-drawing of the European borders. Romania's Eastern neighbours (Ukraine, The Moldavian Republic) will become both the Western frontier of Russia's "close neighbouring area", and the Eastern border of the "new EU neighbouring area". The new geopolitical context will need an active involvement of Romania in the politics of the "new EU neighbouring area", including in the management of "the latent conflicts" from the Commonwealth of Independent States, as well as those from Transnistria. At any rate, Bulgaria's and especially Romania's location in the EU's Eastern neighbouring area represents the biggest challenge for EU's security. The two countries can substantially contribute to applying CFSP through the existent human resources and logistics, as well as through the experience acquired in peace support and regional military cooperation missions, but they also have to mobilize their efforts to ensure an adequate security of their frontiers.

In this context, in spite of some concerns manifested by the European citizens, the 2007 enlargement can take place rather from an impulse of the EU to continue the CFSP construction then from a source of distress. On the other hand, we must not forget that the important economic lag behind manifested by the two countries joining the EU in 2007 in comparison to the rest of the member states can issue a number of delays in the support of different EU initiatives, including on the CFSP axis. The significant differences from the EU25 concerning the GDP per capita (a third), the work productivity, the inflation (in Romania), the trade deficit represent some of the threats against the EU security. The access of the citizens from the two countries to the European workforce market constitutes a reason of worry for the Europeans of EU 15, even if the 2004 enlargement has shown that no important migration took place from the countries which became members two years ago. The fear of the Europeans in the 15 states which signed the Maastricht Treaty against the newcomers is not motivated solely by the drawbacks created by the Eastern citizens, but mostly by the inability of the EU 15 to solve the imperative social problems EU is facing, especially unemployment. This anxiety is fueled by the fact that many Romanians are working in countries like Spain, Germany or Italy in fields like agriculture and constructions, giving the (almost always false) impression that the Easterners have come to take up the jobs of the citizens in the respective countries[17].

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[17] In fact, the central European countries compete more often for projects against distant low-wage rivals such as China and Brazil, and all Europe benefits from central Europe's success. But still, some industrial capacity is shifting directly from the old to the new members. And some workers from central Europe are indeed entering western labour markets, often illicitly, since most EU governments have bowed to public opinion by closing their job markets to the newcomers. Such migration usually helps local economies, but it still upsets local interests ("*Is the EU losing the will to enlarge itself*", The Economist, April 2005, www.economist.com).

Comparing the threats feared by the EU citizens in the context of the 2004 enlargement with the consequences of this extension, we can say that the extension was rather a success than a disappointment. This situation can be extrapolated to the new enlargement wave. There were no obstacles at the level of the communitarian institutions, in spite of the fears related to the increased number of clerk workers, the economic growth was more rapid in the Eastern zone than in the Euro zone, and immigration from the new EU members did not cause social instability in the Euro zone.

Of all the European approaches, the enlargement represented maybe the most successful product exported by the EU. Nevertheless, the desire to extend is more and more diminished in the European countries.[18] The anxiety related to cultural integrity and national security is far too powerful to be able to convince the EU 15 citizens that the enlargement is a useful thing for Europe, especially if by extension we take into account not only Romania and Bulgaria, but also Turkey! Europe is transforming from an exporter of stability into an importer of instability, especially in the light of the international evolutions after 11th September 2001. The EU Eastern borders are becoming more and more unstable in the eyes of the Europeans, taking into account the economic, political and social situation from those countries and the fear that the new frontier-countries (Romania and Bulgaria) will not have the capacity to ensure an adequate border protection (in what Romania is concerned, its somehow privileged relations with the Moldavian Republic are considered a source of insecurity, taking into account the economic and political situation in this country).

Euroskepticism, one of the big enemies of the integration deepening, must not find its source in the new countries joining EU in 2007. In 2002, a Eurobarometre survey showed that 41% of European citizens did not want to find out more about the candidate countries, 76% did not want to live or reside in these countries, and 91% of them "felt no tie of any kind with them"[19]. This indifference or maybe negative attitude was contrasting with the support offered by the enlargement to the candidate countries. Both in the case of Romania and of Bulgaria we witness the same situation: the EU citizens' support toward the new extension wave is even lower than the one for the 2004 extension, while the Romanians' and the Bulgarians' is very strong. The threat does not come only on behalf of the EU citizens. The ones from the recently become members of EU are manifesting a tendency of lowering their support for the European construction, especially because of the feeling that they are considered second rank citizens. This attitude is fueled by the differentiations in the "rights" acquired after joinig EU. For the newcomers, the rules related to the free circulation of the workforce, the level of salaries or subventions are different. Even if these differences have an objective explanation concerning the lag of the recent or future member states behind the average EU 15, the citizens' perception as being unwanted or considered "the poor country

[18] Except for, maybe, Croatia, and this because its beautiful sea coast! ("*Is the EU losing the will to enlarge itself*", The Economist, April 2005, www.economist.com)

[19] "*Is the EU losing the will to enlarge itself*", The Economist, April 2005, www.economist.com

relatives" creates a feeling of frustration which fuels the nationalist and extremist tendencies, that are extremely dangerous to the European security.

By way of conclusion, we believe that the European project of constructing a CFSP is only just beginning. Although there are numerous voices saying that the rejection of the constitutional treaty represents the compromising of CFSP's future, we consider that it is only redefinig itself. Europe has concentrated for almost half a century on the economic aspects of integration and succeeded to impose a certain model at an international level. Will it need the same amount of time to construct a common foreign security policy? There are sufficient specialists believing that Europe is facing an acute democratic deficit and, in this context, the leaders' desire to progress in the field of the common foreign security policy is not shared by the majority of the population. The challenges brought forth by the Eastern enlargement, considering that the problems faced by the new and old members are socio-economically determined (unemployment, intolerance, ageing population), are challenges that need an EU solution as soon as possible.

Debates and Essays

Might the Globalization Button Turn the European Social Bohemia off?[1]

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It is often argued that while ambitious and expensive social spending was in the past compatible with competitiveness, ongoing globalisation makes the reconciliation of EU social and economic goals more difficult. Lisbon addicted at the level of discourse, Europe is still performing unevenly, but on the whole rather poorly. The Hampton Court Summit in October 2005, hosted under the auspices of the EU British Presidency, was one of the first concerted attempts to address the issue of EU global coherence.

The subtle approach

The luxurious Hampton Court Palace has been existing long before the world became global, and Europe became "social". Almost half a millennium since its inauguration, the edifice has been in 2005 a one day host for the European leaders, brought together in order to throw light on whether the anxieties caused by globalization are more properly cured within the capitalistic market logic rather than in that of the feudally scented privileges. Since then, the European Union has mainly improved its anxiety awareness.

Hampton Court will probably remain more notorious in history as the residence of King Henry the VIIIth, than for the October 27th 2005 Summit, tight on producing God knows what revolution of understanding in a Europe that continues to perceive as threats the precise phenomena which disclose the fallacies of many of its politicians.

The Europe of the beginning of the third millennium after Christ, rather than being a Single Market, vast and free, looks, in many respects, more like a frustrated stand up tragic-comedy. The EU-25 leaders quarrelled long wondering how the 2007-2013 budget should look like. Well, it shouldn't be too big, but then again, neither too small. It should contain neither too generous agricultural expenditures (for the French farmers, *biensûr*), nor too scarce; having neither rebate nor lack of it (for Englishmen, of course). In the end, The European Council reached agreement on an overall figure of 862,4 billion euros for the EU's long-term budget in December 2005 and after the European Parliament threat to vote down the deal and demand of an extra 12 billion, and via a series

[1] This article expands on issues treated by the author in analysis hosted by Piata Financiara – Romanian financial and banking monthly.

of trilateral meetings between Parliament, Council and the Commission a final deal was reached on 4 April 2006[1].

Anyway, the big and sole certitude is that it's never ok with Europe. The Union still bears the burden of one unborn Constitution that suffers in backstage, in the absence of one unborn European *demos*. Another embarrassment is the lack of a vision for the development "social model" of the future Europe. Equally disturbing are the "patriotarde" inconsistencies towards the free movement within the Single Market (noticeable in the field of services or in that of workforce mobility). Last but not least, Europe is dazzled by the mumbo-jumbo phobias on the theme of the so called tax and social dumping, expressed by some of the "full-time privileged" from the old member states towards the eastern new recruits.

In 2005, the British hosts' merit, whose *kingdom* holds the *presidency* of the Community, was that they have one of the few relatively sound discourses regarding the EU reform. They offered, on the occasion of the Summit, a simultaneous translation of this European dialogue of the deafs. The opening argument stated by Prime Minister Tony Blair has purposely dodged the intra-community quarrel.

The British presidency from the second half of 2005 has emphasised the role of globalization, pleading, indirectly, in favour of solving indigenous frustrations by focusing the debates on exogenous threats that the former made the latter happen. The European Union is vulnerable to pressures imposed by the global market competition. The British thesis, highly refined from the point of view of political art, was the following: *internal severance leads to delayed reactions against global competition. Be it merely for this reason that we may solve our internal issues, firstly!*

The European *malentendu*

One of the fair definitions of globalization refers to the diminution and, finally, abolition of restrictions imposed by the State upon commercial and capital border-cross flows, as well as the to the more and more integrated and complex system of production and exchange which, consequently, comes into existence[2].

For those who still carry a drop of breath in their lungs after such a formulation, there is one more bewilderment: all fine and dandy; however who should fear globalization? One answer as fair as the aforementioned definition may sound like that: the one who fears competition, may it come from abroad, from beyond the county, from beyond the block in which lies his *petite boutique*, or just around the corner. On the other

[1] This secured an extra 4 billion euros and an additional 2,5 billion euros in the European Investment Bank funds for reaching the Lisbon objectives and equally ambitious and ambiguous goal.
[2] Based on the very concise definition of Cato Institute columnist, Ted Carpenter, in "Globalization is Grrreat!".

hand, no sane consumer suffers because of the multitude of options available. And if so, there is always someone there to remind him of the communist "planned abundance".[1]

In the Europe of the beginning of the third millennium, globalization is an issue as long as there are politicians that simply don't get it that the laws of the *villageois* economics also apply to the global village: the consumers mercilessly arbitrate among producers that compete against each other to fulfil their desires. The issue here is who stops them from fulfilling the desires of the consumers. If we are talking about pure bad management, then, tough luck! If though the institutional premises of competitiveness are out of order, the tough luck bears the name of *Social Europe*!

The French-German *Antante* that governs the Union has prepared an infernal offer for the competitiveness of the European enterprises. What kind of reforming ideas can these two *big states- big regulated economies* produce, when they believe that lowering taxes means playing with fiscal dumping fire and moderate compulsory payroll taxes are nothing more than dangerous sparks of social dumping?[2]

Let's focus on the *françois*: public expenditure that swallow half of the economy, almost one thousand state controlled companies, one public wage sheet that holds one out of five employees, a sclerotic labour market strongly defended by unions, unsustainable and over indebted social and health insurance systems. The *Deutsch* come close by, though they do seem to show signs of an early wake-up, though muddled by the tough governance of CDU-SPD big coalition spurred from the autumn 2005 elections.

All that overwhelming "social" concern, trademark of the modern Europe, means additional costs for the businesses that operate in such unfriendly business environments. On the other hand, all that tacit French-German appetite for *harmonious red tape* on all levels (quality, social, environmental standards) is perfectly explainable as the competition between institutional treatments for economic agents may let you, proactive State, jobless: the budgetary crop drops down together with the capital drain. Moreover, that means unemployment.

[1] A subset of great Ludwig von Mises concept of "planned chaos". In order to acknowledge his works, see www.mises.org.

[2] See a very brief and convincing comment in Grant M. Nulle's "The Franco-German Alliance Against Market Freedom", available at www.mises.org.

British prudence

If you have in the EU an almighty European Commission that still dictates community standards for economic agents to comply with[1], limiting their ability to compete through costs or that could still threaten the states with "irresponsible" tax initiatives that, if they lower the taxes they would kiss the EU funds good bye, how could you tame the Indian and Chinese producers that are not is your jurisdiction and simply do it cheaper?

It is obvious that in the light of the new tests that the European economy was submitted to, the EU leaders summoned by the British EU Presidency could do little but to agree with the idea that Europe must be put back on track. And this can only mean accepting global competition, since the isolation in a protectionist and bohemian fortress is not an option.

The means thought to revive European competitiveness are also uneven. Commission President, Mr Jose Manuel Durao Barroso, speaks of less bureaucracy for the European companies, of more money for R&D, of a more efficient use of energy and even of a fund specially dedicated to help the workers hit by the fierce global competition change their profession.

Indeed, it was impossible not to raise a thrill with the appraisement that EU-25 is exposing itself to the risk of being threatened by the fact that the number of unemployed could reach nine million souls. The foresight was exploited by the French officials that continue to insist on the fact that the cure rests in the salvation of traditional social security schemes from the claws of the merciless "Anglo-Saxon capitalism".

For a clear mind, figures are not allowed to seem more dramatic that the causes that lie behind them. It is hard to say how much of this unemployment figure is caused by the *natural errors of the market* and how much by *bad policy making* within the labour market, that make natural adjustment impossible or at least unappealing. And then, what is to be done? Should one allow the market to act freely or should one spend more public money for the purpose of correcting the very damages caused by *reform adverse* politicians?

The idea of a fund designed to absorb the shocks induced by globalization – which, by the way, would not mean additional contributions but would be nurtured from the amounts left unspent from the common budget – was, of course, met with enthusiasm by the *Francois*, with coldness by the *Deutsch,* for whom the internal need for reform requires prudence towards the payments to the common budget, and with vigilance by

[1] See, e.g., a lucid comment on that in Tupy, Marian, *EU Enlargement. Costs, Benefits and Strategies for Central and Eastern European Countries*, Cato Policy Analysis, No. 489, September 2003, available on www.cato.org.

the Brits. Blair did not hide his suspicion that this kind of fund could be used to obscurely subsidise the companies found inadequate by globalization.

Les "bleus" sont rouges

The previous impression from the Hampton Court Summit, and not at all diluted afterwards, is that between the French government and the majority of its other companions in the Union, a huge abyss has emerged. The Frenchmen seem to have collected all the anti-economic arguments on the market that survived in full global capitalistic era.

For instance, Paris demands, up to the very edge of political hysteria, protection for European farmers (more precisely *French speaking farmers*) against the cheaper agricultural products coming from other parts of the world. This threatened to blow off the common European position regarding the reduction of subsidies and custom taxes, that was expected to take the numbness out of the general commercial negotiations within the WTO Ministerial Conference in Hong Kong. Hypotesis confirmed. The Doha Round collapsed in June 2006 due also to EU reticence in issuing a goodwill position toward opening its agricultural markets in exchange for the opening of the industrial and service markets by the developing countries. In spring 2005, hand in hand, Berlin and Paris gave it another shot, forcing the Commission to take it slowly with the liberalization of services in the internal market, as they feared the invasion of cheap workers from the New Europe invading the rigid (guess whose fault?) French labour market that irremediably corrupted the Services Directive. Moreover, France has made a pact with other countries with highly developed textile industries for the protectionist undertaking of re-imposing import quotas for clothes made in China. Following the same pattern, French authorities came up with a list of ten strategic sectors, in which the take-overs of domestic companies by multinational corporations are banned for fear of consequent restructuring of the former. In that, there was no emotion concerning the breaking of both natural and legal principle of free movement of capitals. And nor was more substantive the attitude towards Turkey because of the same economical and social phobias.

Traditionally, the EU was designed by France as the perfect tool for dominating the continent. But then, enlargement has diluted its influence. Given the internal failure, France, once the acceleration pedal of the Union, became its brake. Economically at least, because, from the point of view of the political centralization/integration, the EU is regarded with hope by one Paris that "can not allow Europe to become a simple free trade area". That is, for the government of one country in which populism is the second official language and where the economy gasps for air precisely because of that ambition. That is why the contemporary global economy, defined by the focus on information and services, should not be allowed to unravel the *archaic industrialism* that Paris is struggling to preserve in the name of "social peace".

Exhausted because of the elections in 2007, French politicians started marching on the easy path of winning electorate with blurry offers of temporary social security designed to work only for the duration of a single electoral mandate. There is a distinguishing sensation that France is always "before elections".

In France, *free market economics* is taught as an Anglo-Saxon academic course in which economic ideas are coloured by nationalistic brushes. But no matter what the politicians of the Seine are campaigning for, the economic laws never need democratic support in order to function. Much less, in the global world of nowadays, prosperity can not be gained by votes. However, one could neither accuse the politicians alone for not knowing what to "offer", as the citizens are equally guilty for not knowing what to "demand". In other words, between *"L'Etat c'est moi"* and *"L'Etat c'est nous"* there is absolutely no difference as long as the economy is moiling and toiling *"dans un mauvais Etat"*. Bad economics leads to bad politics, and bad politics are the language of the Burden State.

What Will Happen after the European Integration?

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Romania's accession towards EU is the most complex and important process of modernization we have undergone. The transition to democracy being accomplished, we are fully confident the economic development will follow the same path and with the same steps the integration process.
The European integration also represents a significant chance for Romania to rejoin the European club, to limit historical discrepancies, but also to contribute to the fulfilment of EU's strategic objectives (the Lisbon strategy).

Despite the general positive effect that the accession has on Romanian economy, the impact might not be equal, meaning that some companies will benefit more than others. Opening the new markets brings pressure on the enterprises, especially those operating in industrial fields with a long history.

The accession to the European Union represents for the Romanian companies the access to a 450 million-consumer market through the removal of the barriers to the free movement of goods and services. The business community must therefore understand that there are both long-term advantages and short-term risks and these must be optimally managed. We want the business community to be informed as well as possible about the procedures of alignment to the Community standards. To this end, the Ministry of European aims to reinforce communication with the business people and provide expertise on various sectors of the acquis, in association with the other institutions concerned and the employers' associations. We believe that if the business people are better informed, they will be able to prepare more efficiently for the Internal Market of the Union.

Our country's accession to the EU will bring advantages to both Romania and the European Union; that is because, after the accession, Romania will secure the Eastern border of the Union and will, therefore, bring its contribution to the strengthening of stability and security in the region. In this context, Romania will bring plus value on the measures regarding the external policy of the European Union.

Romanians should have realistic expectations related to Romania's accession. People are to understand that the European Union is not used to give presents, but an active implication is required in this process.

In the mean time, also the SMEs will be exposed to numerous changes in the business environment mainly caused by economic restructuring and accession preparations. The most affected SMEs will be the ones where the *acquis communautaire* stipulates that it is mandatory to implement EU's standards of environment, quality, hygiene, food safety, product security and work protection. Also, some SMEs might be affected after implementing the *acquis communautaire* in the field of state aid, by eliminating fiscal and quasi-fiscal subsidies and consolidating the financial discipline.

Institutional provisions regarding Romania

As the 7th largest country of the EU, after accession Romania will play an important role in the decision-making process and in shaping the future of the Union.

Romania has representatives in all EU institutions. A national of Romania was appointed to the Commission as from the date of accession, by the Council, acting by qualified majority and by common accord with the President of the Commission, after consulting the European Parliament.

Romania has 35 representatives in the European Parliament between the date of accession and the date of the next elections for the European Parliament in 2009. Before 31st of December 2007, Romania and Bulgaria shall each hold elections to the European Parliament, by direct universal suffrage of their people for the term 2009-2014. Starting with the term of office 2009-2014, Romania will be represented by 33 members of the European Parliament according to the Act / 35 MEPs according to the Protocol.

Where the Council is required to act by qualified majority, Romania will have 14 votes. The qualified majority threshold is fixed at 255 votes out of 345, whereas the blocking minority requires 91 votes. Furthermore, a Member State may request the verification whether these 255 votes represent at least 62% of the total population of the Union.

Romania has 1 judge in the Court of Justice, 1 judge in the Court of First Instance, 1 member in the Court of Auditors, 1 member in the Board of Directors of the European Investment Bank, 15 members in the European Economic and Social Committee and 15 members in the Committee of the Regions.

Financial provisions

Romania will fully participate in the financing of the EU budget from accession, although the financial package agreed is in its favour for the first three years of membership. Without prejudice to future policy decisions, the overall committment appropriations to be made available for Romania over the three-year period 2007-2009, shall amount to EUR 5.974 million for structural actions and to EUR 2.308 million for rural development (2004 prices).

Estimates of the financial implications of agreements reached with Romania under Chapter 7 – Agriculture in the first three years after accession are as follows: for market measures EUR 732 million and for direct payments EUR 881 million (2004 prices). Direct payments will be phased in at 25% in 2007, 30% in 2008, 35% in 2009 and 40% in 2010 of the direct payments level of EU-15 and thereafter increase by 10% increments to reach 100% of the then applicable EU-15 level in 2016.

For the first year of accession, the Union shall provide temporary financial assistance as "Transition Facility" to Bulgaria and Romania amounting to EUR 82 million, to develop and strengthen their administrative and judicial capacity to implement and enforce Community legislation and to foster exchange of best practice among peers. This assistance shall fund institution-building projects and limited small-scale investments.

A Cash-flow and Schengen Facility is also created as a temporary instrument to help Bulgaria and Romania between the date of accession and the end of 2009 to finance actions at the new external borders of the Union for the implementation of the Schengen acquis and external border control and to help improve cash-flow in national budgets. For the period 2007-2009, Romania will benefit of EUR 559, 8 million (2004 prices) in the form of lump-sum payments.

From the date of accession, Romania shall pay 42 300 000 euro as contribution to the subscribed capital of the European Investment Bank, in 8 equal installments up to November 2011, and 29 880 000 euro to the Research Fund for Coal and Steel, in 4 installments, starting in 2009.

Periods of transition and derogations

Romania has negotiated 50 transition periods and derogations, among which:

The EU has requested a transition period regarding the free movement of persons. Romanian workers will have restricted access to EU job market for at least 2 years after accession. The transitional arrangement should in principle come to an end after five years, but may be prolonged for a further two years in those current member states where there would be serious disturbances of the labour market. Similarly, Romania can apply restrictions for EU workers, for the same period of time. During this transition period, Romanians can work in the EU states on the basis of bilateral agreements.

From the date of accession, Romania shall participate in the Economic and Monetary Union, as member states with derogation from the adoption of euro. At least two years after accession Romania has to be part of the Exchange Rate Mechanism and to fulfill the Convergence Criteria established by the Treaty of Maastricht.

Romania was granted a five-year transitional arrangement for the acquisition of land for secondary residences by EU citizens who do not reside in Romania and a seven years transitional period regarding the purchase of agricultural land and forests for EU citizens who are not self employed in Romania. Under the chapter Competition policy there are two specific transitional arrangements regarding fiscal aid measures and a strict timetable for putting into practice the commitments subject to the postponement clause.

Transitional arrangements and a limited number of derogations were granted to Romania in the field of indirect taxation (VAT and excise duties) as well as direct taxation, most of them aimed at allowing to postpone the adjustment in particular of the excise duty rate level to the requirements of the *acquis*, especially for socially sensitive goods.

Various transitional arrangements, limited in time and scope, accompanied by a clear plan for the implementation of the *acquis*, were agreed under the chapter Environment for air quality (3 years), waste management (up to July 2017), water quality (up to 2018), industrial pollution (up to 2017). Their potential transboundary impact is limited and they do not lead to significant distortions of competition. Most of them were required due to financial constraints.

At chapter 7 - Agriculture – Romania will benefit from a transitional period of 8 years to remove prohibited hybrid wine varieties under the EU wine acquis and from periods of up to 3 years for veterinary and phytosanitary aspects. Romania has obtained the recognition and the protection of the designations of origin and the geographical designations of several spirit drinks made of plums (e.g țuică, horincă) and distillate of wine – vinars, of the spirit drink palincă and of several types of food products such as milk, bread, cheese, yoghurt, sausages, pie, pretzels, jam.

Romania's integration into the EU has proved to be a tremendous process in terms of redesigning our strategy and our way to formulate public policies. We are already prepared to act in a responsible, European manner; we know how to establish short- or middle- term goals and objectives, we are able to set appropriate deadlines and define responsibilities. The real integration process (its practical aspect, as opposed to the formal accession), seen as a major social, political and economic transformation, will inevitably mean short-term costs. But the medium and long term benefits will prevail and will be as inevitable as the short term costs. To put it simply, if one wants to see a rainbow, one has to accept the rain.

International Academic Events

The Nobel Prize in Economic Sciences 2006

Full employment, stable prices and rapid growth are central goals of economic policy. But policy always faces difficult goal conflicts. How should inflation and unemployment be balanced against each other? What tradeoff should be made between the consumption of current and future generations? ***Edmund S. Phelps*** *has advanced our understanding of both of these tradeoffs. He has emphasized that not only the issue of savings and capital formation but also the balance between inflation and unemployment are fundamentally issues about the distribution of welfare over time. Phelps's analyses have had a profound impact on economic theory as well as on macroeconomic policy.*

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Inflation and unemployment

According to the prevailing view during the 1960s there existed a stable negative relationship between inflation and unemployment, the so-called Phillips curve. This relationship was apparently confirmed by data from several countries. The implication was that there was a choice for economic policy between low inflation and low unemployment. By expanding demand through fiscal and monetary policy it was possible to reduce unemployment. According to the Phillips curve, this would come at the price of a one-time increase in the rate of inflation.

There were several problems associated with this view. The Phillips curve was a purely statistical relationship. There was no clear link to microeconomic theories about the behavior of individual firms and households. There was also no theory about the minimum possible unemployment. It was of course generally accepted that the unemployment rate could not be reduced to zero, but there was no clear understanding of what level of unemployment was compatible with equilibrium in the labor market.

In the late 1960s, **Edmund Phelps** challenged the earlier view on the relationship between inflation and unemployment. He recognized that inflation does not only depend on unemployment but also on the expectations of firms and employees about price and wage increases. He formulated the first model of what has come to be known as the *expectations-augmented Phillips curve*. This says that for a given unemployment rate a one percentage point increase in expected inflation leads to a one percentage point increase in actual inflation. In setting prices and negotiating wages and salaries, firms and employees base their decisions on their beliefs about the development of prices and wages in general. This hypothesis has received overwhelming support in subsequent empirical research (with the possible proviso that the impact of inflation expectations on actual inflation may be smaller at very low inflation rates).

Phelps's analysis stood in contrast to the earlier views on the ability of an expansionary fiscal and monetary policy to permanently increase employment. Instead, his conclusion was that there is no long-run tradeoff between inflation and unemployment, since inflationary expectations will adapt to the actual inflation. In the long run, the economy is bound to approach the *equilibrium unemployment rate,* at which actual and expected inflation coincide. Equilibrium unemployment is only determined by the functioning of the labor market. Attempts to permanently reduce unemployment below the equilibrium rate will only result in continuously increasing inflation. Stabilization policy still has an important role to play in dampening the short-run fluctuations in unemployment around its equilibrium level.

Phelps's contributions highlighted the importance of analyzing how future possibilities of reaching the goals of stabilization policy are affected by today's policy: high inflation today means higher inflation expectations in the future, thereby rendering future policy choices more difficult. A policy of maintaining low inflation can therefore be regarded as an investment in low inflation expectations, enabling more favorable combinations of inflation and unemployment in the future than would otherwise be available.

Phelps also developed the first model of the determinants of equilibrium unemployment. In this model, firms set wages in order to affect the number of employees. The more a firm needs to expand its workforce and the lower the rate of market unemployment, the higher the wages it will offer. Phelps showed that there exists a unique equilibrium unemployment rate, at which the average firm will raise its wages at the same rate as wages are expected to rise on average in the economy. The innovative aspect of Phelps's approach was that it started from explicit assumptions about the behavior of individual agents in the labor market. Phelps's contribution was also the first to integrate the hypothesis of efficiency wages into macroeconomic theory. This hypothesis states that it may be in the best interest of a firm to set high wages in order to improve workers' morale, reduce labor turnover and attract better qualified employees. Such mechanisms may help to raise the level of unemployment in equilibrium.

Phelps was not alone in criticizing the Phillips curve in the late 1960s. Milton Friedman (1976 economics laureate) also emphasized the role of inflation expectations. In contrast to Friedman, Phelps emphasized that causation runs from unemployment to (unanticipated) inflation. He derived the expectations-augmented Phillips curve from an explicit model of the wage-setting behavior of firms in a labor market in which matching the unemployed with vacant jobs is a time-consuming process.

Phelps's work has fundamentally altered our views on how the macroeconomy operates. The theoretical framework that he developed in the late 1960s soon proved fruitful in understanding the causes of the increases in both inflation and unemployment that took place during the 1970s. He also clarified the limitations of macroeconomic policy. As a result, policy is now conducted in a radically different fashion from before. One example is that central banks now routinely base their interest rate decisions on assessments of the equilibrium unemployment rate and the tradeoffs between the effects of policy at different horizons.

Capital formation

Viewing low-inflation policy as an investment in low inflation expectations was natural to Phelps against the background of his earlier work on capital formation. There he had asked what rate of aggregate capital formation (both in the form of physical capital and human capital, i.e. education as well as research and development) is desirable. What fraction of national income should be consumed now and how much should be invested in order to increase the capital stock, thereby boosting future production and consumption? This question is crucial for the distribution of consumption and welfare across generations. In this area as well, Phelps's contributions have opened the doors to later research and had a profound impact on the debate over economic policy.

In one of his first published articles from 1961, Phelps derived the so called *golden rule* of capital formation. Taking an inter-generational perspective he posited that the goal is to attain the maximum consumption per capita that is sustainable in the long run. The term golden rule makes reference to the ethic of reciprocity: "Do unto others as you would have them do unto you". Here the interpretation is that the consumption level should be the same for all generations. According to the rule, the desirable savings ratio fulfills a simple condition: it should equal the ratio of capital income to national income. An alternative statement is that the savings rate should be high enough to maintain a capital stock that yields a return (a real rate of interest) that is equal to the rate of growth in the economy. Similar conditions had been stated before by Maurice Allais (1988 economics laureate), among others. But it was Phelps's analysis that had the greatest influence on subsequent research.

Phelps's original analysis was restricted to comparing long-run situations, presuming that the economy was there "from the beginning". But the process of *changing* the savings ratio from one level to another may create distributional conflicts. If an increase in the savings rate is required in order to attain the golden rule, the welfare of future generations will increase but the current generation will lose. The reason is that the current generation has to reduce its consumption in order to save more, whereas later generations will benefit from a larger capital stock allowing them to increase both consumption and saving. However, Phelps later demonstrated that there may be situations of *dynamic inefficiency,* where the capital stock is so large that it is possible to increase the welfare of all generations by reducing the savings rate. The explanation is simple. By reducing the savings rate, consumption can be increased immediately. If the original savings rate is above the golden-rule level, this reduction also implies a long-run gain in consumption. Despite a lower capital stock, and hence lower production, the lower savings rate offers scope for more consumption.

Parents tend to care about the welfare of their offspring. In a contribution from 1968 that was long before its time, Phelps (jointly with Robert Pollak) concluded that savings can be too low if the current generation has a different valuation of its own consumption in relation to that of the next generation (their children) than it has of the consumption of the children in relation to their grandchildren. Such so-called time-inconsistent preferences may be expressed as "my parents think that I should save more for my children than I think myself". In these circumstances, public measures in order to increase the savings of all generations, e.g. through a public pension system, can increase the welfare of all generations. Time-inconsistent preferences, like those analyzed by Phelps and Pollak, have recently attracted a great deal of attention in the field of behavioral economics, where insights from psychology have been introduced into economic analysis.

Phelps also analyzed the role of investment in education (human capital) and research and development (R&D) in the growth process and shown that the golden rule can be generalized. In order to achieve maximum long-run consumption, R&D investments (which raise the technology level) should also be adjusted to the level where their return is equal to the growth rate in the economy. In joint work with Richard Nelson from 1966, Phelps emphasized how a better educated work force facilitates the dissemination of new technology, thereby making it easier for poorer countries to "catch up" with richer countries. This may explain why recent empirical research has found that GDP growth appears to depend on the existing stock of human capital, not just its growth rate. The Nelson-Phelps analysis also offered a possible explanation of why the return to education is often high in periods of rapid technological change: during such periods a well educated workforce is particularly important for increased productivity. Such arguments have been put forth in order to explain why the salaries of highly educated employees have increased significantly in the United States (and in many other countries) in recent decades, when the IT-revolution has initiated a rapid diffusion of new technology.

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