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# *PUBLIC ADMINISTRATION*

# CULTURAL SUSTAINABILITY: SOME REFLECTIONS ON THE FINANCIAL ROLE OF THE ITALIAN LOCAL GOVERNMENTS[1]

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***Abstract***: *Considering the indisputable cultural vocation of the Italian context and, in general, given the prominence of the cultural aspect as a factor of influence on many other elements that interact with human actions, this paper considers a fourth pillar joining the three traditional sustainability dimensions (environment, economic, social): cultural sustainability. Local governments have a specific role in implementing sustainability (as highlighted in the Local Agenda 21) and the expense represents an important financial indicator to understand public commitment to sustainability. These elements (the financial role of local government and cultural sustainability) are the starting point for this paper that analyzes the financial commitment of Italian local governments in the cultural sector. The models used shows that cultural expenses are related to the average income of the residents, while they are not related to the cultural heritage of the municipality territory. The empirical results allow the Author to draw some conclusions and to identify some aspects that form the basis for further research.*

## 1. SUSTAINABILITY MANAGEMENT AND LOCAL GOVERNMENT: THE ROLE OF FINANCIAL INFORMATION

In this paper we move away from the traditional concept of sustainable development contained in the Brundtland Report of the United Nations World

[1] This article was prepared jointly by the Authors. However, it is possible to assign paragraph 1 to Daniela Preite, paragraphs 2 and 4 to Fabio De Matteis, paragraph 3 to Fabrizio Striani.

Commission on Environment and Development (WCED 1987). This definition – considered as the main reference for subsequent proposals – defines the sustainable development as the "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

Moreover, sustainable development "is not a fixed state of harmony, but rather a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are made consistent with future as well as present needs" (WORLD COMMISSION ON ENVIRONMENT AND DEVELOPMENT (1987), *Our Common Future*, Oxford University Press, Oxford, U.K.).

Therefore, sustainability is a prerequisite of sustainable development for the implementation of social and intergenerational equity both inside and outside of each local community. This reveals the role of local governments as institutionally appointed to the implementation of sustainable development. Their contribution is officially recognized in the Local Agenda 21, a declination at a local level of Agenda 21 (a document signed by 170 countries in Rio de Janeiro in 1992 at the United Nations Conference on Environment and Development containing the resolutions and policy objectives on environment, economy and society).

Traditionally, sustainability is declined in three dimensions:

▪ environmental sustainability, as the ability to preserve long-term quality and reproducibility of natural resources;

▪ economic sustainability, as the ability to produce durable income and work without compromising non-renewable resources;

▪ social sustainability, as the ability to provide access to all the essential services and the conditions of well-being.

Since 1987, the academic and institutional world has raised the level of awareness on issues relating to sustainability that have been assigned a special place for political agendas of many countries (BEBBINGTON J. and GRAY R. (2001) "An Account of Sustainability: Failure, Success and a Reconceptualisation", in *Critical Perspectives on Accounting*, 12, (5), pp. 557-605).

Policy makers were invited to combine, in the preparation of their agenda, the protection of the natural environment with the economic and social needs of the community (ROGERS P.P., JALAL K.F., BOYD J.A. (2008), *An introduction to sustainable development, Earthscan*, London).

However, to achieve a concrete result from this combination, the principle of sustainability must be present across policy-making at all levels of government, from international to local (STRANGE T., BAYLEY A. (2008), S*ustainable development. Linking economy, society, environment*, OECD Publishing, Paris).

Otherwise, the achievement of a sustainable development remains a mere utopia.

The literature on sustainability has also highlighted the lack of specific research related to the sustainable approach of public institutions (BALL A., GRUBNIC S. (2007), "Sustainability accounting and accountability in the public sector", in UNERMAN J., BEBBINGTON J., O'DWYER B., *Sustainability Accounting and Accountability*, Routledge, London).

For this reason, the paper, representing a first analysis on a specific area of sustainability, can be considered as a contribution to the scientific debate and, above all, as a vehicle for further research and analysis on the subject.

Whatever the scope of sustainability taken into account, it is fundamental to highlight the role of the financial component as a tool for sustainability. In other words, in pursuing and applying sustainability as a management approach, it is necessary to consider several aspects that are related to sustainability.

Among these, the financial aspect is relevant and common to the three pillars of sustainability previously mentioned: the availability and use of financial resources are factors that influence the implementation of sustainability (environmental, social and economic).

With specific reference to the local government, on which this paper is focused, it is interesting to note that accounting (PREITE D. (2015), *La contabilità pubblica come sistema di governo*, CEDAM, Padova) still has a predominantly financial connotation; therefore, this should lead to a more natural attention towards the financial aspects of sustainability. The financial balance is tied to the ability to deal with outgoing cash flows with adequate revenues, or the possibility of financing investments in the short, medium and long term with appropriate funding arrangements (for example, multi-year investments financed with sources of medium-long period).

This balance can obviously affect, over time, the public institution's ability to contribute, in the long-term, to social welfare, economic development and environmental protection through adequate supervision of the financial aspects of sustainability (along with non-accounting elements).

## 2. CULTURAL SUSTAINABILITY: LITERATURE REVIEW AND RESEARCH QUESTIONS

Both Italian and international literature (DUMAY J., GUTHRIE J., FARNETI F., (2010), "GRI Susstainability Reporting Guidelines for Public and Third Sector Organizations", in Public Management Review, Vol. 12, Issue 4, pp. 531-548; WILLIAMS B., WILMSHURT T., CLIFT R., (2011), "Sustainability re- porting by local government in Australia: Current and future prospects", in Accounting Forum, Vol. 35, pp. 176-186) is more focused on aspects related to sustainability reporting (A different approach - that considers the whole planning and control cycle - is followed in: DE MATTEIS F., PREITE D., (2015), *Il ciclo di sostenibilità negli enti locali*, Giappichelli Editore, Torino).

In fact, national and local Public administration, having to abide by the different recommendations and numerous controls, appear to be more facilitated and directed to report on action taken and, consequently, on the performance achieved in terms of sustainability.

But several scholars have shown the existence of other factors that have contributed to the proliferation of papers on sustainability reporting in the local authorities.

For example, some authors (KAUR, A and LODHIA S. (2014) "The state of disclosures on stakeholder engagement in sustainability reporting in Australian local councils", in Pacific Accounting Review: Special issue on Sustainability Accounting and Reporting, 26, (1/2), pp. 54-74) consider stakeholder involvement an essential motivation for the development of sustainability reporting. Other authors (FARNETI, F. & GUTHRIE, J. (2009), "Sustainability Reporting by Australian Public Sector Organizations: Why They Report", in Accounting Forum, 33, (2), pp. 89-98) have the same approach with reference to the Australian public sector: they found that sustainability reporting is justified by the need to inform those who are interested in the organization's activities.

In addition, in the case of public sector organizations, transparency on sustainability is an essential variable linked to their nature (BALL A. and BEBBINGTON J., (2008), "Accounting and Reporting for Sustainable development in Public Service Organizations: issues and emerging directions", in Public Money and Management, 28(6), pp. 323-325).

In this paper, considered the indisputable cultural vocation of the Italian context and, in general, given the prominence of this aspect as a factor of influence on many other elements that interact with human action (culture as the basis of actions and people's way of thinking), the cultural dimension of sustainability is taken into consideration. Therefore, next to the three traditional sustainability dimensions (social, economic and environmental), here cultural sustainability is added and analyzed.

The concepts of "sustainability" and "sustainable development" were first explained to highlight that a healthy economy depends on a healthy biosphere and vice versa, and to introduce the approach of sustainability as a means of integrating economic and ecological concerns in long-term development strategies. This approach, as defined in ecological terms, can be extended and applied to the realm of culture by recognizing parallels between the concepts of natural and cultural capital (THROSBY D., (2005), *On the Sustainability of Cultural Capital*, Sidney, Macquire University Department of Economics, Research Paper 10/2005).

There has been growing interest among scholars to consider culture as an aspect of sustainable development together with the three traditional pillars of sustainability (environment, social, economic). However, only recently, the understanding of culture within the scientific framework of sustainable development has become a focus of analysis. An interesting study (SOINI K., BIRKELAND I., (2014), "Exploring the scientific discourse on cultural sustainability", in *Geoforum*, Vol. 51, pp. 213-223) investigates the scientific discourse on cultural sustainability - by analyzing the different meanings applied to the concept in scientific publications – and highlights that the scientific discourse on cultural sustainability is developed on seven storylines: heritage, vitality, economic viability, diversity, locality, eco-cultural resilience, and eco-cultural civilization. These approaches are partly interlinked and overlapping, but they differ in terms of some contextualized aspects: some of the storylines define the fourth pillar of sustainability (culture), while others can be considered as instrumental, contributing to the achievement of the social, economic, or ecological goals of sustainability. This highlights the absence of a managerial approach deriving from different elements, among which the lack of managerial literature on cultural sustainability.

From this situation stems the opportunity for this paper to become a first contribution on the development of a managerial debate on cultural sustainability. In other words, the research presented in this paper aims to start a scientific debate that can contribute to the definition of both theoretical/defining aspects and empirical elements for the drawing up of managerial tools related to the planning, management, measurement and evaluation of cultural sustainability.

Some authors (AXELSSON R., ANDERSSON K., (2013), "Social and Cultural Sustainability: Criteria, Indicators, Verifier Variables for Measurement and Maps for Visualization to Support Planning", in *Ambio*, Vol. 42, pp. 215-228) also analyzed cultural sustainability in terms of indicators that can be useful to define the cultural sustainability profile of municipalities. We find relevant that among the indicators highlighted, there are none of financial origin considering (as said in the previous paragraph) that financial efforts are an important element for sustainability development.

The literature review leads to the identification of the following research questions:

1 - What is the extent of the financial commitment of local authorities in the current management of the cultural heritage sustainability?;

2 - In order to understand if there is some sort of financial subsidiarity between local authorities and citizens in ensuring cultural sustainability, is there a correlation between cultural current expenditure of local authorities and average income of the residents?;

3 - Is the current management of culture (in financial terms) related to the size of the cultural heritage present in the municipal area?

## 3. METHODOLOGY AND RESULTS

**Model**. The research examines the current expenditure of Italian local authorities expressed in per capita terms and aggregated by region. For this first empirical research on the financial effort of the local governments in cultural sustainability, we consider current expenses, because in the cultural field, investments (both for extent and frequency) can often be of the extraordinary type.

We suppose that the cultural current expenditures depend on:

- the regional average disposal income per capita, because it is assumed that there is a financial subsidiarity between local residents and authorities (local government spends more on culture if the average income per capita is lower, in order to compensate the residents' limited funding available);
- the population, considering that local governments with greater populations have higher financial commitment to cultural sustainability;
- the cultural heritage, because it is assumed that local governments with greater cultural heritage have a larger cultural current expenditure.

We developed two different models; the first model does not consider cultural heritage, whereas in the second model we insert this variable. Following model I and II:

$$s_{it} = k + y_{it} + pop_{it} + u_{it} \quad \text{(model I)}$$

$$s_{it} = k + y_{it} + pop_{it} + pat_{it} + u_{it} \quad \text{(model II)}$$

Where:

$s_{it}$ is the local government cultural current expenditure;

$y_{it}$ is the regional average disposal income per capita;

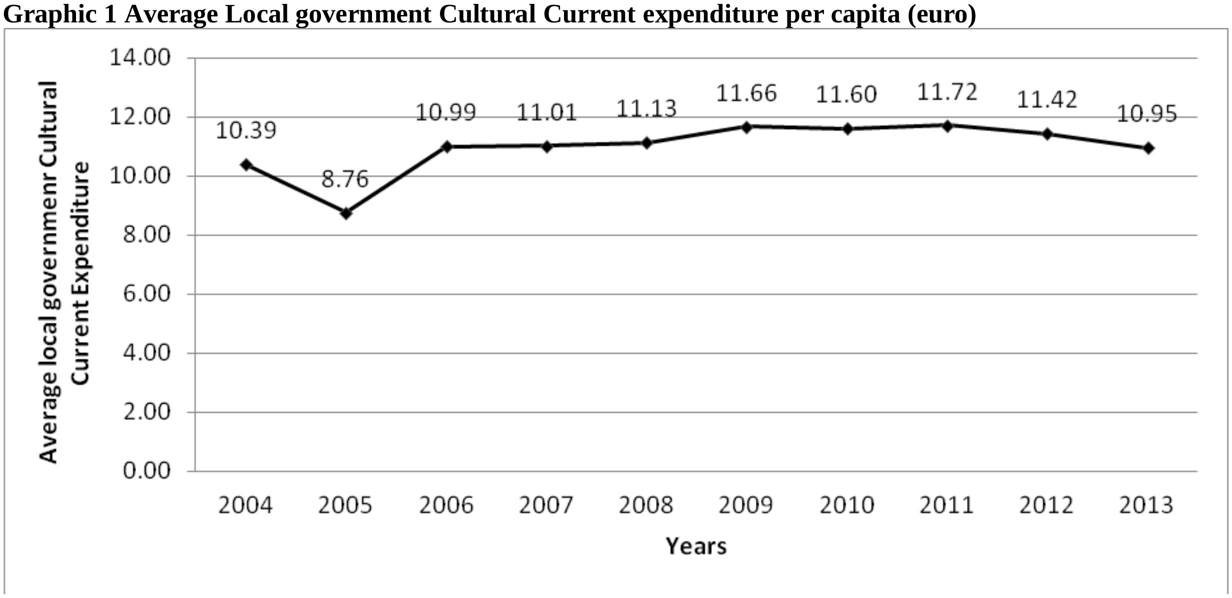
pop is the population;

$pat_{it}$ is the cultural patrimony.

The choice to use two different models depends to the possibility to do a short period analysis and a long period analysis, because of the availability of official reliable data. In fact, for the first model we use the temporal period 2004-2013, whereas for the second model we use the temporal period 2012-2013. The use of more periods allows for a comparative analysis, which corresponds to the intrinsic temporal element of the concept of sustainability.

**Data Analysis**. First of all we show the trend of the regional cultural currency expenditure. To do this we calculate the mean of the aforementioned variable per each years that we consider (2004-2013). We obtain the following graphics:

**Graphic 1 Average Local government Cultural Current expenditure per capita (euro)**




The graph allows us to answer the first research question on the trend of current expenses of Italian local government for the cultural sector. In this graph we denote that the current expenditure is a sufficiently linear trend even if in the year 2005 we have a sharp decrease.

In the following table, instead, we show the most significant statistics of the variable "current expenditure".

**Table 1 Statistics of Local government cultural currency expenditure**

| Year | Mean | Median | Standard Deviation |
|---|---|---|---|
| 2004 | 10,4 | 9,3 | 6,484614264 |
| 2005 | 8,8 | 8,4 | 6,777021466 |
| 2006 | 11,0 | 10,6 | 7,058630424 |
| 2007 | 11,0 | 10,9 | 7,238915401 |

| | | | |
|---|---|---|---|
| 2008 | 11,1 | 10,9 | 7,487574047 |
| 2009 | 11,7 | 11,3 | 7,565774962 |
| 2010 | 11,6 | 11,1 | 7,777218186 |
| 2011 | 11,7 | 10,9 | 8,104524992 |
| 2012 | 11,4 | 10,2 | 8,038611184 |
| 2013 | 11,0 | 11,0 | 7,671146563 |

*Source ISTAT – own elaborations*

The above data show a low variability, compared to the average, of the expenditure for the decade considered. To verify this it is sufficient to note that the standard deviation has sufficiently low values. At the same we can see that the standard deviation value is significant if compared to the average: this means that there can be important differences in the current per capita expenditure for culture from entity to entity. Therefore, it is useful to analyze the correlation between that expenditure and the other elements investigated (average income and cultural heritage).

Below, the data we used for the econometric analysis:

**Table 2 Variables definition**

| Code | Variable | Source |
|---|---|---|
| $s_{it}$ | Local government current expenditure per capita for culture | ISTAT |
| $y_{it}$ | Regional average disposal income per capita | ISTAT |
| $pop_{it}$ | Population | ISTAT |
| $pat_{it}$ | Cultural patrimony | ISTAT |

All data were collected from the ISTAT (Italian Statistics National Institute) website. In this website we find, in the period 2004-2013, all data for the variables $s_{it}$, $y_{it}$ and $pop_{it}$ whereas the variable $pat_{it}$ is available only for the period 2012-2013. With this sample, however, we create two balanced data panels for the two used models.

**Methodology**. The methodology that we use to estimate the two previous panels is the OLS (Ordinary Least Square) method. In this case, we can use this method because we do not have a lagged dependent variable and so the estimator is correct and consistent.

In our models we insert the temporal dummy variables, through which we can capture the cyclical variations of the periods. Then:

$$s_{it} = \beta_0 + \tau_t + y_{it} + pop_{it} + u_{it} \text{ (Model I)}$$

$$s_{it} = \beta_0 + \tau_t + y_{it} + pop_{it} + pat_{it} + u_{it} \text{ (Model II)}$$

At this point we can proceed with the estimation of the two models. To do this we use the econometric program STATA and we obtain Table II.

In the model I, we test if the cultural expenditure depends on the citizen income (research question 2). Then we extend this analysis using the cultural patrimony (model II) to test how the latter variable impacts cultural expenditure (research question 3).

**Table 3 Estimation**

| Variable | Model I | Model II |
|---|---|---|
| Const | -17.209***<br>(5.480) | -13.645**<br>(6.387) |
| tau2004 | 0.984<br>(0.77) | - |
| tau2005 | -1.125<br>(0.748) | - |
| tau2006 | 0.235<br>(0.723) | - |
| tau2007 | -0.673<br>(0.733) | - |
| tau2008 | -0.906<br>(0.746) | - |
| tau2009 | 0.373<br>(0.724) | - |
| tau2010 | 0.449<br>(0.723) | - |
| tau2011 | -0.001<br>(0.733) | - |
| tau2012 | 0.577<br>(0.721) | 0.567***<br>(0.161) |
| tau2013 | - | - |
| *y* | 0.002***<br>(0.001) | 0.001***<br>(0.001) |
| *pop* | - | - |
| *pat* | - | -0.022<br>(0.054) |

Notes: standard errors (in bracket). *** denotes a level of significance at 1%, ** denotes a level of significance at 5%, * denotes a level of significance at 10%.

In order to answer research question 2, we can underline that, in models I and II, the variable y is always significant. The answer to research question 3 arises from the analysis on the variable pat that is not significant (model II).

Moreover, the dummy variable tau2012, in model II, is significant. This probably depends on the events that happened in the year 2012, like the terrible earthquake that struck the Emilia-Romagna, which had an impact on expenditure in general and on cultural expenditure in particular.

## CONCLUSION AND FUTURE RESEARCH OPPORTUNITIES

Cultural sustainability is a matter of particular importance for Italian local authorities (considered the extent of the Italian cultural heritage) and at the same time is a little discussed aspect in management literature. Therefore, this paper can represent a first attempt to contributing to the scientific discussion on the topic.

In particular, we have considered current expenses of the Italian local authorities and the empirical analysis showed that their trend was fairly constant in the decade considered (except for 2005) while highlighting, at the same time, disparities among the different local governments (grouped by Region). Hence, the interest in two variables that can affect these expenses: the average income of residents and the cultural heritage present in the local government area.

The first variable has been taken into consideration in order to understand if, where current expense is contained, there is a high average income of residents that allows them to spend on culture, which compensates for the limited financial commitment of the local governments and vice versa.

In other words, the possibility of subsidiarity between Local Governments and citizens in contributing to the cultural sustainability has been investigated.

The analysis shows a high correlation between current expense on culture and average income, but the data highlight a situation opposite to that hypothesized: where we see local authorities with low levels of current expense on culture, we also find that residents have lower incomes.

This implies different reasonable conclusions:

1. there is an inequality between local governments which spend more on culture and those that spend less (for the which the citizen does not have its own resources to compensate for this lower expenditure). This hypothesis would require further research to understand the reason for this difference: different amounts of financial resources available? Different spending policies?
2. there is an apparent inequality if (through further analysis) it could be demonstrated that the contained current expense on culture for some municipalities is offset by public spending from higher levels of government.

With reference to the second analyzed variable (cultural heritage in the municipal territory), the model demonstrates that it is not significant compared to the current expense on culture. This is particularly unusual and can be explained, at first, only by assuming that much of the cultural heritage is not owned by the local government but by higher levels of government and by private entities. But even this hypothesis represents a further element of disclosure for the development of future research in order to understand the link between expense level for cultural sustainability and ownership of cultural heritage.

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# LEADERSHIP STYLE AND EMPLOYEES' PERFORMANCE IN NIGERIAN FEDERAL POLYECHNICS: A STUDY OF FEDERAL POLYTECHNIC, ILARO, OGUN STATE

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**Abstract**: *This paper examines leadership style and employees' performance in Nigerian Federal Polytechnic a study of Federal Polytechnic, Ilaro, Ogun State. The main objective of this study is to identify the relationship between leadership style and employee's performance, also to verify the extent to which leadership style has facilitated service delivery at the Nigerian Federal Polytechnics. In achieving these objectives, the researcher relied on use of primary and secondary data which were used to analyse the data gathered. The study observed that a large number of employees make prudent application of leadership in their various work processes. The application of this contributes to the employee's performance to some extent. The study further identifies that success or failure of organisations depends on leadership style adopted in an organisation.*
**Keywords**: *Leadership Style, Employee Performance, Failure of Organisations, Service Delivery, Personality Traits, Polytechnic*

## 1. INTRODUCTION

Leadership as a term has numerous definitions and connotations. The definition of a leader may be by whom he or she is (the personal) and by the responsibilities, obligations, and tasks he or she is charged with (the position). Leaders' authority can be great or limited and their legitimacy can rest on moral, rational, or practical foundations (Epley, 2015). Leadership is a dynamic process of influencing people which, in certain organizational conditions, can have an effect on other members, with the aim of meeting the objectives of the group. Leadership is key as it is an integral element in the life of an individual or that of an organization. The history of mankind reveals that leadership is crucial in every human endeavour, from China with Chairman Mao TseTun who led the cultural revolution, to Lenin in Soviet Union who led the Soviet revolution to Nigeria where we have leaders of note like the late Chief Obafemi Awolowo, it is clear that leadership is an important factor in every human activity and in the realisation of human aims and objectives (Bass & Bass, 2008). There is no meaningful human endeavour that has been achieved that is not as a result of leadership. The quality of leadership of an organisation plays a significant role in its development for example in a pluralistic society like Nigeria, the art of governance is ought to be a serious affair. Although it has been found that many who are involved in leadership in Nigeria educational institutions are more concerned about their personal gains and careless about the people they ought to serve and lead (Peretomode, 2012 in Nakpodia, 2012). It is clear that Nigeria's educational institutions do not have the desired respect for committee of academic organizations due to the recklessness of their leadership from primary to tertiary levels. The present level of leadership in Nigeria has become has become worrisome due to the fact that in leadership positions, some leaders are autocratic, professing leadership style on both political, social, economic, religious and educational arenas. In Nigeria, higher institutions have been impacted heavily by leadership and leadership styles. The first generation universities witnessed a high number of crises in the 1970s and 1980s. These crises were recorded at a time the universities had what was considered quality leadership though the leadership styles were diverse. Also, national leadership has a way of impacting on what happens on campuses as university heads are sometimes made to operate as middle level managers whereas they are put in place as chief executives (Koestenbaum, 2002). Higher education is universally acclaimed as the bed rock for national development (Ogunruku, 2013). However, leadership has been a vital tool for the development of the university idea all over the world. Like in every enterprise, leadership is vital (Adair, 2002). And especially in Africa which is known to have undergone colonialism and is highly underdeveloped, leadership is a critical factor in everything that the nations of Africa would achieve. Running higher institutions in the military era and post military democracy in Nigeria has proved to be more challenging, this has been so more because the situation is compounded by the fact that the resources available to run these institutions are limited. The challenges then tend to be heightened by the paucity of finance. But money itself by itself does not solve problems. In actual fact, part of what leadership brings to bear on any situation is the management of resources and finances.

Leadership is a major concern to organizations and the focus of several researchers for its significant role in determining the success of an organization. The leader has the responsibility to direct the effort of subordinates to achieve organisational goals and objectives. Educational institutions are not left out from this leadership influence. Leadership as a term is arguably one of the most observed and yet least understood phenomena on earth (Burns in Abbasialiya, 2010). In past years, scholars have proposed many different styles of leadership as there is no particular style that can be considered universal. Despite of the numerous style of leadership, an effective leader inspires, motivates and directs activities to help achieve organisational goals. It is widely known that leadership plays an important role in all organisations. Although, progresses have been made by scholars in understanding the traits of leadership. However, there exist the need to realize that much were not known about these activities. i.e. how can we effectively apply the leadership styles in organizations to enhance performance? Having known the benefits of managerial leadership, how can business organizations adopt it and how does it help the business organizations in achieving their corporate goals especially for attaining a desired level of workers' performance? The only solution to these problems is the adopting of effective leadership styles which will boost performance in the organization.

It is against this backdrop that this paper discusses the roles played by leaders in the performances of its employee in the Nigerian Federal Polytechnics using the Federal Polytechnic, Ilaro as a case study. The Federal Polytechnic, Ilaro was established by Decree No. 33 of July 25, 1979. It was opened to students on November 15, 1979 on a temporary site provided by its host community, the ancient town of Ilaro, Ogun State (www.federalpolyilaro.edu.ng). The first site of the Polytechnic was the premises of the Anglican Grammar School, llaro about half a kilometre from Ilaro township junction.

The general objective of the Federal Polytechnic, Ilaro is to provide technical and practical – oriented training to meet the manpower requirements for the industrial, agricultural, commercial and economic development of Nigeria. This paper aims to assess the extent to which leadership styles influences employees' performance in Nigerian Federal Polytechnics.

## 1.2 Statement of the Problem

Goal attainment is one of the main purposes of modern organizations including educational institutions. There is a growing interest to determine which leadership style is capable of enhancing employee's morale such that higher institutions achieve its goals and objectives optimally. Issues of leadership styles in higher institutions in Nigeria have been raised in many instances, by trying to find out the causes of poor standard of tertiary education in Nigeria. It seem to be out of the mind of most leaders that leadership style in the office is an outstanding determinant of the worker's performance. Moreso, if lecturers who are also employees do not portray a good leadership style, it would also serve as a determinant on the students' academic performance. Issues like this are of utmost importance in a situation where employees seem to have lost the passion and commitment for their job. It is believed that some employees of the polytechnic are better in maintaining discipline in their offices through the leadership styles. In polytechnics, the leadership qualities of the chief executives become very important because a lot of power resides in the Rector of a polytechnic and the way this power is wielded determines how the community receives decisions and policies. At the Federal polytechnic, Ilaro leadership has always been an issue. This is because the staff and students are always focused on the person of the Rector of the Federal Polytechnic, Ilaro. Additionally, they focus on his personality, his style of handling situations and personality factors is known to a generality of staff and perhaps students and when they react to situations, their perception of who the rector is, personality factors and his conduct determines the reaction of these people to situations on campus.

One of the problems of leadership style on employee's performance is the inflexibility of the leadership styles by most leaders. Most leaders fail to adjust their style of leadership to the changing situation and current matters arising. The failure is a result of the lack of understanding the fact that no one particular style of leadership can fit into all conditions.

Another of the problem of leadership style on worker's performance is the absence of an effective line of communication between the manager and their employees. Communication gaps that exist between leaders and their subordinates in most organisations are reasons why employee's performances are low.

Leadership is said to be the backbone of any organisation. If the leadership style of any organisation is poor, it will tell on the overall performance of the organisation. With this understanding, most organisations are faced with the problems of how to investigate the leadership styles and organisational effectiveness. Knowing whether the relationship between leaders and subordinates affect organisational growth and even having broad knowledge of the leadership style adopted by the organisation can improve organisational effectiveness.

It is on this ground that this paper aims to assess the extent styles influences or impact employees' performance in Nigerian Federal Polytechnics.

## 1.3 Research Questions

This study seeks to answer the following questions:

i) What is the relationship between leadership styles and employee's performance in Nigerian Federal Polytechnics?

ii) Leadership styles of different Rectors of the Federal Polytechnic, Ilaro has not been a core determinant of workers performance.

iii) Are there challenges of leadership styles to effective employee's performance at the Federal Polytechnic, Ilaro?

iv) What leadership style are mostly used by employees of the Federal Polytechnic, Ilaro?

## 1.4 Objectives of the Study

The objectives of the study are:

- To identify the relationship between leadership style and employee's performance with emphasis on the Federal Polytechnic, Ilaro.
- Verify what extent has leadership style facilitated service delivery at the Federal Polytechnic, Ilaro.
- To examine the challenges of leadership styles on employee's performance at the Federal Polytechnic, Ilaro.
- To identify the leadership style mostly used by employees of the Federal Polytechnic, Ilaro

## 1.5 Hypotheses

For the purpose of this study, the hypothesis will be limited to the following:

- There is no significant relationship between leadership style and employees performance in Nigerian Federal Polytechnics.
- Leadership styles of different Rectors of the Federal Polytechnic, Ilaro has not been a core determinant of workers performance.

## 2. LITERATURE REVIEW

### 2.1 Meaning and Role of Leadership Styles in Organisation

Leadership style in an organisation is one of the factors that play significant role in enhancing or retarding the interest and commitment of the individuals in the organisation. Messick and Kramer, 2004) argued that the degree to which the individuals exhibits leadership traits depends not on his characteristics and personal abilities, but also on the characteristics of the situation and environment in which he finds himself. Thus, (Glantz, 2002) emphasizes the need for a manager to find his leadership style. The extent to which members of an organisation contribute in harnessing the resources of organisation equally depends on how well the leaders of the organisation understand and adopt appropriate leadership style in performing their roles as managers and leaders. Therefore, effectiveness in resource mobilisation, allocation, utilisation and enhancement of organisational performance depends to a large extent on leadership style among other factors. (Akpala, 1998) identifies attitude to work, leadership style as some of the factors that exert negative effect on organisational effectiveness. The best leadership style in any organisation is that which inspire subordinates potentials and working ability to enhance efficiency and effectiveness in the process of organisation for achieving his objectives (Mohammad, Rafi & Saad, 2012).

### 2.2 Leadership Styles and its Types

Leadership Styles are the approaches used to motivate followers. Leadership Styles to Olagboye (2004) are the various patterns of behaviours leaders adopt in the process of directing the efforts of subordinates towards the achievement of organizational goals. Leadership as a term is not a one size fits all" phenomenon. Leadership styles should be selected and adapted to fit organizations, situations, groups and individuals. It is therefore useful to possess a thorough understanding of the different styles as such knowledge increases the tools available to lead effectively. Scholars over the years have focused on the different leadership styles such as the autocratic, democratic, laissez-faire and so many other leadership styles. Challenges faced by modern organizations to meet higher performance, better job- satisfaction, increased morale and productivity in subordinates has led to the demand for better quality of leadership. Prominent among new leadership models proposed are the transformational and transactional leadership styles (Burns, 1978; Avolio & Bass, 2004). Toolkit (2012) articulated a number of leadership styles. Among the highlighted leadership styles are:

### 2.2.1 Autocratic Leadership Style

The autocratic leader keeps all issues and elements in close control. He uses coercive elements, and rewards as a means of control. The leader exerts close control over all processes and developments and desires to be briefed on all developments in order to take decisions and dictate the direction to follow and how to handle issues (Hicks & Gullet, 1982). The leader believes he towers above his followers and does not give them the privilege to participate in decision making. He takes all decisions for them. This style of leadership centers control in one person or source and decisions are arrived at speedily but it robs the majority of the people of participation and denies the situation of the contributions and richness that a variety of perspectives can bring to the table. Autocratic leadership is often best used in situations where crisis arises, when decisions must be made quickly and without dissent.

### 2.2.2 Bureaucratic Leadership Style

Bureaucratic leaders follow rules rigorously, and ensure that their staffs also follow procedure precisely. This is an appropriate leadership style for work involving serious safety risks (such as working with machinery, with toxic substances or at dangerous heights) or offices where large sum of money are involved. Bureaucratic leadership is also useful in organizations where employees do routine tasks (Shaefer, 2005). The major drawback of this type of leadership style is that it is ineffective in terms of and organizations that rely on flexibility, innovation and creativity (Santrock, 2007).

### 2.2.3 Democratic Leadership Style

Democracy is about participation, it gives power to the people and draws contribution and participation in the decision making process from the widest possible basis. Democratic leaders make the final decisions, but include team members in the decision-making process. In the organization, the democratic style allows the workers who are directly involved in the running of the organization to participate in the process of decision making within their environment. There is a rich environment of workers, followers and leaders cooperating and contributing to the decision on the direction to follow in the organization. Democratic leadership style encourages creativity, and the team members are often highly engaged in projects and decisions (Amanchukwu, Stanley & Ololube, 2015). The organization in getting the workers to participate in decision making s heightens their morale, and this gives the workers satisfaction on their job. Also, because of the many sources from which ideas are coming, there are different levels of responsibility and there is a situation in which the majority is not looking to the leader to supply solutions or dictate to them.

### 2.2.4 Laissez-Faire Leadership Style

Laissez-faire leadership may be the best or the worst of leadership styles (Goodnight, 2011). Laissez-faire, the French phrase for "let it be" when applied to leadership describes leaders who allow people to work on their own. Laissez-faire leaders abdicate responsibilities and avoid making decisions, they may give teams complete freedom to do their work and set their own deadlines. Laissez-faire leaders usually allow and give their subordinates the power to make decisions about their work (Chaudhry & Javed, 2012). They provide teams with resources and advice, if needed, but otherwise do not get involved. This leadership style can be effective if the leader monitors performances and give feedback to team members regularly. The main advantage of laissez-faire leadership is that it gives team members so much autonomy that can lead to high job satisfaction and increased productivity. It can also be damaging if team members do not manage their time well or do not have the knowledge, skills or motivation to do their work effectively.

### 2.2.5 Charismatic Leadership Style

Charismatic leadership theory describes what to expect from both leaders and followers. Charismatic leadership is a leadership style that is identifiable but may be perceived with less tangibility than other leadership styles (Bell, 2013). Often called transformational leadership style, charismatic leaders inspire eagerness in their teams and are energetic in motivating employees to move forward. The ensuing excitement and commitment from teams is an enormous asset to productivity and goal achievement. The negative side of charismatic leadership is the amount of confidence placed in the leader rather than in employees. This could create risk of a project or even in an entire organization collapsing if the leader leaves.

## 2.3 Approaches to leadership

There are about three major approaches to the study of leadership. These approaches are (i) traits approach (ii) situation approach (iii) behavioural approach.
Traits Approach: Investigations by some behavioural scientists on leadership reveals that leaders are born with some special qualities and character which a leader possesses that distinguish him/her from their followers. Qualities like courage, zeal, intelligence, self-confidence etc are embedded in such a person and which were said to be transferable from one generation to another. Since all individuals do not have all these qualities, only those who have them will be considered a potential leader.
Situational Approach: This explains that the situation or circumstance in which the leader is operating determine leadership style to be used. That a person is a successful Managing Director of a big firm does not automatically mean that he will achieve the same level of success as the Managing Director of a Multinational Co-operation. This implies that management's effectiveness is a function of the situation variable.
Behavioural Approach: In this approach, the behaviour of the leader is being isolated so as to know its effectiveness. In other words, rather than try to figure out the effectiveness of a leader, the approach determines what effective leaders do, how they communicate

and how they try to motivate subordinate in relationship of the leader and follower. In some cases, followers totally depend on the leader and lack initiative while in several cases followers have their initiatives and pursue the goals of their organisation when the leader is absent. Leaders give the followers the total freedom to act with or without guidance.

## 3. METHODOLOGY

The Federal Polytechnic, Ilaro is the case study for this research. The Federal Polytechnic, Ilaro was chosen for purpose of an effective and more detailed research on leadership style and employees performance.

### 3.1 Population of Study

The research population comprised the academic and non-academic staff of the institution under study. The staffs selected include junior and senior staff, male and female staff. The available data shows that the staff strength of the Polytechnic is six hundred and seventy two.

### 3.2 Sample and Sampling Procedures

Stratified random sampling technique was used for sample selection. For proportional allocation strategy, the size of the sample in each stratum is taken in proportion to the size of the stratum. Sixty members of staff which constitute the population of academic and non-academic staff of the Institution make up the sample for the study.

### 3.3 Procedure for Data Analysis

The instrument found appropriate for the analysis of the data gathered is simple percentage and chi-square. Chi square was used because it is good for the prediction of the outcome of dependent and independent variables. It also facilitates the interpretation of the relationship between variables.

The hypothesis enables the researcher to either accept or reject the null hypothesis.

However, in generating the results gotten from this data, the researcher employed the use of SPSS Software package and Minitab 16. This software made it possible for the researcher to apply the relevant variables in order to generate the necessary results for the research.

## 4. ANALYSIS AND INTERPRETATION

This is designed in a way that it captures respondents' bio data and characteristics in order to provide background information on the population and show their relevance and positioning in relation to the subject of research. This is the purpose of the first part of the questionnaire. The second part comprises structured questions directly addressing the research questions and hypotheses. The structuring of the questions using Likert's scale predisposes the responses to being easily analyzed quantitatively.

## 4.1 Bio-data of respondents

We have here the characteristics of the respondents as captured in the questionnaire:

**4.1.1 Table 1: CLASSIFICATION OF RESPONDENTS**

| | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| MALE | 33 | 64.7 | 64.7 | 64.7 |
| FEMALE | 18 | 35.3 | 35.3 | 100.0 |
| Total | 51 | 100.0 | 100.0 | |

*Source: Survey Research, 2014*

The analysis revealed that out of 51 respondents, 33 are male representing 64.7% and 18 are female representing 35.3%.

**4.1.2 Table 2: AGE GROUP**

| | Frequency | Percentage | Valid Percentage | Cumulative Percentage |
|---|---|---|---|---|
| 31 – 40 | 10 | 19.6 | 19.6 | 19.6 |
| ABOVE 40 | 41 | 80.4 | 80.4 | 100.0 |
| Total | 51 | 100.0 | 100.0 | |

The age group shows that respondents within the age group of 31 – 40 years are 10 representing 19.6% and other respondents are above 40 years representing 80.4% of the total respondents.

**4.1.3 Table 3: MARITAL STATUS**

| | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| SINGLE | 1 | 2.0 | 2.0 | 2.0 |
| MARRIED | 49 | 96.1 | 96.1 | 98.0 |
| WIDOW | 1 | 2.0 | 2.0 | 100.0 |
| Total | 51 | 100.0 | 100.0 | |

49 of the respondents are married representing 96.1% and we have 1 respondent each as single and widow representing 2% each.

**4.1.4 Table 4: EDUCATIONAL QUALIFICATION**

| | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| ND | 4 | 7.8 | 7.8 | 7.8 |
| HND/BA/BSc | 17 | 33.3 | 33.3 | 41.2 |
| MSc | 30 | 58.8 | 58.8 | 100.0 |
| Total | 51 | 100.0 | 100.0 | |

There are 4 ND, 17 HND/BA/BSc and 30 MSc holders among the respondents representing 7.8%, 33.3% and 58.8% respectively.

**4.1.5 Table 5: LENGTH OF SERVICE AT THE FEDERAL POLYTECHNIC, ILARO**

| | Frequency | Percentage | Valid % | Cumulative % |
|---|---|---|---|---|
| 5 - 9 YRS | 11 | 21.6 | 21.6 | 21.6 |
| 10 - 19 YRS | 18 | 35.3 | 35.3 | 56.9 |
| 20 - 29 YRS | 16 | 31.4 | 31.4 | 88.2 |
| ABOVE 30 YRS | 6 | 11.8 | 11.8 | 100.0 |
| Total | 51 | 100.0 | 100.0 | |

Out of 51 respondents, 11 are within the age limit of 5 – 9 years, 18 within 10 – 19 years, 16 within 20 – 29 years and 6 are above 30 years, representing 21.6%, 35.3%, 31.4%, and 11.8% respectively.

**4.16 Table 6: NATURE OF WORK**

| | Frequency | Percentage | Valid % | Cumulative % |
|---|---|---|---|---|
| ADMINISTRATIVE | 12 | 23.5 | 23.5 | 23.5 |
| ACADEMIC | 32 | 62.7 | 62.7 | 86.3 |
| NON-ACADEMIC | 7 | 13.7 | 13.7 | 100.0 |
| Total | 51 | 100.0 | 100.0 | |

For the nature of job, 12 respondents are Administrative Staff, 32 are Academic Staff and 7 are Non Academic Staff and these represent 23.5%, 62.7% and 13.7% of the total respondents.

**4.1.7 Table 7: NUMBER OF RECTORS RESPONDENTS' HAVE WORKED WITH**

| | Frequency | Percentage | Valid % | Cumulative % |
|---|---|---|---|---|
| ONE | 9 | 17.6 | 17.6 | 17.6 |
| TWO | 16 | 31.4 | 31.4 | 49.0 |
| THREE | 11 | 21.6 | 21.6 | 70.6 |
| FOUR | 15 | 29.4 | 29.4 | 100.0 |
| Total | 51 | 100.0 | 100.0 | |

9 of the respondents worked under one Rector, 16 worked under two, 11 worked under three and 15 worked under four Rectors, representing 17.6%, 31.4%, 21.6% and 29.4% respectively.

CHI SQUARE TEST

The computational formula for the test is given as:

$X^2 = \sum_{t=1}^{n} \sum_{j=1}^{k} \frac{(0y-Ey)^2}{Ev}$ ere represents the row and j represents the column.

Testing Hypothes

There is no significant relationship between leadership style and employees performance at the Federal Polytechnic, Ilaro.

Responses from questions on five Likert scale will be applied in testing the hypothesis.

| | SD | D | U | A | S.A. | Total |
|---|---|---|---|---|---|---|
| A (Observed Counts)<br>(Expected Counts) | 1<br>0.67 | 1<br>1.68 | 1<br>5.03 | 19<br>22.14 | 29<br>21.47 | 51 |
| B (Observed Counts)<br>(Expected Counts) | 0<br>0.67 | 0<br>1.68 | 4<br>5.03 | 26<br>22.14 | 21<br>21.47 | 51 |
| C (Observed Counts)<br>(Expected Counts) | 1<br>0.66 | 4<br>1.64 | 10<br>4.93 | 21<br>21.71 | 14<br>21.05 | 50 |
| Total | 2 | 5 | 15 | 66 | 64 | 152 |

*Source: Fieldwork survey, 2016*

Chi-square Test

Chi-Sq = 0.161 + 0.274 + 3.232 + 0.447 + 2.638 +0.671 + 1.678 + 0.212 + 0.671 + 0.010 + 0.178 + 3.373 + 5.201 + 0.023 + 2.363 = 21.131

DF = 8, P-Value = 0.0067

### 4.2.1 Research Result

The chi-square test revealed that the test is significant at $\alpha = 0.05$ with p-value of 0.0067, hence the alternative hypothesis is accepted and we conclude that there is a significant relationship between leadership styles and employee's performance in Nigerian Federal Polytechnics.

### 4.3. Hypothesis Two II

Leadership styles of different Rectors of the Federal Polytechnic, Ilaro has not been a core determinant of workers performance.

| | S.D. | D | U | A | S.A. | Total |
|---|---|---|---|---|---|---|
| D (Observed Counts)<br>(Expected Counts) | 4<br>6.0 | 1<br>1.00 | 5<br>6.33 | 18<br>22.3 | 23<br>15.33 | 51 |
| E (Observed Counts)<br>(Expected Counts) | 6<br>6.00 | 1<br>1.00 | 8<br>6.33 | 21<br>22.33 | 15<br>15.33 | 51 |
| F (Observed Counts)<br>(Expected Counts) | 8<br>6.00 | 1<br>1.00 | 6<br>6.33 | 28<br>22.33 | 8<br>15.33 | 51 |
| Total | 18 | 3 | 19 | 67 | 46 | 153 |

*Source: Fieldwork survey, 2016*

Chi-Square test
Chi-Sq = 0.667 + 0.000 + 0.281 + 0.841 + 3.833 + 0.000 + 0.000 + 0.439 + 0.080 + 0.007 + 0.667 + 0.000 + 0.018 + 1.438 + 3.507 = 11.776
DF = 8, P-Value = 0.161

### 4.3.1 Research Result

The chi-square test revealed that the test is not significant at with p-value of 0.161, hence the null hypothesis is accepted and we conclude that leadership styles of different Rectors of the Federal Polytechnic, Ilaro has not been a core determinant of workers performance.

## 5. DISCUSSION OF FINDINGS

This study examines leadership style and employees' performance in Nigerian Federal Polytechnics with specific focus on the Federal Polytechnic, Ilaro. To achieve the objectives of the study, three research hypotheses were formulated and tested using the Chi –square ($X^2$) analytical techniques.

In hypothesis one, the chi-square test revealed that the test is significant at $\alpha$ =0.05 with p-value of 0.0067, hence the alternative hypothesis is accepted and we conclude that there is a significant relationship between leadership styles and employee's performance in Nigerian Federal Polytechnics. The second test showed that leadership styles of different Rectors of the Federal Polytechnic, Ilaro has not been a core determinant of workers performance.

The finding from the research question shows that large numbers of employees make prudent application of leadership in their work process. This contributes to employee's performance to some extent. This finding agrees with Onoyese (1991) who says that the type of leadership that exists between leaders and the lead is an important variable that contribute to the success or failure of an organization. However majority of the employees of the Federal Polytechnic, Ilaro strongly agreed that the rector's leadership style determines the way departments and units handle issues. The study reveals the importance of a good leadership style as a veritable tool for employee performance and effectiveness as indicated by the high regression between the leadership style and employee performance. That by implication, for any percentage increase in good leadership style in an organization, the higher the employee performance and effectiveness.

## 6. CONCLUSION

It must be observed that the success or failure of an organisation depends on leadership. Success demands that a leader adopts the style appropriate to the organisation with employee education and sophistication, unilateral action by leadership is resented and could affect morale and consequently productivity. Research findings shows today that the approach to effective leadership stress that no style is the best, but rather the successful leader is the one who can access the situation and choose the most appropriate style, paying attention to the needs of the individual, the group and the organisation. A close analysis of the situation in which the organisation operates and the identification of the style of leadership the organisation uses will help to enhance leadership training.

Furthermore, the impact of leadership styles on employees' performance as well as employees' output requires adequate efficient and effective type of leadership styles to be adopted in order to enhance profitability, accountability, employee performance and organisational productivity.

However, the Federal Polytechnic, Ilaro is described as an educational institution by virtue of its establishment. To ensure improvement on employees' performance, growth and development of the employees within the organisation, there is need for leadership to possess certain qualities, personality attributes includes aggression, diplomacy, intelligence, initiative, drive for achievement and for power, interpersonal skills, self-confidence, administrative ability, imagination, qualitative education and emotional stability. These are the traits the leaders should possess such that they were able to move mountains in their time. Quality thinking has considerable relevance for successful performance.

Finally, the factors that determine leadership styles are very important for every leader to understand so as to identify what situation prevails in the organisation and to adopt his style to match. Others are the ability to handle stressful situations, ability to exhibit flexibility of behaviours under varying circumstances and ability to balance conflicting superior and subordinate expectation.

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# EU POLICY TOWARDS PROMOTING LOCAL DEMOCRACY IN UKRAINE

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**Abstract**: *Administrative-territorial structure of Ukraine is far from being the one that is aimed at providing even social-economic development and promoting prosperity in its regions. The system of local government doesn't meet the needs of Ukrainian society. Not only it doesn't grant getting essential public services and having equal opportunities in justice but also doesn't provide the creation and maintaining of the favorable living space for the development and self-realization of the human. After "the revolution of dignity" Ukraine embarked on public administration and local government reform. The research supports an idea that transformations in Ukraine may be achieved with local solution. Strengthening the capacity of local communities is the only way to empower people. European Union provides constant advice, expertise and financial support to Ukraine. The main aim of this article is to investigate EU policy toward promoting local democracy in Ukraine and analyze the EU activities in democracy-building as well as to present the different challenges that EU facing within implementation of the Association Agreement.*
**Keywords**: *local democracy, local government, local community (gromada), decentralization, devolution, administrative-territorial reform, public administration reform, europeanization, integration*

## INTRODUCTION

Reforming public administration in line with European standards is an integral part of the Ukrainian integration into EU administrative space. It supposes the approximation of the Ukrainian law to the standards, principles and rules that are based on the fundamental values of freedom, democracy, rule of law and respect to human rights and freedoms.

The current system of governance in Ukraine and its spatial division does not meet the needs of Ukrainian society, the criteria of its European choice and principles of "good governance": effectiveness, transparency, accountability and social cohesion (Council of Europe, 2014). Its drawbacks lead to the slowdown of Ukraine's development and low competitiveness of the country in the world.

Ukraine is a unitary state with the following tiers of sub-national government: (1) oblasts (could be compared to a region within the European Union context), (2) rayons, (3) city councils, (4) rural councils. Local communities (gromadas) in Ukraine are quite fragmented and, besides, vary in terms of population size, infrastructure, and financial capability and in some cases ethnic compound as well. That is a great obstacle to effective management and control and in the terms of European normative understanding of good governance this sub-division is far from ideal.

## UKRAINE ON THE WAY TO REFORM

The signing up of Ukraine – EU Association Agreement (political provisions were signed on 21 March 2014; economic part - 27 June 2014) opens the way to the various progressive changes for Ukraine. The treaty becomes a pointer to the profound economic and social reforms ensuring the irreversibility of Ukraine's European integration and confirming a final choice in favor of a European model of social and economic development (Chernykov, Khorolskyi, Synookiy, 2014).

Ukrainian government has been taking active measures for the development and modernization of public administration and local government. On April 1, 2014 the Government of Ukraine approved "The Concept of Reform Local Self-Government and Territorial Organization of Government in Ukraine" (Verkhovna Rada, 2014). Then on June 24, 2016 it approved the Public Administration Reform Strategy 2016-2020 (Verkhovna Rada, 2016).

From the other side European Union provides constant hands-on advice, expertise and financial support. The focus of European financial aid for 2015/2016 has been on decentralization and public administration reform (European Commission, 2016).

Decentralization is a priority reform area due to many factors. Firstly, Decentralization is an integral part of democratization – the real right of people to define the form of their governance, representation, policies and service delivery. Secondly, Decentralized governance can be an important element for the strengthening of civil society. The more power is decentralized, the stronger local government capacity is. Besides, the existence of local government along with the emergence of local institutes of civil society is the sign of political pluralism, which is the best mean of ensuring democracy (UNDP working paper, 1999).

One of the strongest forms of decentralization is devolution. It is defined as a mechanism for reconciling territorial autonomy with the unitary state where regions have a key role as intermediaries, between central and local government and between state and civil society (Keating, 2009). High level of civil society development and participatory democracy as well as the developed accountability mechanisms are the key characteristics of "devolution in action".

Civil society organizations serve as stakeholders in the decentralization process and a "city" is a center of modernization, innovation and an engine of change. Unfortunately in Ukraine there is a problem of the structural weakness of civil society an urban activism in general. Realizing the importance of cooperation between civil society and local government authorities in order to promote democracy, local development and social capital nevertheless Ukraine constantly deals with the limited transparency, mistrust between them and lack of financial capacities. As CSOs are the main stakeholders in the decentralization process, the development of local democracy is of the highest importance in the context of the administrative reform.

The notion of autonomous self-government as a form of local democracy is not well rooted in Ukraine. This reflects the strong Soviet expectations that the state rather than community should take care of people needs. As a result, citizens of Ukraine have little knowledge of and interest in local self-government, preferring either to passively wait for the resolution of their problems by local authorities with state support, or to solve the problems by themselves with no consideration for the wider community. This is a key challenge for the effective delivery of all EU programs and initiatives, and prohibits the adoption of EU norms with democratic life in Ukraine (Aston Centre for Europe, 2011).

## BACKGROUND OF EU POLICY

The EU's mandate to support democracy in its neighborhood derives from the article 21 of the Treaty of the European Union (1992), which states that democracy, the rule of law and the universality and indivisibility of human rights and freedoms are the guiding principles of the Union's external action.

Human rights and democracy remain high on the EU agenda as shown by the EU Action Plan on Human Rights and Democracy for the period 2015-19.

The EU implements its democracy-assistance activities through a range of specific policies and their attached instruments. Much of the EU's democracy assistance work in the countries neighboring the Union is conducted within the framework of the European Neighborhood Policy (ENP) which is based on mutual commitments to common values such as rule of law, good governance, respect for human rights and sustainable development.

Realizing the differences in historical, cultural and political background of the countries ENP was further complemented by additional initiatives. One of them is the Eastern Partnership (EaP) which includes Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. Under the objective of accelerating political association and economic integration, the EaP includes a program of visa liberalization and enhanced access to European market through the Association Agreements, including Deep and Comprehensive Free-Trade Agreement. Trough ENP Action Plans, the EU covers a variety of issues including economic development, promotion of democracy and human rights, energy, transport, environmental protection, people-to-people contacts, development of political institutions and cross-border and regional cooperation (International IDEA, 2016).

Since its adoption, the ENP has faced quite a lot of challenges connected with the post-soviet tradition of state-building and authoritarian resilience. Despite differences countries share many political and social economic challenges, including fragile institutions, corruption, poverty and conflicts.

Trying to address the drawbacks of its policy, EaP introduced a new tool toward the more bottom-up and locally driven democracy support. One of the most important EaP innovations has been a greater involvement of broad range of non-government actors (including NGO, local citizen's groups, trade association and cooperatives, trade unions, local organizations involved in decentralized regional cooperation and integration, scientific organization, communities, the media and independent foundations etc.) in the EU's cooperation with neighboring countries.

In order to promote contacts among civil society organizations (CSOs) and facilitate their dialogue with public authorities an EaP Civil Society Forum was created. In addition one more independent institution – A European Endowment for Democracy was established in 2012 to complement the initiatives of the EU instruments – support civic-society actors and other stakeholders in their efforts to deepen democracy and human rights. The Neighborhood Civil Society Facility and dedicated funding at regional and country level proves that engagement with civil society is a key element of the Eastern Partnership. The EU strategies for promoting political reform in the neighborhood continue to develop by raising the budget of existing aid instruments and consulting local CSOs (Shapovalova, Youngs, 2012).

For Ukraine (and for the five other eastern European partners as well) the institutional plurality is still a recent phenomenon. The structural weakness of local democracy goes back to the communist period, when civil participation was prohibited.

## CHALLENGES FOR DEMOCRACY

An in-depth analysis of EU activities on reshaping its democracy promotion policy through stronger civil society support illustrated quite serious challenges (Shapovalova, Youngs, 2012). Here are the following:

- The empowerment of civil society actors is an obstacle for the further development. The granting system is too complicated for local NGO's and seems to have a focus mostly on the well-established and highly professional ones (Sator, 2010).
- Week environment for civic society. The existence of the GONGO (a government-organised NGO) phenomenon as well as an attitude to foreign-funded NGOs as foreign agents and traitors of the national interest is quite widespread (Lisnychuk, 2013).
- Inefficiency and bureaucratic nature of the local government authorities. Effective mechanisms of accountability are not developed.
- The lack of awareness of the population about the running EU projects and about the Association Agreement negotiation process in general raises the public mistrust and as a result leads to the low civic engagement. Civil society is not involved in the consultations related to the Association Agreement negotiation process and that's why not informed about the benefits of future agreement. It provokes the reluctance of the further EU integration.
- The absence of effective monitoring and evaluation tools (except from ENP Action Plan's progress reports) makes very difficult to assess the real state of civic society in the country.

## CONCLUSION

All things considered the EU in supporting local democracy in Ukraine is accelerating mutual cooperation and providing constant advice and financial support. Nevertheless it faces some challenges that preclude democratic development in Ukraine. The EU should improve the balance between aid going to Ukrainian state and non-state actors. Reforming funding procedures and making them more transparent would raise the awareness of population on the hand and strengthen the participatory mechanisms from the other hand. Due to the problem of constant mistrust between civil society and state authorities building the bridges is of the highest importance. EU should also find ways to reach out the group that do not embrace European values as there is a tendency of polarization in Ukrainian society. By using more diplomatic tools and international arrangements there is a chance to promote a more conductive environment for SCOs. The EU should also cooperate with local philanthropists considering the low level of corporate and individual philanthropy in Ukraine and create more effective schemes and evaluation procedures.

A reform of local government to make it independent of central government interference is not simply desirable for Ukrainian democracy, but absolutely essential. This fact cannot be overlooked. Only democratic local government reform can bring an end to the temptation for central government to use administrative resources in order to pursue their own interests. And only local government reform can end the Soviet-era direct chain of command from the centre to the smallest locality that frustrates local democracy, local economic development and the advance of Ukrainian society.

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# ADMINISTRATIVE AND FINANCIAL REFORMS IN THE NIGERIAN PUBLIC SECTOR

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**Abstract**: *The paper x-rays administrative and financial reforms in the Nigerian public sector. The purpose is to explore several programmes and policies initiated in Nigeria and examine the effect of these reforms as it foster transformational change in the country's public sector. This is imperative given observable professional revolution between government and the workers on one side and among professionals on the other side. This paper adopted an exploratory approach in carrying out the research. Findings of the study reveal that there were abundant of literature on public sector reform with no study or review on administrative and financial restructuring programmes in the public sector. Therefore, the study concludes that reform programmes are key and indispensable in ensuring efficient service delivery in the Nigerian public sector as well as national development. It finally recommends inter alia: continuous and systematic review of programmes and policies of government to ensure alignment with national objectives; mobilization of adequate resources for successful execution and implementation of programmes; and collaboration among all tiers of government and professionals.*
**Keywords**: *Administrative, Financial, Reforms, Nigerian Public Sector*

## INTRODUCTION

The integration of Nigeria into the world political and economic structures requires the intensification of transformational change processes. One of the most important tasks in this process is the renewal of the effective activity and the increase in the competitiveness of the base link of the economy – public sector enterprises, most of which are rapidly overcoming the consequences of the world economic crisis. The crisis of the last few years has revealed that it was most sensitive to negative changes in the economic situation. Therefore, there is a real requirement to develop effective methods of rehabilitation (restructuring, reorganization, reformation) for public sector enterprises complex, and for the renewal of its economic potential.

Restructuring from positions of modern scientific research is one of the ways of public sector restructuring (Tovazhnyanskiy, 2010).That is, if the reformation of public sector has any possibilities of transformation and change, then restructuring is one of the concrete methods of reforming public sector by the structural reorganization of its basic subsystems. In a number of cases, the term 'restructuring' is interpreted ambiguously. Sometimes restructuring is understood as the simple division of a large enterprise into component parts: in other words, dismantling the structure and creating autonomous enterprises from the unique whole. A change of organizational structure, dismantling, division and the selection of the economic personified subsections are only the elements of restructuring, but not necessarily its constituents or purpose. Organizational changes which will be or will not be carried out depend on the aims of the restructuring and on those methods chosen to achieve this goal.

Restructuring in the public services has only recently entered popular and political discourse. Public services have, for a long time, been regarded as a stable world with its own way of working, of employing people, managing HR and social dialogue. However, things have changed and the borders between the profit and non-profit economy, between public and private sectors have blurred. Restructuring is now on the agenda of public sectors in third world countries like Nigeria and is driven by a range of factors including but not exclusively the crisis and the public debt. Austerity, cuts in public spending, externalization of services, rationalization of resources are at stake in many countries. They impact, sometimes drastically, not only public employment in a quantitative way but also the nature – or even the ethos – of the public sector.

Of course, when talking about public services the differences are huge from one country to another: in some countries, public services are predominantly staffed by civil servants while in other the proportion of civil servants employed is much smaller. The nature of the organization could also differ greatly as the public sector can include: public owned companies, central administrations, local authorities, hospitals, education, railways, services of general interest, delegated to private entities, etc. The public sector in Nigeria has grown tremendously over the years. The share of government in the economy is unduly large since consolidated government expenditures rose from 29% of GDP in 1997 to 50% in 2001 (Makinde, 2003).

In point of fact, the Nigeria's decentralized government structure vis-à-vis the three tiers of government often overlaps in some areas of economics activities and basic service provision. Government in Nigeria is perceived as a provider of contracts and a big employer even though this is in the context of a civil service that has been largely de-professionalized and appears to be bottom heavy (Dada, 2003). The public sector had over the years been weakened with an over expanded public expenditure profile, persistent deficits financed by domestic and external borrowing with resultant high debt service burden, breakdown of the traditional instruments of control leading to corruption and misappropriation of funds, incidence of ghost workers, poor costing of programmes and projects, a large portfolio of abandoned/on-going projects especially in efficient and wasteful parastal (Aduke, 2007). Not only that the system has accumulated pension arrears but some states and agencies of the federal government are beginning to accumulate salary arrears and payments due to contractors and suppliers. Furthermore, the traditional instrumentality of the rolling plan has become discredited and hardly informs the preparation of the budget, and indeed major policies. The era of comprehensive planning details had become unmanageable and resources scarcity cum political intervention in priority setting had contributed in rendering the plans impotent

The paradox consist here in the fact that Administrative and Financial Restructuring in the public sector has been dominated by the dire state of public finances resulting from the financial crisis of 2008. This was primarily a result of the banking crisis. As the crisis also threatened the existence of many currencies, the state of public finances became of increased relevance at global level and several legislative initiatives strengthened global governance in this context. Public sector restructuring, however, is not a new phenomenon for many countries of the world. Reforming and reorganizing some public sector entities with the aim to rationalize structures and increase cost efficiency has been ongoing for some decades (Demmke and Moilanen, 2013; Naumann and Naedenoen, 2013). Although, government responses and progress on financial restructuring have varied considerably, nevertheless, public sector restructure programmes have a wide agenda to address.

Consequently, scarcities of financial, technical and managerial resources severely constrain the ability of Nigerian government to sustain a comprehensive public sector restructure programme. Even when the wherewithal is there, the challenges of the complexities and sensitivities of some of the public sector restructure processes remains. Unfortunately, the dawn of the new millennium witnessed various manifestations of discontentment in the areas of resource control, salaries and wages, education, deregulation, privatization and so on. These manifestations of discontentment were demonstrated with increasing frequency and intensity bordering on ineffectiveness, inefficiency and wastage of the national resources (Abdullah, 2007). Despite the growing interest, the main attention of researchers is mainly focused on the analysis of restructuring determinants and other factors, while only a few researchers examined the impact of restructuring on value and financial results in the private sector. While little or lack of known national investigations determining effects of administrative and financial restructuring how to effectively implement the transformational agenda and how to evaluate the impact this process has on the public sectors in Nigeria.

Consequent upon the above factors, the desire to reform the public sector administration capabilities with a view to the burgeoning challenges became sacrosanct. The rationale for this paper therefore, is to assess the administrative and financial public sector restructuring in Nigeria since it is designed to transform and change the economy positively.

## METHODOLOGY

Methodology is the procedure for seeking an in-depth, insight and deeper exposition of problems under study. It involves a careful enquiry to discover new relation and information to expand an existing knowledge. In any given study, it may be necessary and, in fact desirable to use two or more of the general types of research techniques. One may seek the solution of a given problem by studying its history through an examination of documents which is been referred to as secondary sources, and determining the present status by field survey here it is called the primary source. The secondary method of data collection will be adopted this include extraction of relevant information from public documents, journals, Newspapers, Magazines, Conference Papers, Books, Radio and Television commentaries. Thus, the research design adopted is exploratory research design. This is because it satisfies the researcher curiosity and desire for better understanding of the subject matter. Thus, this enables the researcher to obtain background information on the subject matter.

However, this study is bedeviled with certain limitations which consequently affect the findings, among such limitation and problem is time constraint, this is because the time for this study is not sufficient to conduct an exploratory research of this nature. Another challenge is the financial constraint because there is no sufficient finance to subscribe to multiple international journals to access the availability of materials from international perspectives. However, the researchers were able to explore and review available publications in the textbook and other journals.

## LITERATURE REVIEW

Several attempts have been made by scholars to pin down the meaning and nature of public sector restructuring. Essentially, some scholars have argued that public sector in the developing countries is everything and that the most important catalyst of development is an efficient service, while at the same time its inefficiency constitute the heaviest milestones of any country (Bangura, 2000; Ayeni, 2002; Borins, 1994). To some, restructure connotes a deliberate and planned change (Halligan, 1997; Lam, 1997; Denhardt & Denhardt, 2000). For them any intervention which fails to produce fundamental changes in the way public service operates and conducts its business is not restructure. To this end, public sector restructure is a systematic intervention aimed at improving the structure, operations, systems and procedures of public services to enable its transformation as a multifaceted agent of change, and as a veritable instrument of national cohesion and socio-economic development. Similarly, restructure ambitions focus on improving the merit bases of public sector employment and on changing the incentives that individual public servants face, aligning them with the overall policy and goals of government.

Intuitively, public sector restructure seek to achieve a better balance between the fiscal burden of public employment and the need to provide incentives that attract competent staff. It is therefore aimed at improving the confidence of the public and of business, that the public service is both honest and efficient. Against this backdrop, the restructure is predicated on the need to address the following critical issues; reduction of public expenditure, improvement on policy responsiveness and implementation; and to improve service delivery and build public and private sector confidence since Obasanjo (2000) aptly captured the essence and rationale for restructuring in Nigeria thus;

*At certain epochs in the history of a people, they must pause, reflect, take stock and resolve to do some things differently or to undertake certain projects that would make a significant difference in their lives. Such institutions, relationships, policies and programmes, and the identification of negative coalitions, contradictions, challenges, and crises points that have mediated the ability to make progress. If they tell themselves the truth, they also have the courage and sense of mission to map out viable solutions to their problems.*

Anna Kwiatkiewicz (2013) focuses in her analysis of the "Main drivers of change affecting Public Sectors" on human resources. She states that public services including services of general interest (SGI) are highly relevant for the population in general (as providers of essential services) and as employers (giving jobs to large numbers of workers). Kwiatkiewicz identifies the following main drivers of transformational change: Liberalization, technological change, financial uncertainty, changing nature of demand,

and climate change. The author identifies a range of major consequences that can be (in our view) organized in four groups:
a) Job reduction, changed contractual arrangements and increased workload,
b) Flexibility, work organization,
c) New challenges in relation to skills and training,
d) Customer orientation.

*Public Service Restructure Programmes in Nigeria*

"Instead of progress and development which we are entitled to expect from those who governed us, we experienced in the last decade and a half, and particularly in the last regime but, one, persistent deterioration in the quality of our governance, leading to inability and the weakening of all public institutions" NEPA, NITEL,Roads and Railways, Education, Housing and other social institutions were allowed to decay and collapse(Obasanjo,1999:132).

The assertion captures the state of chaos and near despair that characterized most of the federal institutions after the Ayida reform of 1994. Outside the inherent loopholes associated with the panel's report and its implementation afterwards, there were myriads of factors that further compounded the problem of central government machinery and more to the federal civil service (Adebayo, 2004 and Abba, 2007).The relationship between government officials (politicians /public office holders), public servants and citizens was beclouded with mistrust, corruption and inexperience (Jega 2007, and Okorie 2007), inefficiency in the delivery of social services, insensitivity to general welfare, indifference to the norms guiding the conduct of public official and rampant corruption (Olaopa 2008: 157).

Nigeria's machinery of public bureaucracy from the last lapse of military junta was characterized with capitalist bureaucrats whose interest is rather what they would gain and not necessarily what they would inject into the system. It is very instructive to note that the provisions of Ayida's committee report left the public service with greater confusion, cadre conflict and disregard to the principles of neutrality and non-partisanship which is the crux of survival in the civil service. Among the forty two (42) recommendations of the panel which continued as the bedrock before Obasanjo's administration, there were major flaws (Nwizu2002: 422). The flaws destroyed what was left of the civil service before Obasanjo introduced several public service reform programmes in the country between 1999 and 2007.

Bayo (2012: 18) summarized Obasanjo's reform renewal under the following broad ways which include: pension reform, monetization policy, restructuring of pilot Ministries, Departments and Agencies (MDAs), Down-sizing and payroll reform. Others are public service procurement and due process, wages and salaries adjustment and awards (Public Service Rules 2010). The reform trends of Obasanjo administration was specifically guided by the principles of transition to pure capitalist economy. In other to achieve the fundamentals of the renewal programme, Bureau for Public Enterprise (BPE) was established and seen to be strategic in achieving the reform agenda. It has the mandate of ensuring smooth transition to capitalist economy.

*Restructuring and Repositioning of Ministries*

The Obasanjo administration was essentially committed to achieving civil service that is based on international best practice, establish technologically driven workers through ICT friendly and professionalism to solve the problems of over-bloated staff and restore the confidence of Nigerians' in public institutions, resolve the problem of duplication and overlapping functions between agencies and tiers of government. It was seen to be one of the major ideals that would reposition the federal civil service. This aspect of reform would solve the problem of ghost workers syndrome, determine the relevance of departments/agencies and parasatals, the actual number of staff needed per ministry, the work schedule for each cadre and post as well as identify areas of training for the respective ministers.

By September 2004, Bureau of Public Service Reforms (BPSR) was established as an independent agency in the presidency. This is part of the system response in the re-organization and re-assigning of all Ministries Departments and Agencies (MDAs) of all arms and branches of the federal government. The bureau recommended that respective ministries be restructured between 4-8 departments depending on the scope and responsibilities. Every restructuring was subject to the approval/ratification by the Federal Executive Council (FEC).

*Monetization Policy*

One of the discontentment's that flanked Ayida panel of 1994 was its inability to provide abating force against corruption in the civil service. In other to provide the needed lead for war against corruption, the administration was poised to clean up the public sector from corruption by providing what it considered the road map for monetization and monetary policy. The fundamental foci for the initiative were to determine the actual cost of governance in order to prevent wastages and financial leakages in all government businesses, and to improve the pay package of public workers. The policy was introduced in June 2003 starting from political office holders and later extended to core public servants. The policy was aimed at quantifying in money terms, those fringe benefits provided for workers as part of their conditions of service and remuneration, some of which include: utility bills such as electricity, water and telephone services. Others to be monetized are, cost of maintaining chains of domestic servants, upholstery and ward-rope allowances. Official car was as well monetized by procuring the car while the officer convenient lie pays back on monthly basis. The policy as well permitted the sale of official quarters to occupiers or auctioned.

The fundamental reason was to close windows of financial leakages and corruption, improve maintenance culture and attitudinal change. It also monetized the salaries and allowances of all categories of federal public servants that were formally paid in kinds (Stephen, 2011). It raised the national minimum wage from N2, 500 to N3, 500per month with effect from 1$^{st}$May 2000 and much later it was raised to N7, 500. In order to reconcile the wages and salaries differences, a panel was established to harmonize issues of variation in salary as well as consolidation of salaries and wages.

*Down-Sizing in the Public Sector*

Federal institutions witnessed astronomical increase in the staff strength shortly before Obasanjo's administration. In 1988 the workforce was 213, 802, and in 1990 they were about273.392 workers (FOSAAS 1997, Otobo 1999 and, Adamolekun 2005). One of the fundamental problems faced by Obasanjo administration was over-bloated staff strength and the number of MDAs. This increased the cost of re-current expenditure without corresponding output in terms of service delivery. In other to downsize the workforce, some of the parasatals were merged, scrapped and rationalized. For instance, the number of departments in the Ministry of Finance was rationalized from 13 to 10, National Planning Commission restructured from 11 to 7, National Manpower Board merged with the Nigeria Institute of Social and Economic Research (NISER), and the National Centre for Economic Management and Administration (NCEMA) merged with the Centre for Management and Development (CMD) (Olaopa 2008: 176).

The policy resulted in purging of the workforce. Criteria for disengagement was developed and applied which include; (a) officers appointed without due authorization, (b) officers with case of service misconduct; (c) officers that are medically unfit (d) staff in jobs which services are monetized, outsourced or abolished e.g. cleaners, drivers, cooks, security men, messengers etc., (e) staff that have become redundant due to the scraping or restructuring of their organization/department (f) officers without entry qualification or mandatory skills for their jobs (g) staff adjudged to be inefficient or have unsatisfactory character and (h) officers wishing to proceed on voluntary retirement. These principles respond to the fundamental questions of how many people do we need to do the job? And with what skills, and what is the best way to get this work done (Olaopa 2008:176 Eme & Ugwu2011: 48)

In order to apply the above principle, the administration engaged in biometric data documentation and head count exercise. This was aimed at reducing the ghost worker syndrome, present a clearer picture for the actual staff strength and quantify the monetary value. Federal Executive Council approved introduction of Integrated Payroll and Personnel Information System (IPPIS). It was considered pertinent to organize pre-retirement programme particularly for the class of scrapped cadre such as drivers, domestic servants, security, cleaners and so on following the exercise and determination of the administration, about 35,700 staff were served with retirement letters by the Federal Civil Service Commission.

## FINANCIAL REGULATIONS AND ANTI-CORRUPTION POLICY

Before Obasanjo's administration, there was no strong fiscal policy to checkmate corruption and in still financial discipline. Financial regulation was in circulation before the administration, but it lacked the needed force to prosecute defaulters. Attempt by previous reforms was weak and the judicial system was not reliable enough to grant quick dispensation of justice. Previous regimes particularly the military institutionalized corruption directly and indirectly. There was observable penchant for corruption across all the sectors in the country. Civil servants joined the bandwagon to become bourgeoisie bureaucrats. This was a major challenge facing the new regime and must be adequately checkmated. Shortly after Obasanjo assumed office, an anti-corruption bill was sent to the National Assembly. By 2000, National Assembly enacted an Act and subsequently Independent Corrupt Practice and Other Related Offences Commission (ICPC) and Economic and Financial Crimes Commission (EFCC) were established. The agencies were added teethes in the war against corruption. They were to restore confidence in the conduct of government businesses, enthrone prudent and effective management of public fund.

**Table 1 Chronology of Public Sector Restructuring in Nigeria**

| Date | Government involved | Subject (outcome) | Recommendations | Chairman |
|---|---|---|---|---|
| 1946 | The established staff two-structured of four West African Colonies: Nigeria, Gold Coast, Sierra Leone and Gambia | Structure, guiding terms | Two-structured service-junior and senior | Sir Walter Harragin |
| 1948 | The entire government of Nigeria | Conditions of service and training | Training and recruitment of Nigerians for its senior civil service posts | Sir H. M. Foot. |
| 1954 – 1955 | All governments of the Federation | Re-structuring, grading, terms and conditions of service and training; production of five cadres in the service | Reviewed wages and General condition of service | Mr. L. H. Gorsuch |
| 1958 | Western Region government | Review of salaries and wages | Reviewed remuneration and structure of the service and noted absence of middle category and created 5 main grades | Mr. A. F. F. P. Newns |
| 1959 | Federal Government, Northern Regional Government and the Government of Eastern Region and Southern Cameroon's | Integrity ministries and Departments to end the era of ministers without portfolio | Proposed integration of ministries and departments. | Justice I. N. Mbanefo |
| 1963 – 1964 | All the Governments of | Review of wages and salaries and | Reviewed salaries and wages of the | Justice A. Morgan. |

| | | | | |
|---|---|---|---|---|
| | the Federation | conditions of junior employees in both private and public sector. | junior federal staff, introduced minimum on geographical basis. | |
| 1966 | All the governments of the federation | Grading of post in the public service | Examined anomalies in the grading of posts to proposed uniform salaries for officials performing identical duties | Mr. T. Elwood |
| 1970 – 1971 | All the Governments of the Federation | Review of wages and salaries, organisation, structure and management | Proposed establishment of a Public Service Review Commission to examine the role of the Public Service Commission | Chief S. O. Adebo |
| 1972 – 1974 | All the Governments of the Federation | (Public Service of the Federation Review Commission) organisation, structure and management, Recruitment and conditions of Employment Programmes and superannuation's regarding of all posts and Review of Salaries, introduction of result-oriented Management in the Public service. | Focused on the issues of efficiency and effectiveness, made design to improve the structure and system, introduce open reporting system for performance evaluation, A unified grading and salary structure for all covering all posts. | Chief J. O. Udoji |
| 1976 | The Federal Government of Nigeria | Looked into complaints and extent of implementation of accepted recommendations | Proposed full implementation of accepted recommendations | Chief S. Olu Falae |
| 1985 | All the Government of the Federation Nigeria | The structure, staffing and operations of the Nigerian Civil Service in the mid-80s and beyond, attempt at professionalizing the service. | Abolished the office of Head of service and permanent secretary | Professor Dotun Philips |

| | | | | |
|---|---|---|---|---|
| 1986 | The Federal and State Governments of the Federation of Nigeria. | Worked out guidelines for implementation of the civil service reforms as embodied in Udoji's and Philips Reports. | Proposed efficiency and effectiveness, and professionalism. | Vice Admiral Patrick Koshoni |
| 1994 | All governments of the Federation | To provide guideline on implementation of Dotun Philips Reform. Introduced reversals of novelties that turned out as failures. | Abrogation of civil service re-organisation Decree No 43 of 1988 | Chief Allison Ayida. |
| 1999 | All Government of the Federation | The Charter for Public Service in Africa | Established professional values for public service, prescribed code of conduct for public service employees. | |

*Source: Adegoroye, G. (2005) and Abdullah S. A. (2007)*

## OTHER REFORM INITIATIVES IN NIGERIA

| Date | Government involved | Subject Matter (outcome) | Initiated by |
|---|---|---|---|
| 2003 | Federal Government of Nigeria | Public Service Reforms (PRS), National Economic Empowerment and Development Strategy (NEEDS), Service Delivery and Due process | Obasanjo Administration |
| 2004 | Federal Government of Nigeria | Pension Reform | Obasanjo Administration |
| 2004 | Federal Government of Nigeria | Bureau of Public Service Reforms: to act as secretariat or engine room to all public service Reforms | Obasanjo Administration |

## RECENT PUBLIC SERVICE REFORMS SINCE 1999

The goal of most public service reforms is to transform ailing public service into a knowledge-based, professional and accountable system, rendering timely, diligent and effective service to the public. With the introduction of the public service reform, the machinery of state governance is modernized and reinforced in order to enhance the performance and effectiveness of the state.

## CONCLUSION

Reform in the Nigerian Public sector is a demanding task and should not be seen as a quick solution for problems militating against our national development. Building national coalition in support of public sector restructure to include all stakeholders and partners such as public service, labor unions, public servants, the media, civil society organizations, political parties and the academics is necessary if the restructure, is to stand the test of time devoid of sabotage. It is also possible for one to conclude that most of the strategies pursued by Nigerian to restructure her public sector have not been able to achieve its desired outcomes basically because of political, historical, economic, institutional, cultural and other environmental constraints. The prospects of the public sector restructuring are pigeonholed on the implementation of such reforms. The public sector as the principal vehicles through which the promises of a better life can be achieved must naturally be the centre-piece of public attention and, apparently, its transformation should be a cardinal policy imperative of the regime in power.

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# MUNICIPAL STRATEGIC MANAGEMENT AND PERFORMANCE

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**Abstract:** *Strategic management by which managers guide their organizations towards strategic objective can be as important in the businesses as in the municipalities. Particular importance has strategic performance management, which puts a great emphasis on the importance of strategy execution in municipalities, too. Municipalities should be able to identify success factors, especially intangible, which mould make the municipality make an successful and different one. The paper emphasises the central importance of municipal strategic management. The aim of the contribution is to identify solved priorities and deficiencies in strategic plans based on the collection of secondary sources (websites of municipalities) and to discuss strategic planning of municipalites within the Moravian-Silesian Region in the Czech Republic. The paper suggests the improvement in the strategic plans based on an analysis of these plans and on a primary research.*
**Keywords:** *Municipalities, strategic plans, performance.*

## INTRODUCTION

Strategic planning is a deliberative, disciplined approach to producing fundamental decisions and actions that shape and guide what an organization (or other entity) is, what it does, and why it does it. Strategic planning is not a substitute for strategic thinking, acting, and learning, or for leadership. Instead, strategic planning is a leadership tool meant to enhance strategic thinking, acting, and learning. Strategic planning can produce several benefits, but there is no guarantee that it will. There are a variety of approaches of strategic planning some approaches emphasize process, while others emphasize content. Strategic management is a broader concept that links planning and implementation (Bryson, 2004).

Municipality can be a city, town, or village. Territorial self-government in the Czech Republic has two tiers. Currently, there is a total of 6 249 municipalities in the Czech Republic, of which there are 20 chartered towns, 496 towns and 5 733 municipalities. The Constitution of the Czech Republic anchors the division of the Czech Republic into basic (municipalities) and higher (regions) territorial self-government units. Municipalities in the Czech Republic administer their territories within the framework of independent competence (SMO CR, 2016).

Although utilization of strategy and strategic management is especially in business sector, it is possible to use principles of strategic management in public sector. Public administration organizations are more bureaucratic, public managers do not have to limited possibilities to determine missions of organizations. There are many potential benefits from adopting the concept of strategy in public sector organizations, municipalities. Public sector makes decisions according to especially legislative rather than market-driven changes (Kerlinová & Tomášková, 2014; Ferlie, 2002; Rusaw, 2007). Implementation of strategic management principles is closely connected with elaboration of strategic plan.

## THEORETICAL FRAMEWORK

Effective strategic management of municipalities supports and encourages adaptive capacity to maintain or improve the conditions of socio-ecological systems and management aspects of profit and nonprofit organizations (Dutra *et al.*, 2015). From an organizational and management perspective, few studies identify municipality attributes that are necessary to build and strengthen adaptive capacity in profit and nonprofit organizations (Dale *et al.*, 2013; Dutra *et al*., 2015).

Dutra *et al.* (2015); Folke *et al.* (2007); Ford *et al.* (2006); Stocker *et al.* (2012) write about the key drivers related to municipalities and governance: learning and human capacity, leadership, trust, cooperation and coordination, creation of open and transparent processes, communication, information and knowledge exchange, voluntarily. According to Ladner (2016) a lot of municipalities have continued to reform their political, administrative and management system along the ideas of new public management.

Battarra *et al.* (2016) argue that organized networks of citizens (such as non-profit organizations or private associations) together with networks of institutions (such as partnerships amongst municipalities or universities) are needed in order to improve the decision-making processes and strategic planning of municipalities.

Foged (2016) did research within 239 Danish municipalities he examined the attractiveness of municipalities for population. Ruiters & Matji (2016) present public-private partnership (PPP) framework models for funding and financing infrastructure at municipalities. Yinger (1986) provides a general treatment of disparities in a system of municipalities (including strategic areas of municipalities). Wang, Feeney (2016) examine the adoption of information and communication technologies (ICTs), which aim to increase efficiencies for the municipal governments. On the other hand the study of Moon (2002) suggests there are some widely shared barriers (lack of financial, technical, and personal capacities) to the progress of municipal ICTs. Duncombe & Yinger (1993) analyze returns of scale in municipalities their results indicate economies of scope, increasing returns to quality scale to municipalities. Falcao & Santos (2016) did a case study whose objective was to map and analyze organizational processes with the objective of making the public service more responsive, efficient and focused on the user the study object was the process of the simplified public selections made by a municipality.

Strategic planning is an effort that produces fundamental decisions and actions that shape and guide an organization. Strategic plan (strategy) is output of the strategic planning. Strategic management is about the strategy that management carries to achieve better performance. Despite its appeal for improving government, many local governments (municipalities) have not developed performance-measurement system, and even fewer use these systems to improve decision making (De Lancer Julnes & Holzer, 2001). Ammons & Rivernbark (2008) examine patterns of performance measurement use among a set of cities and conclude that the types of measures on which officials relay, the willingness of officials to embrace comparison, and the degree to which measures are incorporated into key management systems distinguish cities that are more likely to use performance measures for improvement from those less likely to do so. Grossi *et al.* (2016) contribute to the debate on the use of performance in the context of public sector performance management they examine the interest of politicians and senior managers in using such information about performance for decision-making and monitoring within the municipal budget cycle. According to Kerlinová & Tomášková (2014) public administration organizations and municipalities in the Czech Republic have some barriers in strategic management not only with development of strategic plan however with its implementation and performance measurement. Municipalities and public administration organizations should know that strategic management is important instrument for decision process.

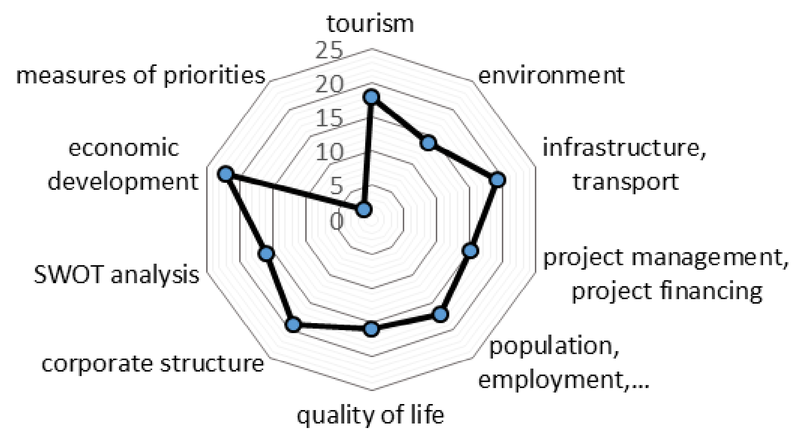
## METHODOLOGY AND FINDINGS

Based on the collection of secondary sources (websites of municipalities) there are identified solved priorities and deficiencies in strategic plans. According to comparison of the analyzed strategic plans there are written conclusions and recommendations. The author used subjective determination of evaluation criteria to perform content analysis of published strategic plans. 100 municipalities of the Moravian-Silesian region were analyzed, there were analyzed the websites of the municipalities. Only 22 basic municipalities of the Moravian-Silesian region have published its own plan.

Participation of interest groups as schools, non-profit organizations, entrepreneurs, office clerks, general public in the development of the strategic document is relatively high 14 municipalities from 22. The results showed (Figure 1) that the area of tourism is in 18 plans a strategic priority. 19 of plans mention transport links and infrastructure and entrepreneurship. Priorities such as the quality of life (housing, social, health and education) are mentioned in 16 plans. The environment is mentioned in 14 plans. In all plans, a main priority is determined by economic development. Strategic plans of 16 municipalities best meet the conditions of the SWOT analysis. This analysis is not contained in less than 28 % of these documents. Strategic plans of municipalities are not treated in terms of complexity. Around 59 % of the analyzed municipalities have not developed a strategic plan. Autonomy of these municipalities is unaware of the strategic management and development of a strategic plan that would allow them and their future followers established the basic starting points to develop the municipality. Most plans do not solve measures of solved priorities in the analyzed plans 20 plans do not measure the priorities as objectives, and they are not setting benchmarks to fulfill them. Control of such strategic plan is carried out without prior sophisticated objectives and measures without logical continuity and coordination in 90 % of analyzed plans of municipalities (22 plans).

Based on the collection of secondary sources (websites of municipalities) there are identified deficiencies in strategic plans especially in the area of measurement of priorities, project management and environment.

**Figure 1 Solved priorities in strategic plans**




*Source: own processing*

Survey method was chosen to collect the primary data. The research facility of this study was of municipalities within the Moravia-Silesian region. The aim of the survey was to get to know how important are areas – strategic priorities - for municipalities involved in the table 1. The key respondents were chairmen of municipalities. A total of 50 questionnaires were randomly distributed to the respondents. Only 24 were deemed usable for further analyses. As such, the response rate was 48 %. It is worth mentioning that the data collection process is still on-going at the point of time this paper was written. A self-administrated questionnaire consisted of 15 questions. All items were designed in 10-point Linkert-type rating scales to ease the respondents in making their choice by simply rating „out of ten“ Specifically, 1 denoted „strongly disagree“, 5 meant „slightly disagree“, 6 „slightly agree“, 10 „strongly agree“.

Table 1 summarizes the values of mean and standard deviation for strategic management. There were 15 items related to this variable. The individual mean value for all items was above 6.00 (slightly agree). The overall mean was 7.22 and standard deviation was 1.07. Two items were found to have a mean greater than 8.00, they were item 13 (M = 8.22; S.D. = 1.67) and item 15 (M = 8.12; S.D. = 1.81). Particularly, item 13 obtained the highest mean. The lowest mean was recorded by item 7 (M = 6.39, S.D. = 2.15). The results indicated that respondents were generally agreed that they possessed positive or favorable strategic management attitude. Therefore, in regards to perceived desirability, respondents perceived that strategic management was important for the analyzed municipalities.

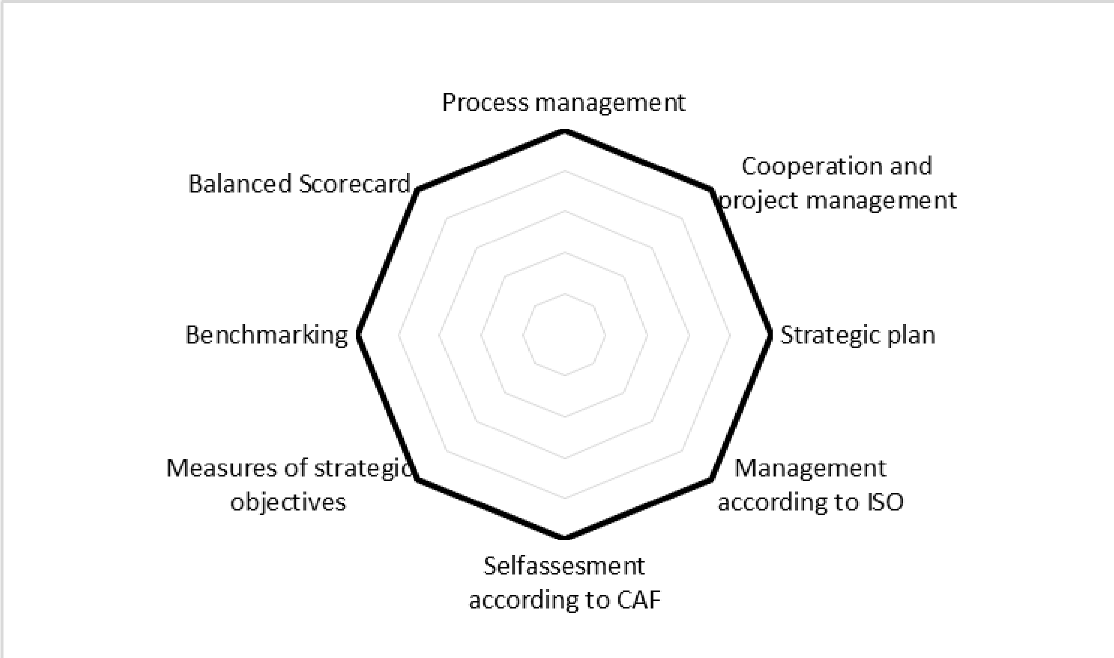
**Table 1 Mean and standard deviation for strategic management**

| Item | Description | M | S. D. |
|---|---|---|---|
| **1** | Identify and believe visions | 6.57 | 2.12 |
| **2** | Pleasant region to live | 7.07 | 2.24 |
| **3** | Safe city | 6.46 | 2.04 |
| **4** | Job opportunity | 7.10 | 2.01 |
| **5** | Effective management of funds | 7.36 | 1.79 |
| **6** | Preparation and implementation of investment projects | 7.80 | 1.74 |
| **7** | Train employees for sustainability | 6.39 | 2.15 |
| **8** | Entrepreneurship development | 7.02 | 2.22 |
| **9** | Improving the process of planning and project management | 7.59 | 1.64 |
| **10** | Fostering an environment of cooperation, trust | 6.44 | 2.38 |
| **11** | Leasure activities and tourism | 6.71 | 2.06 |
| **12** | Quality of services, educational facilities | 7.61 | 1.64 |
| **13** | To be creative and innovative | 8.22 | 1.67 |
| **14** | Have a feedback to items 1-13 | 7.94 | 1.81 |
| **15** | Measurement and management of items 1-13 | 8.12 | 1.81 |
| | Overall Value | 7.22 | 1.07 |

*Source: own processing*

The analyzed municipalities have positive attitude to measurement and management of strategic priorities (item 15 of the Table 1). When making plans for the new programming period, the strategic management of municipalities should try to apply appropriate managerial concepts and tools that can streamline the process of strategic management, define bottlenecks and should measure strategic initiatives of strategic plans. Appropriate managerial concepts and tools can help municipalities effectively eliminate deficiencies in strategic plans in the future. The development of municipalities within the area of strategic management should involve the process of strategic management development (Figure 2) based on the survey results.

**Figure 2 Process of strategic management development**




*Source: own processing*

Based on the secondary and primary research the municipalities should implement the process of the strategic management development and it should be fulfilled in step like progression from process management to Balanced Scorecard method (see figure 2). Balanced Scorecard concept belongs to the managerial methods of strategic management. Balanced Scorecard method is focused on the management of organizations and the method measures financial and non-financial indicators of the organizations, which brings together a monitoring and a comprehensive picture of the organization. This method is particularly widespread in business practice, but in the second half of the 90s of the 20th century the method began to be used also in public administration and municipalities. Municipalities can adopt and use the scorecard to help them describe their strategic plans and implement a new strategy management system based on scorecard measurements. The development of the strategy management system transformed the Balanced Scorecard from being an extended diagnostic system to an interactive system, defined by Simson (1995) to have the following characteristics: Information generated by the system is an important agenda addressed by the levels of management; information generated by the system can be interpreted and discussed in meetings of subordinates. The Balanced Scorecard is a catalyst for the continual challenge, for strategic planning.

## DISCUSSION

Falcao & Santos (2016) found that simplified selection processes were scaled on performance levels and their study found that it is possible to decide more objectively in relation to the sequence of activities, distribution of work and the time planned for its execution. However, in most cases it has been indicated that lack of technical and financial skills and monitoring of the private operator are serious challenges (Ruiters & Matji, 2016).

The study of Longo & Rotolo (2016) explores strategic awareness and its implications for strategic planning in public organizations. The expectation is that better awareness of emergent strategies is the basis of effective strategic thinking and planning. The results highlight some relevant drivers promoting strategic awareness: a mindset change from an internal view to an external needs coverage analysis, the use of horizontal staff involvement to avoid responsibility issues in a structured strategic thinking process and total disclosure within a window of opportunity to show the structural impossibility of reaching universal coverage.

The model showed in the figure 2 “Process of strategic management development” should bring solution for municipalities how to work with factors involved in the table 1. Figure 2 highlights that municipalities should develop their strategic management based on the implementation of the model in the figure 2 in step like progression but it is important to know that the criteria in the model have the same importance and they need to be balanced in municipal strategic management. Moreover the model suggests the implementation of the universal management tool called Balanced Scorecard which can help to measure and evaluate the criteria involved in the table 1 because these criteria play important role in the development of municipal strategic management.

## CONCLUSION

Strategic management is essentially a process and it needs to facilitate decision-making and feedback about the feasibility and progress of objectives. Strategic planning is a process which sequences activities in terms of responsibilities and resources to manage an organization´s purpose, objectives and strategy. Seeing strategy in terms of figure 2 which will manage the features of the table 1 can help clarify thinking of municipalities about what kind of job such a strategy should do.

This paper was conducted to study the factors associated with analysis of factors playing important role for strategic management of municipalities of Moravian-Silesian Region of the Czech Republic. This paper is not without any limitations. This showed that municipalities are rather positive about becoming sustainable developing of their territories. The paper highlights the solved priorities in the strategic plans of the municipalities based on the secondary research and analyses the strategic priorities within municipalities based on the primary research. Based on the secondary and primary analyses there is created model which should bring a direction how to manage a municipality effectively and how to develop the municipal strategic management and performance.

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# *FINANCE*

# DOES DEMOGRAPHY MATTERS IN GROWTH OF GOVERNMENT EXPENDITURE? A CASE STUDY OF JAMMU AND KASHMIR (INDIA) WITH CO-INTEGRATION APPROACH

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**Abstract**: *The paper investigates the behavior of demographic dimension on the growth of aggregate Government expenditure in the state of Jammu and Kashmir (India) in long and short run. Demographic dimensions, anywhere, are related to different aspects of population which pushes the government expenditure to higher level. The state of Jammu and Kashmir is not the exception, the increasing trend in different aspects of population, rising needs and aspirations of the growing population forces the government to increase expenditure on that count, which result in increase in aggregate government expenditure. Using multivariate co-integration technique followed by VAR model on annual time series data for the period 1984-2013, the study found that demographic dimensions do not have long run association with government expenditure. The demographic variables affect government expenditure only in short run. Our study found that population above 65 and rate of urbanization are significant demographic factors which produce positive change in government expenditure while increase in total population is insignificant to produce change in government expenditure.*
**Keywords**: *Population above 65, Hospitals, Education, government expenditure, Co-integration*

## INTRODUCTION

Public spending, particularly on Demographic aspects, is a significant tool in the development process of an economy. Public spending has remained a fundamental issue in a welfare characterized state like Jammu and Kashmir, where the economy is characterized by high population growth, growing urbanization, poor infrastructural service delivery, declining productivity, high level corruption and policy instability. Over the years researchers have examine the impact of demographic level on economic growth. But how far the demographic level stimulates the government expenditure in short and long run is an empirical question to investigate. The non availability and lower quality of goods and services for majority of population, changes the entire courses of public spending. It is due to the fact that different aspect of population will demand more and qualitative infrastructure such as roads, water and sanitation, transport and communication, health amenities, Education etc to fulfill their needs. Therefore, demographic dimensions are important drivers of government expenditure over time, and how far this dimensions have a positive impact on the growth of public expenditure in the state of Jammu and Kashmir is an open question and the present study is geared up in that direction.

The government expenditure, all over the world, is the mechanism in which different goods and services are brought together by state to fulfill the demands of people. It create public bequest for the society and produce positive externalities for the economy. Therefore, it can be said that government expenditure is always related to the population of the region, and how population or in other words demography of the region will change, in terms of tastes, priorities and demands; government expenditure will also change in same direction. Literature suggests that demographic structure and the level of Government spending have long term relationship. Feldstein (1996) found that the Demographic variables like elderly population influence the level and composition of public spending, as an aging population demand greater spending on health, housing, and social security. Dao (1995) find that structural differences, such as the degree of urbanization or population density, also affect government spending. (Aregbeyan et. al. 2013; Udude & Deve, 2014) find that while urbanization, younger population and population density exert a significant impact on government recurrent expenditure (especially on general administration, transport and communications), its influence on government capital expenditure, though positive, but is insignificant. Sanz &Velazquez (2003) stated that health, education, social security, transport and communication, public/private prices, age structure of the population and land area determine the composition of government expenditures in OECD countries. Killian (1998) highlighted on factors such as size of territory and population in a country as a significant determinant of the level of military spending.

With such background, how far the demographic level affects the allocation of government expenditure is an open debate. Therefore, this paper is an attempt to analyze the impact of demographic levels on government expenditure in short as well as long run in the state of Jammu and Kashmir. Rest of the paper has been divided in to three sections. Section I discuss the background and objectives of the study. Section II deals with the methodology and description of the variables Section III analyze the result and discussion of demographic determinants of government expenditure followed by conclusion.

## BACKGROUND OF STUDY

The financial condition of Jammu and Kashmir State over last three decades has been a source for deep concern. Over the years, the consolidated financial position of the state has revealed a noticeable deterioration in some of their major deficit indicators. One of the primary weaknesses of state government finance can be credited to the increases in non developmental expenditure, mainly the revenue component of the non-developmental expenditure, and interest payments as a share of revenue receipts. Structural imbalances in the form of revenue and capital deficit in particular and large budget deficit in general, results rising interest burden, increasing distortions in the pattern of expenditure, and very slow growing non-tax revenues are major problem areas for Jammu and Kashmir state financial system. These problems, over the years have been motivated a great deal because of several economic and political ups and downs in the state.

Government expenditure has increased tremendously in state over last three decades. In welfare characterized state, the quantum of public expenditure has not only increased tremendously but also has reached fantastic heights. Explosive public expenditure in Jammu and Kashmir in recent years most probably has not given enough momentum to the growth of the economy due to several leakages rather it has helped the state in extending the various tasks of the various governments. The extended tasks are; managing population and their requirements like health, education, law, social security, health facilities, roads, transport etc. Though significant development has taken place in some sphere since independence, access to opportunities for a reasonably minimum standard of living is one of the lowest in the country. While all other special category states get 70 percent as central grants and assistances and 30 percent as loan to bridge their fiscal gaps, the state of Jammu and Kashmir gets 90 percent as grants and assistances and 10 percent as loans which makes the state of Jammu and Kashmir different from other special category states.

The total government expenditure of the State has grown to nine times between 1990-91 to 2013-14 with average annual growth rate of 60.1 percent The tremendous increase in public expenditure in first phase might have been due to increased public expenditure on general services for containing law and order, organs of state and the increasing demand for social services such as education and health. Secondly, the tremendous increase in public expenditure might be due to growth of GDP, per capita income, growth of population, urbanization and other social and economic factors. There is also a vast change in the public expenditure in General services, economic, services and social services in Jammu and Kashmir. The expenditure in General services has increased 43 percent during 2006-07 to 2009-10 and 68 percent during 2009-10 to 2013-14. The average growth rate of General expenditure is 10.2 percent annually. The expenditure on General services has always remained high in the state which most probably might have been due to political conditions, rate of unemployment, security purpose, growing population etc, While the expenditure on social services has increased by 48 percent between 2006-07 to 2009-10 and by 44 percent between 2009-10 to 2013-14, the average annual rate of growth of Social service expenditure stands at 8.2 percent during the same period. The public expenditure on economic services grew by 45 percent during 2006-07 to 2009-10 and 17 percent during 2009-10 to 2013-14 with average annual growth rate of 11 percent.

The demographic and infrastructure indicators have fluctuated considerably over the years. The total population of the state has increases at an average annual growth of 2.1%. Rate of urbanization is increasing constantly as the job opportunities and increase in standard of living attract far flung areas to move towards urban cities and towns. Population density of the state has increases tremendously of last decade with strength and accumulation of more economic activities in plane areas of the state. The population of elderly people is constantly increasing over the years which increase the rate of dependent respondents. Also the level of literacy and other demographic indicators are still below than average level.

Keeping in consideration the above background of the study, the primary objectives of this is are as follows:

- To identify, whether Demographic dimensions have short and long run association with Government expenditure
- To study the demographic determinants of government expenditure in the state of Jammu and Kashmir

**Sources of Data**

The study is primarily based on the time series data using the time period of 30 years from 1984-85 to 2013-14. The specification of this time period is that, the entire period has witnessed wide economic ups and downs were the economic activities in the state have reduced widely. Further entire period has witnessed a drastic political instability and social unrest leading a wide change in revenue generating capacity of state. The major sources of data for the study are; Annual budget papers of the Jammu and Kashmir state, state Finance reports Reserve Bank of India, Annual Reports on Currency and Finance and also from Economic Surveys of J&K, census reports and NSSO Rounds. In case of unavailability of some data necessary to estimate different components in the exact form, we would like to prepare the data base by using arithmetic adjustments.

## METHODOLOGY

The econometric framework adopted in this paper is based on developments in co-integration and error correction model suggested by Johansen (1988, 1995). By applying VAR techniques to the time-series data, based on the results of unit root and multivariate co-integration test, we are able to approximate a dynamic structure in which initially all the variables in both the models are treated as endogenous. Most time-series analysis demonstrate non-stationary characteristic in their mean or trending pattern. Therefore, in order to determine the suitable method of time-series econometric analysis, a common approach is to identify the form of the trend in the data and whether individual data series contain unit root characteristic. If the data is trending, then some form of de-trending is needed. The most common de-trending practices are differencing and time-trend regressions. Thus, the first step in co integration modeling is often taken by testing for unit roots to determine whether trending data should be differenced or regressed on deterministic functions of time.

After employing unit root and co-integration modeling for the time series data set of each determinant function, we are able to constitute a model with free of spurious properties and having dynamic robustness structure. Based on the unit root and co-integration results we identify the error correction models which are suitable to generate robust results in terms of demographic determinants of government expenditure. As stated above that this study employ employs Johansen multivariate co-integration approach developed by (Johansen, 1988; Johansen and Juselious, 1995), specified as a reduced-form VAR model of order *p*. Therefore, in this study, the VAR model is used to assess the determinates of government expenditure through demographic variables in the state of Jammu and Kashmir. Therefore, the basic model specified for all the three studies is as:

$$y_t = A_1 y_{t-1} + \dots \dots + A_i y_{t-i} + \dots \dots + A_p y_{t-p} + Bx_t + e_t \qquad (1)$$

Where:

$y_t$ is the vector of endogenous variables(i.e, Government expenditure

$x_t$is the vector of deterministic variables (Demographic and infrastructure variables)

$A_i$ and *B* are matrices of coefficients of the variables to be estimated

$e_t$is a residual *vector*

*i* is the lag length, *p* is the maximum lag length and *t* is the time period

The above equation (1) states that the procedure by which the dependent variables in $y_t$ vary about their time-invariant means is entirely determined by the parameters in $A_i$ and *B;* and the (infinite) past history of $y_t$ itself, the exogenous variables $x_t$ and the history of independently and identically distributed shocks, $e_{t-1}, e_{t-2} \dots \dots$ Therefore, the joint distribution of $y_t$ is determined by the distributions of $x_t$ and $e_t$ and the parameters *B*, and $A_i$.

However, according to the granger representation theorem (Engle-Granger, 1987), if Co integration is established among a vector of variables in the model, then a valid error correction model may be estimated if not then VAR is used. Therefore, in this study, the choice of whether to use VAR or VECM for estimations follows Granger representation theorem; that is, it is based on Co-integration results. Interpretation of results in VAR models is based on Impulse Response functions and Variance Decompositions which are discussed in detail in the later sections of this chapter.

***Description of variables***

Dependent variable: Aggregate Government expenditure

Independent variables: Total population, Urbanization, Population above 65

***Estimation Procedure***

Non-stationary data leads to spurious regression due to non-constant mean and variance (Dimitrova, 2005). If a series is stationary without any differencing, it is said to be I(0) or integrated of order 0. However, if a series is stationary after first-difference is said to be I(1) or integrated of order 1.To this end, the Augmented Dickey-Fuller (ADF) (1979) and Philips Pearson (PP) (1992) test has been adopted to examine the stationary, or otherwise, of the time series data. The lowest value of Akaike Information Criterion (AIC) has been used in this to decide the optimal lag length in the ADF and PP regression. These lags were used in ADF and PP regression to make sure that the error term is white noise. If all the variables in an equation are in integral order of I(1) and the resulting residuals are I(0) then according to Engle and Granger (1987), it can be declared that there resides a corresponding error-correction mechanism (ECM or *et-1*) and the basic models will be transformed accordingly. The regression form ADF test is in following form:

$$\Delta y_t = \alpha_0 + \alpha_1 y_{t-1} + \sum_{j=1}^{p} \gamma_j \Delta y_{t-j} + \varepsilon_t \qquad (5)$$

Where, $\Delta$ is the first-difference operator, $y_t$ is the respective variable of expenditure over time, *p* is lag, $\alpha_0$ is constant, $\alpha_1$ *and* $\gamma_j$ are parameters and $\varepsilon_t$ denotes stochastic error term.

If $\alpha_1$= 0, then the series is said to have a unit root and is non-stationary. Hence, if the hypothesis, $\alpha_1$ =0, is not accepted according to equation it can be concluded that the time series does not have a unit root and is integrated of order I(0), or in other words it has stationarity properties.

Similarly the regression form Phillips-Perron (PP) test is in following form:

$$y_t = \alpha_0 + \alpha_1 y_{t-1} + \alpha_2 (t - T/2) + \mu_t \qquad (2)$$

Where $\alpha_0$, $\alpha_1, \alpha_2$ are the expected least-squares regression coefficients. The hypotheses of stationarity to be tested are *H0:* $\alpha_0$ = 1 and *H0:* $\alpha_1$ = 1, $H0{:}\ \alpha_2$= 0.

***Cointegration test***

The Johansen's co-integration method is used to verify whether there exist a co-integrating vector among the variables or in other words whether there exists any long run association between the variables (Johansen, 1988). The Johansen's co-integration test employ two test statistics to identify the number of co-integrating vectors which are: the Trace test and the Max Eigen value test. The Trace statistics tests the null hypothesis of r co-integrating vectors/equation in the given series against the alternative hypothesis of n co-integrating equations. The trace statistic test is calculated by using the following expression:

$$LR_{tr}(r/n) = -T * \sum_{i=r+1}^{n} \log(1 - \breve{Y}_1)$$

Where

$\breve{Y}$ is trace statistic value, n is the number of variables in the system and r = 0, 1, 2, ..., n-1co-integrating equations.

Similarly the null hypothesis for the Max Eigen value is to test r co-integrating equations against the alternative of r+1 co-integrating equations where r = 0, 1, 2, ..., n-1 and n is the number of variables in the system. The test statistic for Max Eigen value is computed as:

$$LR_{max}(r/n+1) = -T * \log(1 - \breve{Y})$$

Where

$\breve{Y}$ is the Max Eigen value and T is the sample size.

In case Max Eigen value statistic and the Trace statistic yield different results, then trace test statistic will be preferred as suggested by Alexander (2001).

***Model specification***

After the Johansen co-integration test, next is to fit the suitable time series model. If co-integration has been establish between the variables, and then this implies that there exists a long run relationship between the variables under integration equation. Hence, the VECM is applied in order to determine the short run relationships of co-integrated variables. On the other hand, if there exists no co-integration, then the VECM is transformed to Vector autoregressive (VAR) model, followed by impulse analysis, variance decomposition tests has been used to determine short run casual links and response of dependent variable towards independent variable with period of stability. The estimated model, is the modification of equation 1 after co-integration test. VAR model has been used to identify short run relationship of demographic variables to government expenditure in absence of long run co-integration. The estimated models for demographic determinants of Government expenditure are as follows:

$$govtexp_t = \alpha_4 + \sum_{i=0}^{n} \theta_i \, govtexp_{t-i} + \sum_{i=0}^{n} \theta_i \, urbnpop_{t-i} + \sum_{i=0}^{n} \theta_i \, pop65 +_{t-i} + \sum_{i=0}^{n} \theta_i \, tpop_{t-i} + \mu_t \qquad (3)$$

In the above VAR model 3, $govtexp_t$ is the dependent varable at time t, $\alpha_4$ *is the constant*, $\theta_i$ are the adjustment coefficients of the respective demographic variables at time period I where I is running from 1....2. The hypothesis of the equations is tested on probability value of t-statistics at 5% and 10 % level of significance.

***Diagnostic tests***

In order to check the strength of our models estimated, different diagnostic tests have been carried out. The diagnostic tests applied in the restricted equations of the government expenditure and NSDP are: the Breusch-Godfrey Serial Correlation or LM Test done for serial correlation of the model, ARCH Test (autoregressive conditional heteroskedasticity) has been carried for Heteroskedasticity. Similarly, the test for parameter stability of the model has been performed by the CUSUM statistics and the Normality test has been done through Jarque-Bera test. All the diagnostic tests are estimated through null hypothesis which are tested through the test statistic value of each test at the probability value at 5% level of significance.

## RESULTS AND DISCUSSION

The empirical analysis begins with the lag creation. Akaike's Information Criterion (AIC) has been used to find out the lag order of each variable under study. In beginning, the preliminary analysis of the data is performed to check whether the data is stationary. The Augmented Dickey Fuller (ADF) and Phillips-Perron test is used to check for stationarity of variables in the dataset. In addition, the Johansen Co-intergartion test will be used to determine the appropriate time series model to fit. Further, the results of VAR are specified and interpreted.

***Unit root test***

The Augmented Dickey-Fuller (ADF) test and pearson Philips (PP) test was conducted to pretest the variables for unit roots to verify that the variables are not integrated of an order higher than one. Table 1.1 provides the cumulative distribution of ADF and PP test based on Mackinnon (1991).

| Table 1.1: Estimated results of Augmented Dickey-Fuller and Phillips-Perron test for Stationarity | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Variables | At level | | | | Difference | | | | Order |
| | t-statistic | 1% | 5% | P value* | t-statistic | 1% | 5% | P value* | |
| Govtexp | -1.078 | -3.679 | -2.968 | 0.711 | -4.682 | -4.324 | -3.581 | 0.0044 | I(1) |
| urbanpop | -0.428 | -4.310 | -3.574 | 0.981 | -5.379 | -4.324 | -3.581 | 0.0008 | I(1) |
| pop65+ | -2.464 | -4.324 | -3.581 | 0.342 | -5.587 | -4.339 | -3.581 | 0.0006 | I(1) |
| Population | -1.567 | -4.310 | -3.574 | 0.781 | -5.614 | -4.324 | -4.324 | 0.0005 | I(1) |
| M Mackinnon (1991) * 1% level of significance ** 5% level of significance<br>Sources: Calculated by Author | | | | | | | | | |

The estimated results of ADF and PP test in table 1.1 showed that all variables were found to be non-stationary at levels but were stationary after first differencing. It implies that, the variables likes Govtexp, urban pop, pop65+ and total pop are integrated of order one which further implies that the variables are having I(1) integrating order. Therefore, the unit root test has predicted a trend in the time series variables at level and after first difference the trend has been removed from the variables, so that the regression model would not be bias.

Since the time series are non-stationary, it became essential to test for co-integration. By using the log-level form of the series, we estimate a multivariate co-integration relationship to establish the existence of a long-run equilibrium relationship between the variables.

***Cointegration test for demographic series***

The preliminary analysis shows that all the demographic variables incorporated in this study like population above 65 (*POP65+),* rate of urbanization (*URBNPOP*) and total population (*TOTPOP*) are non stationary at level and stationary at 1st difference. Thus to identify the best model which will enable us with good results and to know the long run relationship of these demographic variables with government expenditure of the state, Johnson co-integration test has been carried out. The demographic variables were found to be non stationary at level and stationary at integral order of I(1) which implies that the variables have unit root after first difference. Therefore we can go for the co-integration test to identify the number of co-integrating equations along with we can find weather there exists any long run relationship between demographic variables and government expenditure. Table 1.2 shows the estimated result of Johnson co-integrated test.

| Table 1.2: Series: LNGOVTEXP LNURBNPOP LNPOP65 LNPOP | | | | |
|---|---|---|---|---|
| Unrestricted Co-integration Rank Test | | | | |
| Hypothesized | | Trace | 5 Percent | 1 Percent |
| No. of CE(s) | Eigenvalue | Statistic | Critical Value | Critical Value |
| None | 0.602534 | 46.61506 | 47.21 | 54.46 |
| At most 1 | 0.319354 | 20.78095 | 29.68 | 35.65 |
| At most 2 | 0.256393 | 10.00898 | 15.41 | 20.04 |
| At most 3 | 0.059384 | 1.714171 | 3.76 | 6.65 |
| Hypothesized | | Max-Eigen | 5 Percent | 1 Percent |

| No. of CE(s) | Eigenvalue | Statistic | Critical Value | Critical Value |
|---|---|---|---|---|
| None | 0.602534 | 25.83411 | 27.07 | 32.24 |
| At most 1 | 0.319354 | 10.77197 | 20.97 | 25.52 |
| At most 2 | 0.256393 | 8.294811 | 14.07 | 18.63 |
| At most 3 | 0.059384 | 1.714171 | 3.76 | 6.65 |

*(**) denotes rejection of the hypothesis at the 5%(1%) level
Trace test indicates no co-integration at both 5% and 1% levels
Max-eigenvalue test indicates no co-integration at both 5% and 1% levels

The results of trace and max-eigen statistic indicate that the demographic variable does not have long run relationship with government expenditure. It implies that over longer period of time demographic variables like population of 65+ age group, urban population and total population does not produce significant impact on government expenditure. The trace and max-eigen statistic indicates no co-integrating equation at both 5% and 1% level of significance. Therefore, we can only identify the short run relationships between demographic variables and government expenditure.

***Demographic determinants of government expenditure***

The VAR model is carried out through three techniques for structural analysis of variables like the Granger causality test, impulse-response analysis, and the variance decomposition method. In the VAR model, the mutual relationships between variables are obtained by the Granger causality test. While variance decomposition analysis establishes the interaction between variables, impulse-response analysis is used to reveal symmetrical relationships to determine dynamic relationships between the examined variables (Cansu, 2006). However most studies using VAR generally employ impulse-response analysis and variance decomposition methods rather than interpreting the calculated coefficients of the model (Gacener, 2005). Therefore our study has used VAR coefficients and impulse-response analysis to reveal the impact of demographic variables in government expenditure in absence of long run relationship. The results of VAR model used to identify the short run estimates of demographic variable are shown in table 1.3.

**Table 1.3: Dependent Variable: DLNGOVTEXP**

Method: Least Squares

DLNGOVTEXP = C(1)*DLNGOVTEXP(-1) + C(2)*DLNGOVTEXP(-2) + C(3)*DDLNPOP65(-1) + C(4)*DDLNPOP65(-2) + C(5)*DLNPOPDN(-1) + C(6)*DLNPOPDN(-2) + C(7)*DLNURBNPOP(-1) + C(8)*DLNURBNPOP(-2) + C(9)

| | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| Govtexp(-1) | -0.301646 | 0.222358 | -1.356576 | 0.1927 |
| Govtexp(-2) | -0.271951 | 0.213844 | -1.271728 | 0.2206 |
| Pop65+(-1) | 2.984152 | 0.908140 | 3.286004 | 0.0392* |
| Pop65+(-2) | 2.358501 | 3.523998 | 0.669268 | 0.5123 |
| TotPop(-1) | 0.720355 | 1.079987 | 0.667004 | 0.5137 |
| Totpop(-2) | -0.784873 | 1.133901 | -0.692188 | 0.4982 |
| urbnpop(-1) | -0.603638 | 0.955893 | -2.631491 | 0.0361* |
| Urbnpop(-2) | 0.322793 | 1.086744 | 2.297027 | 0.0700** |

| | | | | |
|---|---|---|---|---|
| C | 0.219957 | 0.072414 | 3.037476 | 0.0074 |
| R-squared | 0.740880 | | Adjusted R-squared | 0.711824 |
| Log likelihood | 37.95514 | | Durbin-Watson stat | 2.109459 |

Sources: calculated by Author, * at 5% level of significance ** 10% level of significance

The results of VAR model suggest that in short run the demographic variables are significant to produce any change in government expenditure. The table shows that government expenditure of two periods lag does have negative impact on current year's government expenditure but is insignificant as the probability value is more than 10% level of significance.

Further population above 65 age group has revealed interesting results. The population above 65 years age group shows that it has positive and significant impact on growth of government expenditure at lag 1 and at lag 2 though it is positive but insignificant. The table shows that 1% increase in previous year's population of above 65 years age group will increase the current year's government expenditure by 2.98% as the coefficient is significant at 5% level of significance. It is expected because with the growing old age population the expenditure related to old aged people such as old age homes, health services, pension, large subsidies, and different social welfare schemes etc increases considerably.

Increase in total population shows positive impact on government expenditure at lag 1 and negative impact on lag 2 but at both lags the impact on government expenditure is insignificant. It might be the due the slow growth of population and also due to the small population of the state in terms of the area which hardly impact the government expenditure allocation.

Lastly, rate of urbanization (urban population) shows negative but significant impact on government expenditure at lag 1 and positive and significant impact on lag 2. The table shows that 1% increase in urban population in previous year will reduce the current years government expenditure by 0.63% as the coefficient is significant at 5% level of significance, while as 1 percent increase in urban population in previous of previous years will increase the government expenditure by 0.32% as the coefficient is significant at 10% level of significance. It might be due to the increasing demand of services needed for urban population like education, health, transport and communication, roads etc which force government to increase expenditure to fulfill those demands.

Thus the demographic variables like population above 65 age group and urban population shows positive impact on growth of population in short run while as in long run they are insignificant. It might be due their small proportion which cannot led to long run impact on government expenditure and their demands can be fulfilled in short period of time.

The adjusted $R^2$ suggests that the demographic variables in the model statistically explain the changes in the position of the government expenditure in Jammu and Kashmir. 74% changes of the dependent variables are attributed to the independent variables. The Durbin-Watson statistics is also significant having a value of 2.109459, it allows us to conclude that there are no problems of autocorrelation between the variables.

Various other diagnostic tests have been done to estimate the significance of our model and specification of our coefficients. Breusch-Godfrey Test has been conducted to estimate weather our model suffer from serial correlation or not. The results shown in table 1.4 suggest that there is no problem of serial correlation in the model as the probability of observed R-square is greater than 5% levels of significance which compel us to accept our null hypothesis of no serial correlation. Similarly heterocidasticity has been tested by ARCH test. The null hypothesis of the test is accepted as the probability value of the test is greater than 5% level of significance. The table also suggests that the series in the model are normally distributed as the jerque-Bera statistic shows that probability value is more than 4%level of significance. The stability of the estimated coefficient of the error correction model has been presented in graphical representation through Cumulative Sum (CUSUM) test. The cumulative sum (CUSUM) plot which is shown in Figure 1.1 from a recursive estimation of the model also indicates stability in the coefficients

| **Table 1.4: Diagnostic tests** | | | |
|---|---|---|---|
| Equation III | | | |
| Breusch-Godfrey Serial Correlation LM Test | | | |
| F-statistic | 0.153484 | Prob* | 0.859044 |
| Obs*R-squared | 0.521408 | Prob* | 0.770509 |
| ARCH Test | | | |
| F-statistic | 0.320272 | Prob* | 0.576925 |
| Obs*R-squared | 0.343341 | Prob* | 0.557907 |
| Normality test | | | |
| Jarque-Bera statistic | 0.82827 | Prob* | 0.66091 |

Sources: calculated by Author, * at 5% level of significance

**Figure 1.1: CUSUM test**

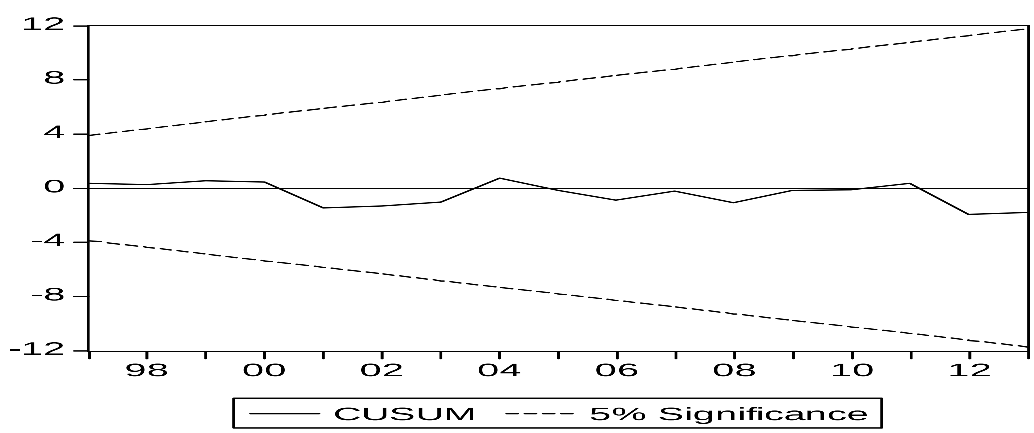

**Figure 1.2: Impulse response of demographic series**

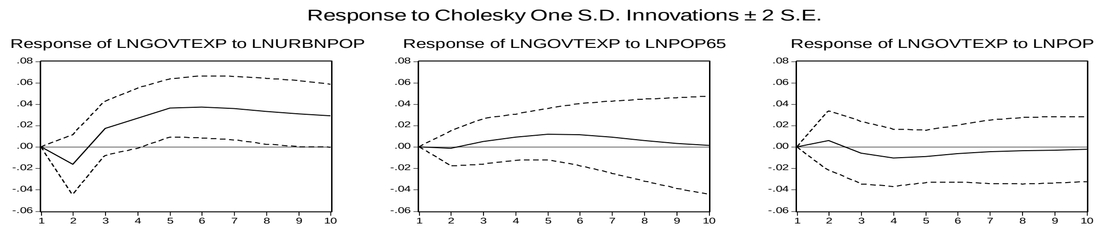


Figure 1.2 shows the response of govtexp to pop above 65, totpop and urbnpop. The response of government expenditure to standard shock in population above 65 age increase from 2nd period and after 2nd period it goes increasing upto 6th period and after 6th it decline but remain positive until 10th period. It shows any standard shock in population above 65 can be restored after 10th period.

Similarly the response of government expenditure towards shock in total population growth shows that standard shock in total population, the response of government expenditure is to increase until 2nd period and after 2nd period it will decline until 4th period. After 4th period the response of government expenditure is to increase but remain negative until 10th period. This shows the impact of total population in short run only.

Further, the response of government expenditure to shocks in urban population growth shows that a standard shock in urban population, the response of government expenditure is to decrease until 2nd period. After 2nd period it shows increase in expenditure and cross positive increase after 3ed period. After 3rd the response of government expenditure is to increase in later periods and stay positive. It implies that any shock in short run in urban population increase government expenditure only after 2nd period till 10th period.

## CONCLUSION

The study has identified the factors of demographic dimension that influence the government spending in the state of Jammu and Kashmir. Using Co-integration method followed by Vector Autoregressive model (VAR) we found that demographic dimension do not have long run association with government expenditure. The demographic variables affect government expenditure only in short run. Among the variables we find that population above 65 is significant to produce change in government expenditure. Also the rate of urbanization is significant factor to change government expenditure. While as increase in total population is insignificant to produce change in government expenditure. Over last decade the state of Jammu and Kashmir has witnessed highest growth in elderly population and also heavy migration of people from hilly and remote areas to main towns and cities of the state for employment, trade and other purposes. Therefore, the expenditure of the state related health, education, transport, water and sanitation, old age houses, pension and social welfare schemes has increased tremendously.

Therefore, in nutshell, we conclude that that the demographic status of the state is positively correlated with the growth of Government expenditure but the demographic dimension of the state cannot influence the long run policy making of government expenditure. It implies that demographic dimension does not create any pressure on government spending policy in the state of Jammu and Kashmir. Hence our study has given a concrete and logical conclusion and a favorable policy recommendation to the policy makers of the state. A long term policy programs should be adopted to take care the demographic factors so that in short run their impact on expenditure will be minimum. Also that state should give more focus on level of infrastructure to stabilize its enormous expenditure and to enhance its economic growth.

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# MARGINAL EFFICIENCY OF PRODUCTION FUNDS: A METHODOLOGICAL PERSPECTIVE

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**Abstract**: *In this study, the effect and the efficiency of investments in addition to operation is presented both graphically and analytically. The author suggests a method for calculating the recovery period. In author's view, investments must be focused mainly on creation and modernization of production funds in the agri-food sector/industry.*
**Keywords**: *Effect, investments, efficiency, production funds, capital, production function, physical depreciation of capital.*

It is difficult that all factors of economic growth be enumerated and classified in order of their importance. We may name three factors with a direct impact on economic growth: labour, production funds and technical progress. Leaving aside technical progress, GDP noted $Y$ is the result of the action of two main factors: labour force ($L$) and production funds ($K$). Each combination of the two factors provides a specific amount of production ($Y$) that may be noted as a function $Y = F(K, L)$, in which $K \geq 0$; $L \geq 0$, is called a production function. The increase of the amount of production funds by $\Delta K$ contributed to the increase of production by $\Delta Y$, the volume of labour force $L$ remaining constant. The evolution may be interpreted graphically (Fig. 1)

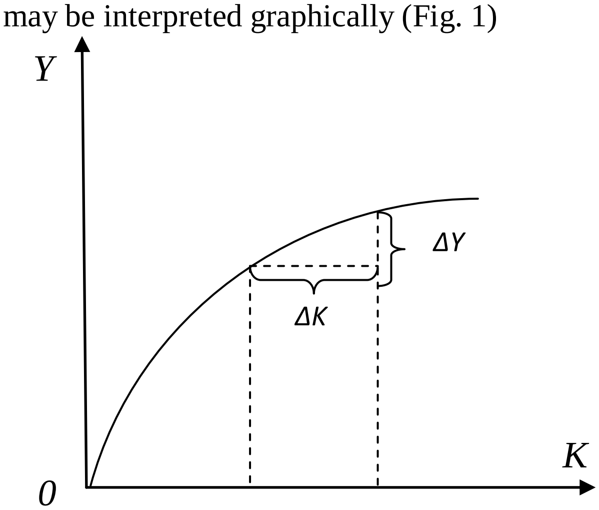


**Figure 1 Production volume growth by $\Delta Y$ as a result of production funds growth by $\Delta K$**

The relation $\frac{\Delta Y}{\Delta K}$ shows how many units of production growth are there per each growth unit of production funds. Let us take the limit of this relation:

$\lim_{\Delta K \to 0} \frac{\Delta Y}{\Delta K} = \frac{\partial Y}{\partial K}$ called marginal efficiency pf production funds

If, for example, the production function is known $Y = F(K, L)$, then $\frac{\partial Y}{\partial K}$ may be called the expected efficiency of production funds. It is natural that the expected efficiency in various economic operations be different. In this case, the expected efficiency turns into „test" identifying the economic sectors, operations, where production funds generate the highest expected efficiency. The highest expected efficiency makes it possible to identify the shortest period for recovering production funds. If, for example, hypothetically, production funds are not subject to renovations, then they lose over time their value, they become physically depreciated. In formal language, the speed of production funds depreciation $\left(\frac{dK}{dt}\right)$ is directly dependent on the volume of operational production funds ($K(t)$) or

$$\frac{dK(t)}{dt} = -AK(t), \qquad (1)$$

where $A$ – is the coefficient of proportionality. The equation (1) is a separable first order differential equation. Let us separate the variables:

$\frac{dK}{K} = -Adt$, we take the integration on both sides and obtain

$$\int \frac{dK}{K} = -A \int dt \ \ or \ ln|K| = -At + c \ from \ where \ K = e^{-At} * e^{c}$$

In the initial period $t = 0$, the volume of production funds is $K(0) = K_0$. We calculate the value of constant $e^c$:

$$K_0 = e^{A*0} * e^c; \ e^c = K_0$$

so, $K = K_0 e^{-At} = \frac{K_0}{e^{At}}$ – is the evolution of physical depreciation of production funds that may be interpreted graphically (Fig. 2).

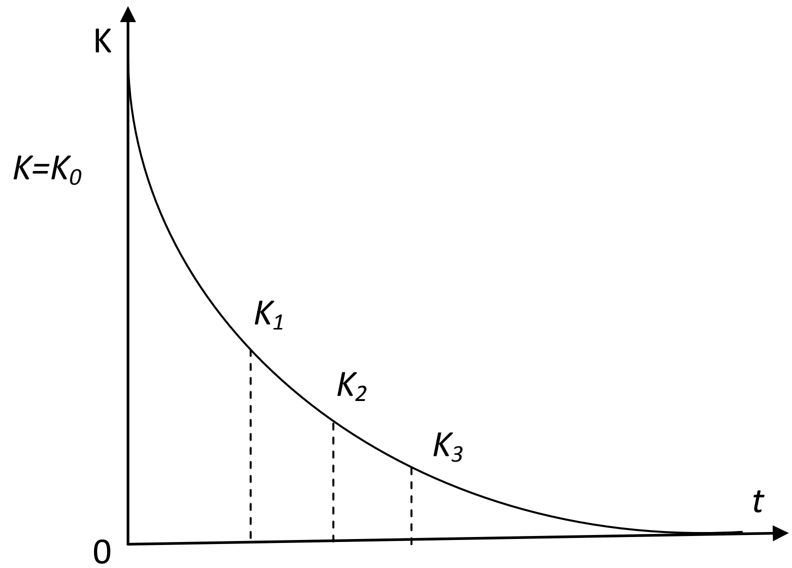


**Figure 2 Evolution of physical depreciation of production funds**

The depreciation of production funds leads also to the decrease of production volume *Y*(*t*). We assume that in the initial period *t≈0*, investments have been made in the amount *I*. Production funds are $(K_0 + I_0)$. Similarly, we calculate the evolution of physical depreciation of the volume of production funds $(K_0 + I_0)e^{-At}$. Up to the increase of production funds by I units, the production function is $Y = F(K_0 e^{-At}, L)$, after the increase, it is $\bar{Y} = F\left((K_0 + I_0)e^{-At}, L\right)$. We calculate the balance, the effect generated by investments $I_o$:

$$\Delta Y = \bar{Y} - Y = F\left((K_0 + I_0)e^{-At}, L\right) - F(K_0 e^{-At}, L).$$

In a time interval (*0*, ∞), the effect is:

$$\text{Effect} \cong \int_0^\infty \left(\bar{Y}(t) - Y(t)\right)dt = \int_0^\infty \left(F\left((K_0 + I_0)e^{-At}, L\right) - F(K_0 e^{-At}, L)\right)dt.$$

The effect of making the investments $I_o$ may be interpreted graphically (Fig. 3)

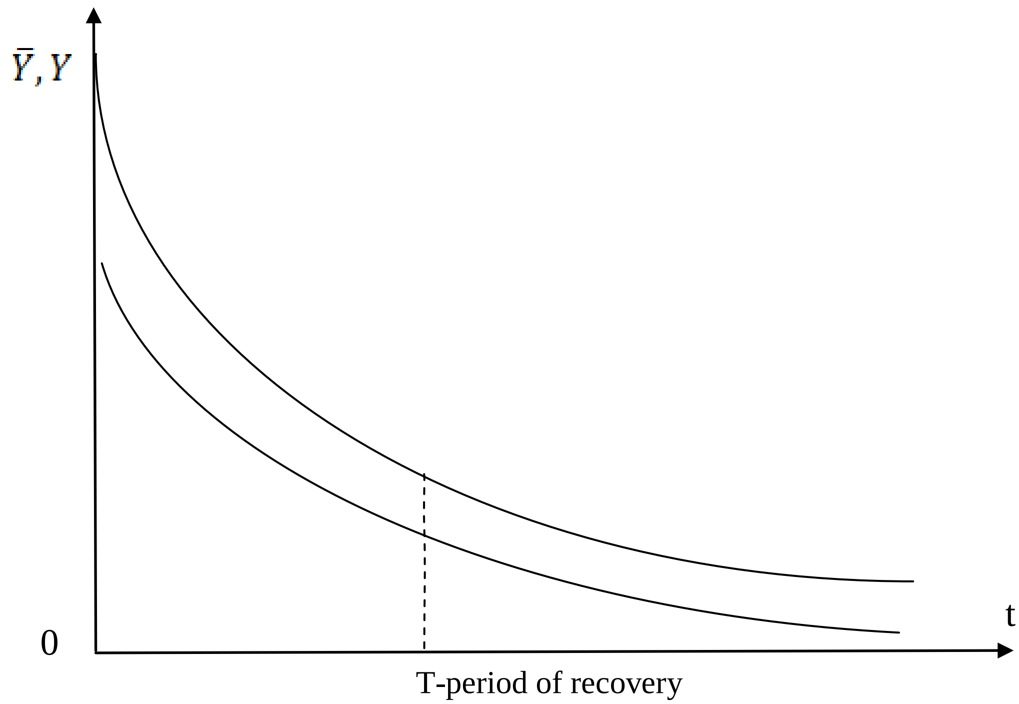


**Figure 3 The effect of investments $I_o$**

The effect of making investments $I_o$ in fig. 3 is the surface between the two curves. The relation $\frac{Efectul}{I_0 e^{-At}} = e$ is the efficiency of investments $I_o$ or how many effect units are there per each unit of investments $I_o$. In this context, the period of investment recovery $I_o$ is the time interval (*0*, *T*), in which the integral effect becomes equal to investment costs $I_o$. The definition may be presented formally, as follows

$$\int_0^T \left( F\left((K_0 + I_0)e^{-At}, L\right) - F\left(K_0 e^{-At}, L\right) \right) dt = I_0$$

Let us examine the effect of investments $I_o$ for the Cobb-Douglas function $Y = A, K^{\alpha} L^{\beta}$, where α, β stand for elasticity of production funds (*K*), labour (*L*)[2]. We assume 0<α<1. We calculate the effect of investments $I_o$ for the Cobb-Douglas function in the time *t*:

$$E(t) = \bar{Y}(t) - Y(t) = A_1 (K_0 + I_0)^{\alpha} e^{-\alpha A t} L^{\beta} - A_1 K_0^{\alpha} e^{-\alpha A t} L^{\beta} = A_1 K_0^{\alpha} L^{\beta} \left( \left(1 + \frac{I_0}{K_0}\right)^{\alpha} - 1 \right) e^{-\alpha A t}$$

$$= Y_0 \left( \left(1 + \frac{I_0}{K_0}\right)^{\alpha} - 1 \right) e^{-\alpha A t}$$

In the period (0,∞):

$$Effect = \int_0^\infty Y_0\left(\left(1+\frac{I_0}{K_0}\right)^\alpha - 1\right)e^{-\alpha At} = Y_0\left(\left(1+\frac{I_0}{K_0}\right)^\alpha - 1\right)\int_0^\infty e^{-\alpha At}\,dt$$

$$= Y_0\left(\left(1+\frac{I_0}{K_0}\right)^\alpha - 1\right)\left(-\frac{1}{\alpha A}e^{-\alpha At}\Big|_0^\infty\right) = \frac{Y_0}{\alpha A}\left(\left(1+\frac{I_0}{K_0}\right)^\alpha - 1\right)$$

$$Efficience = \frac{Efectul}{I_0 e^{-At}} = \frac{Y}{\alpha A L_0 e^{-At}}\left(\left(1+\frac{I_0}{K_0}\right)^\alpha - 1\right)$$

Let us analyse the evolution of the effect $E(t) = Y_0\left(\left(1+\frac{I_0}{K_0}\right)^\alpha - 1\right)e^{-\alpha At}$;

$$\frac{\partial E(t)}{\partial t} = Y_0\left(\left(1+\frac{I_0}{K_0}\right)^\alpha - 1\right)(-At * e^{-\alpha At}) < 0$$

The decrease of the effect interpreted also in fig. 3 may be explained by physical depreciation of productive funds, whose efficiency is decreasing.

## CONCLUSIONS

According to data of the National Bank of Republic of Moldova at end of 2016, the foreign direct investments in national economy amounted 3,58 billion US dollars, an increase of 3,3% compared to 2015. Being mostly from the EU, main economic operations that benefitted from foreign capital remained processing industry, followed by financial operations. Main measures taken to attract private investments in Republic of Moldova were provided for in the commitment and roadmap of the Economic Council on investment policies. Among main goals of the commitment were the consolidation and modernization of the legal framework related to investments and implementation of international practices in the field and a constructive dialogue with the business community. In this regard, it is important that businesses, academic community entered into various partnerships, contributed with methodological recommendations, orientation of investments mainly towards creating production funds in the agri-food sector and rural areas. Investments targeted at various sectors may generate various economic and social effects. These are important for all economic sectors and analysis should be made as to identify their effects and efficiency. Approaches and methodological interpretations should be carried out for each sector. The investments represent a common effort for all options, although their effect will be different. Consequently, the efficiency will also vary. The BNS data show that the high percentage in the structure of GDP of retail and wholesale trade (20%), followed by industry (16%), communications (7,5%). We believe that considering this trend changes are needed. The most important economic challenge faced by the Republic of Moldova is the modernization of its agri-food industry. All measures, including investments, should be channelled to this area.

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# BREXIT IMPLICATIONS OVER THE ENGLAND BANKING SYSTEM – AN EVENT STUDY APPROACH

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***Abstract:*** *The UK economic and political environment has been seriously challenged this year. The most significant event was the possibility of leaving the European Union. From February 2016, when the date of the referendum has been settled, the pro and cons of this scenario have been much debated on social media. The study aims to identify the BREXIT implications over the England banking system. In order to assess whether the referendums results have influenced in a positive or negative way the investors' behavior, we have conducted an event study on a panel of 11 financial institutions listed on the London Stock Exchange. The results have shown that in the post event window, the values of the abnormal and cumulative abnormal returns have dropped significantly, the market impact being negative. The outcome of the study has been completed by quantitative analyses, revealing the short term implications over the banking system. Nevertheless, the BREXIT effects over the UK economy have been mostly negative, the investigation showing a decrease of the financial stability.*
***Keywords:*** BREXIT, UK banking system, event study analyses
***JEL Classification***: D53, G14, G21

## 1. INTRODUCTION

The UK banking system has been the biggest financial sector from Europe, with more than 311 banks and 47 building societies, continuing to be the third on a global scale. (BBA, 2014) As per a BBA report from 2015, UK banking system valued over 6 trillion GBP, approximately 25% of its activity being from retail services, 35% from corporate and other financial services, the remaining 40% being assigned to the entities with foreign offices. In the last years, the UK economy started to regain its growth and stability, overcoming the 2007 effects: the unemployment rate has fallen at 5%, the GDP values have been on an ascending trend, the inflation reaching 0.6%, the industries activity and the quality of life in general, being improved.

The possibility of Britain exit from the European Union has been discussed as far back as 2012, when David Cameron, the Prime Minister of the United Kingdom, has rejected the idea of a referendum. From that point forward, the topic has been much deliberated, in national and international channels and media. After many months of persuasive campaigns, on the 23rd of June, the population decided in favor of the UK leaving the European Union, generating panic and uncertainty over economic, political and social environments. The main objectives of the article are to determine the magnitude of the event over the financial markets and its consequences. In order to do that, an event study metrics has been applied to a panel data of eleven banks.

Notwithstanding, for a much more comprehensive paper, the analysis results have been correlated with the news from the social media and the authorities` press releases.

If in the first weeks after the referendum, only the negative effects have been observed, for the next period of time, the situation will not be improved. The enticement of UK assets will diminish, the capital inflows being cut down; the credit conditions, especially the ones regarding the mortgage loan will tighten, due to the housing markets instability. The core financial segments could face liquidity and funding issues, the outlook of the UK economy being unpredictable. (National Banks of England, 2016)

## 2. LITERATURE REVIEW

The first article which has used an event study approach has been performed by Dolley in 1933, which demonstrated the implications of the stock-splits over the stock prices. Many studies are using this methodology in order to determine the impact of an announcement over the wealth of company's shareholders (Cybo-Ottone & Murgia, 2000; Chong et al, 2006; Dilshad, 2013).

Over the years, the main focus of the event studies has been the effects of the mergers and acquisitions over the shareholders' wealth. In theory, a merger or an acquisition should create value as the synergies of two companies are summing up. If Cornett and Tehranian (1992) and Zhang (1995) have demonstrated that the added value of a merger is real, leading to a more efficient and profitable institution, Hannan and Wolken (1989), Houston and Ryngaert (1994) or Pilloff (1996) have established that there is no connection between an acquisition and wealth enhancement, being more a transfer of the acquirers synergy to the new organization.

In 1998, Cosimano and McDonald have used the methodology to determine whether the elimination of a reserve requirement will enhance monopoly power. Some US studies have focused on the impact of the changes of monetary policies, the operational losses or interest rates adjustments, showing an increase of the cumulative abnormal returns in the post-event window (Aharony, Saunders and Swary, 1986; Cummins & Wei, 2006; Strong, 1992). As it can be seen, from 1933 the methodology has been improved, being used for a variety of events and scenarios: stock trading and prices, return volatility, social and political events, mergers, acquisitions or other business cases

The article "Short run reaction to news announcements: UK evidence" established the connection between more than 8,000 corporate news disclosure involving 100 companies for over 10 years, and the implication over the market efficiency. When it comes to economic institutions, it is well known that increased level of risks and uncertainty will determine strategies focused on costs reduction and enhanced revenues. The investors are changing their expectation and behavior, based on the market information, even if there are only rumors. Furthermore, the market reactions to the negative information are more significantly than the ones to the positive information.

Given the time-frame of the event, there are not many articles or studies on this topic, the research being an attempt to quantify the BREXIT effects using an event study methodology. The majority of the information related to this matter is brought by consultancies or advisors as reports or case studies. Furthermore, the UK financial institutions (Bank of England, BBA) or the biggest press centers are analyzing the implications of the event on a daily bases.

A recent study of Ashurst, a global law firm, has argue the main effects of the BREXIT situation: there will no longer be an European single market for the England companies, issues regarding grants and other funds may appear, some restrictions related with the free movement of people could arise, local currency could be affected by the market fluctuation, appearing new regulation, as well as another fiscal treatment. Other affected areas might be the intellectual property or the data protection. For sure, London as one of the biggest global financial center will experience some movements affecting not only UK but the whole world.

As per the last Financial Stability Report of the National Bank of England, the banking sector has been the most affected on short term, especially with the drop of the sterling. After the 23$^{rd}$ of June, the equity banking prices have decrease with approximately 20%, the price to book value reaching 0.58 from 0.72. These are only the beginning of a period of economic and regulation changes, the challenges of UK leaving the EU being unpredictable.

## 3. DATA AND METHODOLOGY

The event studies are trying to investigate the effects of the economic, political or social circumstances over the market. The basic idea is that the markets are efficient, so the asset prices will reflect any changes or consequence of an event. If at the beginning the monthly returns have been used, in recent years the studies have focused on the daily and intraday results.

The methodology is relatively simple, this representing the main reason why it is being used so much by researchers. In the first place, the event date needs to be established. The exactitude of the time frame it is very important because if it's not precise, we may analyze the wrong panel of abnormal returns. Furthermore, in many cases the information is leaked to the press long before the official announcement influencing the investors' position towards the market. In our case this was not difficult to assess, the referendum being on the 23$^{rd}$ of June 2016. Even if the possibility of UK leaving European Union has been a very popular subject this year, we've consider day 0 the referendum date because of all the skepticism and confusion surrounding the topic in the previous months. The pre and post event window included 10 days and the estimation window 221. As per Khotary and Warner (2006) a below 12 months period is considered the best lengths of the estimation window from three points of view: specification, power against specific types of hypothesis and sensitivity. In this way, the horizon becomes well specified, the risk of misspecification being minimal.

-221 -10 0

+10

estimation window pre event post event

window window

The sample is represented by the banks listed on London Stock Exchange. Taking into consideration that as benchmark we have used FTSE100, the chosen financial entities are part of one of the FTSE index. Bear in mind that only the biggest companies are part of this category of index, so the results can be generalized for the whole financial system. From 14 entities, three have been rejected for the lack of data. The stock prices have been collected from Yahoo Finance. In Table 1 it can be observed all the selected entities.

**Table 1 - Selected banks for the analysis**

| No. | Name | Symbol | Comments |
|---|---|---|---|
| **1.** | Aldermore Bank | ALD | |
| **2.** | Barclays | BARC | Top 5 |
| **3.** | BGEO Grup | BGEO | |
| **4.** | Caribbean Investment Holding Ltd | CIHL | Rejected, constant prices, no returns |
| **5.** | Clydesdale Bank and Yorkshire Bank | CYBG | Rejected, last stock price on 03.02.2016 |
| **6.** | HSBC Holdings PLC | HSBA | Top 5 |
| **7.** | Lloyds Bank PLC | LLOY | Top 5 |
| **8.** | Metro Bank | MTRO | Rejected, last stock price on 07.03.2016 |
| **9.** | Royal Bank of Scotland | RBS | Top 5, state cap |
| **10.** | Sberbank CIB | SBER | |
| **11.** | Secure Trust Bank | STB | |
| **12.** | Shawbrook Bank | SHAW | |
| **13.** | Standard Chartered | STAN | Top 5 |
| **14.** | Virgin Money Holdings | VM | |

*Source: own computations based on the data provided by London Stock Exchange (http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/indices/constituents-indices.html?index=&industrySector=8350&page=1)*

The normal returns are being calculated for the whole period, resulting 242 values for each financial institution. The parameters of the market model are established based on the first 221 values. For the pre and after event window, the abnormal and the cumulative abnormal returns (CAR) are determined, on the day zero being the highest value. If the values from the post event window are greater than zero, the market implications have been positive, the investors being optimist in respect to the future trend of the company.

The market model equation has the following components:

$$AR_{it} = R_{it} - \hat{\alpha}_i - \hat{\beta}_i R_{mt}$$

$AR_{it} \rightarrow abnormal\ returns\ for\ the\ stock\ price\ i, at\ time\ t$

$R_{it} \rightarrow actual\ returns\ of\ the\ stock\ price\ i, at\ time\ t$

$\hat{\alpha}_i \rightarrow ordinary\ least\ square\ of\ the\ intercept$

$\hat{\beta}_i \rightarrow ordinary\ least\ square\ of\ the\ slope$ *of the coefficient*

$R_{mt} \rightarrow market\ return\ at\ time\ t$

In order to see if there is an abnormal return, we must determine in the first place the value of the normal returns in the absence of the event. The daily returns are being calculated based on the stock prices, using the below formula. The time frame is 03.08.2015 – 08.06.2016, resulting 221 values for the estimation window. The estimation window framework is almost a year, the length needed to be middling. If we take into consideration to many or a few days, the market model parameters can be affected. The pre and post event window is between 09.06.2016 and 07.07.2016, with 21 values.

$$R_{t+1} = \frac{P_{t+1} - P_t}{P_t}$$

$R_{t+1} \rightarrow daily\ returns$
$P_t \rightarrow closing\ price\ of\ the\ day\ before$
$P_{t+1} \rightarrow closing\ price\ of\ the\ current\ day$

The benchmark is represented by FTSE100 index, formed by the first 100 largest companies listed on the London Stock Exchange (LSE). The index is used as a barometer of the market, the biggest five banks being a constituent. The other financial institutions involved in this study are part of the other FTE indexes. For each day, by summing the previous abnormal returns, we obtain the CAR value, as per below formula.

$$CAR_t = \sum_{t=1}^{t} AR_t$$

$CAR_t \rightarrow cumulative\ abnormal\ returns$
$AR_t \rightarrow abnormal\ return$

A t-Test is being performed in order to establish whether the abnormal returns values are different from zero. Two hypotheses are issued:

$\boldsymbol{H_0}$ : The BREXIT announcement had no implications over the stock prices, mean or variance of returns. The event did not influence the market.

[α (CAR)] / [β (CAR)] = 0

$\boldsymbol{H_1}$ : The BREXIT announcement had some implications over the stock prices, mean or variance of returns. The event can influence the market.

[α (CAR)] / [β (CAR)] ≠ 0

Following the above methodology, we can state whether the confirmation of the UK exit from European Union has influenced the stock market and if so, in what way. Furthermore, we will determine which banks have been more affected by the changes.

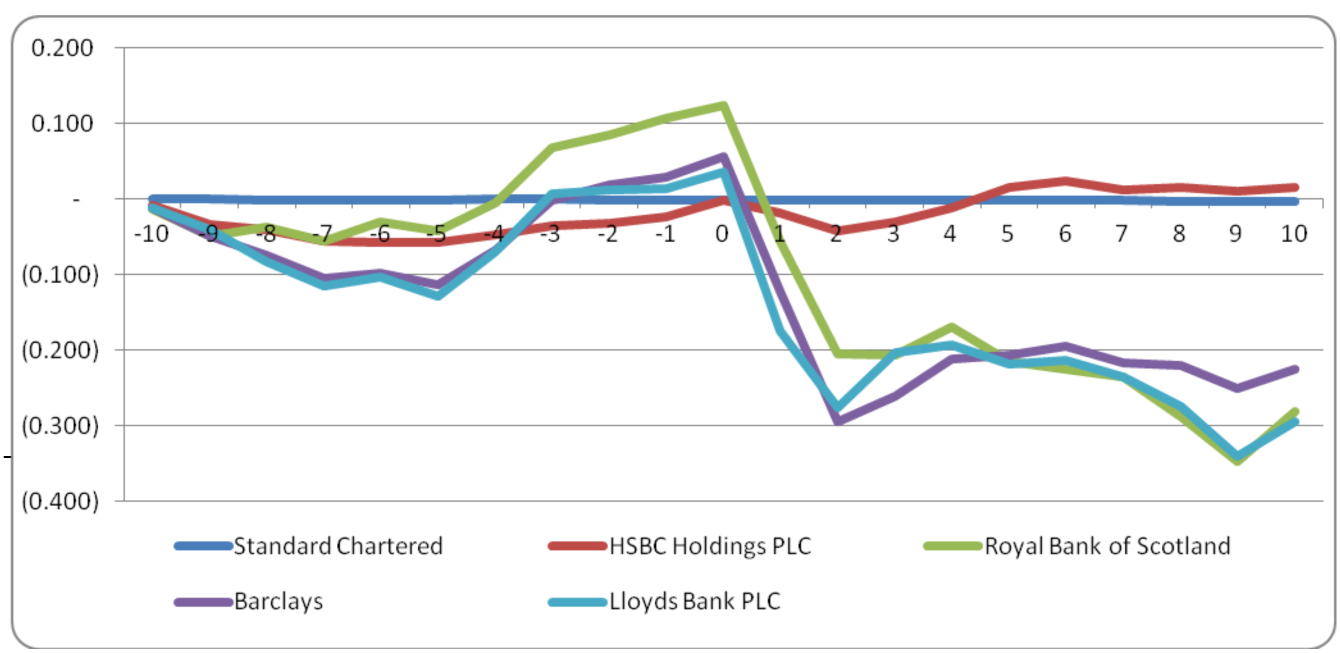
Even if the sample is not adding all the financial institutions listed on the London Stock Exchange, the results can be generalized, mostly because of the banks' asset value.

## 4. RESULTS

The main objective of the study was to identify the market reaction to the BREXIT announcement and its implications over the banking system. As we can see in Graph 1 and 2, in the first day after the announcement, values of the cumulative abnormal returns have dropped significantly, meaning that the event has influenced in a negative way the market. The UK exit from the European Union is not a precedent, the first time a country voted willingly this decision being Greenland. Nonetheless UK is a big player on the international market and a veteran member of EU institution, the referendum results being something unexpected for a big part of the world. An event like this, for sure will have implication on the countries functionality and its relationship with the world. In these circumstances, the results of the study are only a confirmation of the uncertainty of the England markets in the present.

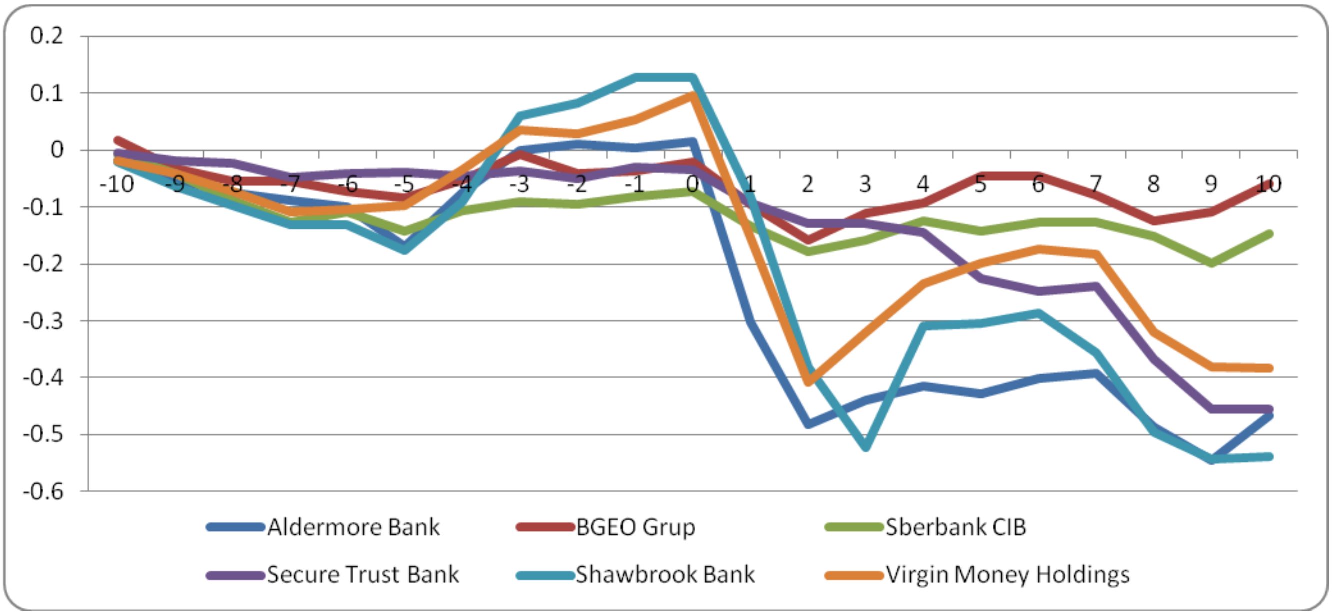
The regulation landscape will be changed completely in the following years. Until now, UK was acting under European Union, all the transactions made with the partner countries being regulated by this. From the financial sector point of view, under these circumstances the foreign activity will face a dropdown. MIFID (Markets in Financial Instruments Directive) is the most important piece of legislation regarding the banking and investment activity, being a passport for the foreign banks. The worst case scenario of the 'missing passport' may be the relocation or the closing of many UK and overseas branches or headquarters. If for the rest of the sectors this will imply a cost increase, for the banking industry the legal right to provide services is at stake. A recent statement of the chief executive of the British Bankers' Association has stated that the value of the transactions involving UK banks and the countries from EU27 is rising at 1,1 trillion pounds. Taking into consideration that the financial system is considered the biggest export industry, the consequences of an exit scenario will be ruthless. The rumors are saying that the smaller banks are already looking to relocate until the end of 2016, the bigger ones postpone it for the first quarter of 2017.

***Graph 1 – CAR value of the Top 5 banks***



*Source: own computation*

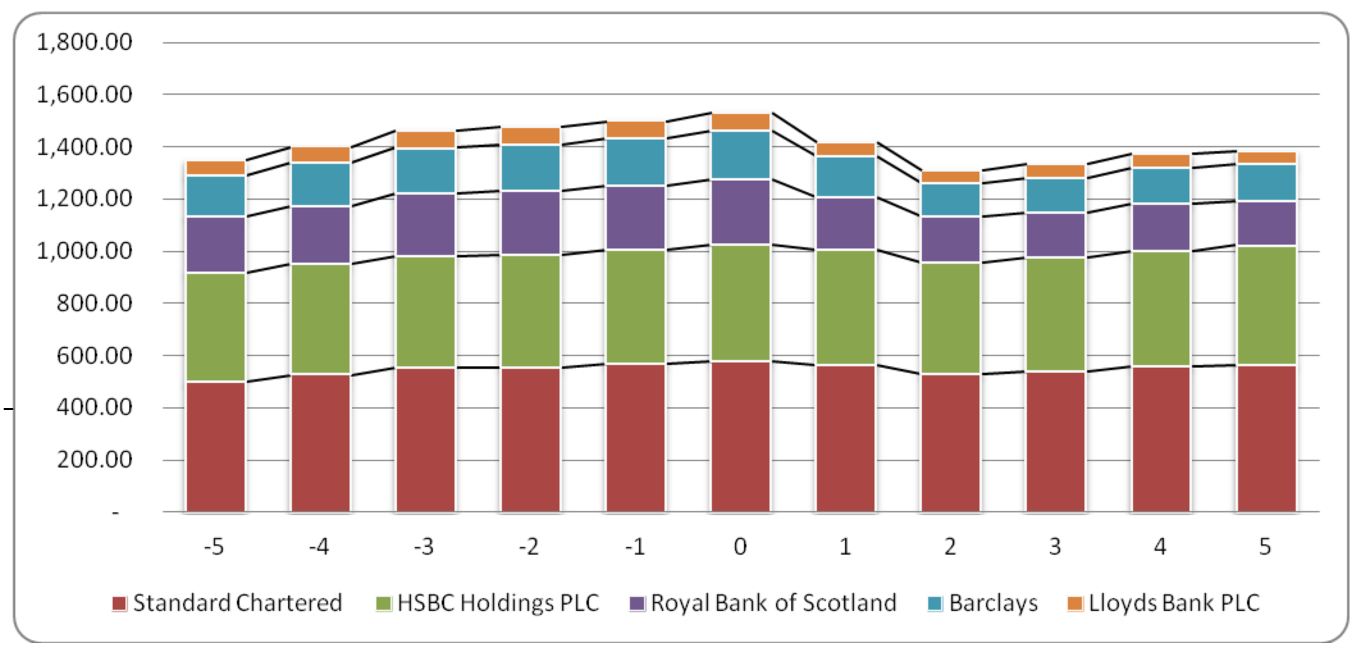
***Graph 2 – CAR value of the others banks from the sample***




*Source: own computation*

In respect of the stock behavior, after the referendums results, the prices have fallen significantly. The biggest drop has been assigned to Aldermore, with 47% (205.7 GBP vs 139.8 GBP) and Virgin Money Holdings with 33% (364.4 GBP vs 273.8 GBP). These two are relatively new banks, whose activity is focused on mortgage lending and small companies' financial services. The annualized housing prices have grown at 8% in July, the tensions on the market starting to increase. Even if the applications for a mortgage loan have risen with 3%, the total number of approvals has decreased with approximately 20%. Shawbrook Bank and Secure Trust are another SME oriented banks, being highly affected by the BREXIT situation. Due to the lack of liquidity, increase lending activity, size and targeted clients, the smaller banks will experience difficult times. The banks with a very powerful mortgage lending focus will be at risk in the following months, mostly due to the rising of the housing prices and unemployment.

***Graph 3 – Stock prices in the pre and post event window of the Top 5 banks***



*Source: own computation*

In the opposite direction are HSBC Holding and Standard Chartered. These have shown the smallest values of the abnormal and cumulative abnormal returns, meaning that the event did not have the same impact on their activity as in the other cases. HSBC Holdings Plc is the biggest bank from United Kingdom, with more than 2,000 billion USD. Standard Chartered Plc is on the fifth position, with only 725 billion USD. Taking into consideration that both institutions are well capitalized, with many branches and offices all over the word, providing extensive business lines, they managed to mitigate the negative effects. Furthermore, these two have the most expensive share prices from their category. The size, the age, the clients segment or the diversity of the financial services are influencing the magnitude and the time frame of the banks recovery.

In the case of the other three large banks, the prices have declined with approximately 20%. The CAR values have followed the same trend, decreasing in the first three days. The social media in the post event period was suggesting that the referendum may not be approved in Parliament. Along with the Prime Minister resignation and the reassurance of the political and financial authorities have counterbalanced the negative effects triggered on the 23$^{rd}$ of June. As it can be seen in Graph 1, 2 and 4, in the first 10 days after the announcement, there is a fluctuation of the abnormal and cumulative abnormal returns, reflecting the market players` efforts to adapt and absorb the news.

Another consequence of the BREXIT decision which had a significant impact on the stock market as well was the sterling decline with more than 6%. The drop is bigger than the GBP fall from 1992 (4.3%), EURO fall from 2008 (2.75%) and USD fall from 1973 (4.8%). In the next months, the currency will be very sensitive to all the political transformation, influencing the market performance. Furthermore, the profitability of the banking system is linked with the overall national economy. Taking into consideration that the actual figures provided by Thomson Reuters are suggesting a decrease in the national indicators, due to the interconnection with all de sectors, the financial systems growth will diminish. The events after BREXIT vote is like a domino, one consequence leading to another. The short term facts have proven this scenario, the national authorities doing everything they can to soften the transition to a non-EU member.

***Table 2 – Average returns on the pre and post event window***

| | **Average returns on -10 window** | **Average returns on +10 window** | **Variation (%)** | **Price variation % (day 1 vs day 0)** |
|---|---|---|---|---|
| **Standard Chartered** | 0.0019256 | 0.0017843 | -0.01% | -3% |
| **HSBC Holdings PLC** | (0.0005461) | 0.0022983 | 0.28% | -1% |
| **Royal Bank of Scotland** | 0.0094643 | (0.0418398) | -5.13% | -22% |
| **Barclays** | 0.0028403 | (0.0279901) | -3.08% | -21% |

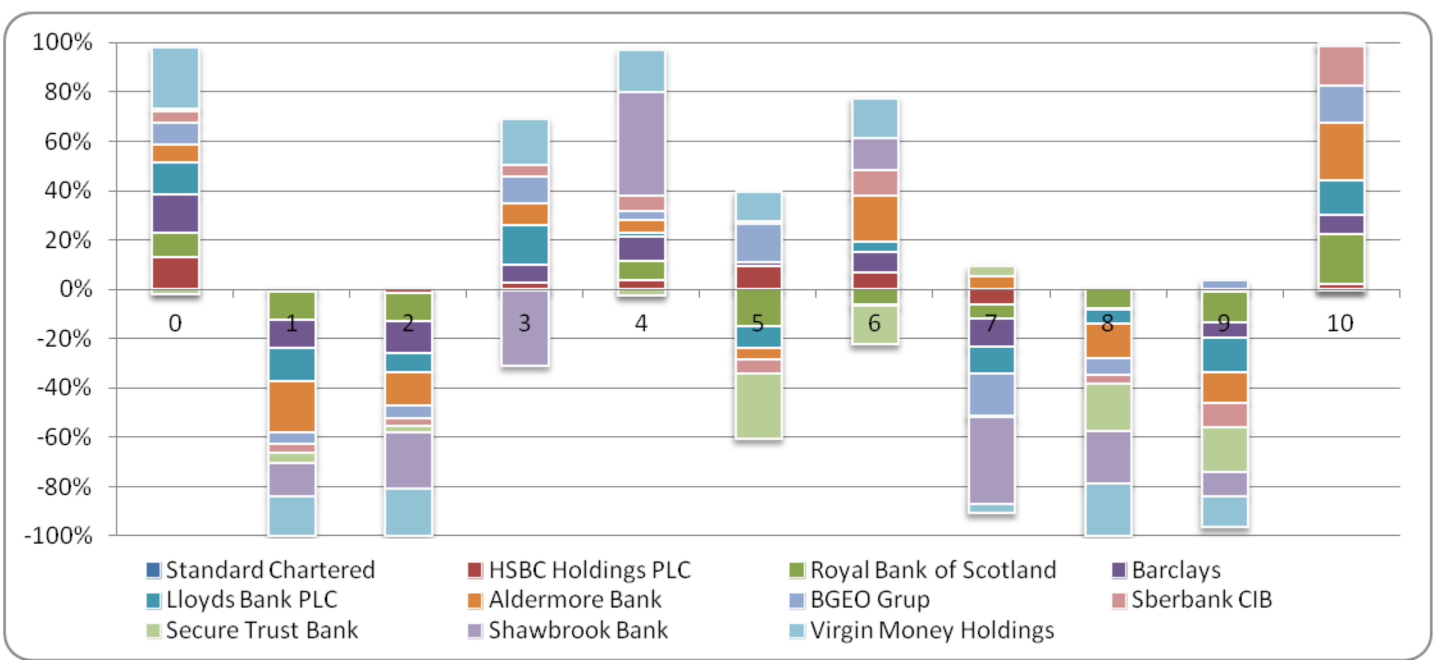
| | | | | |
|---|---|---|---|---|
| **Lloyds Bank PLC** | 0.0016706 | (0.0333833) | - 3.51% | -27% |
| **Aldermore Bank** | (0.0030497) | (0.0503630) | - 4.73% | -47% |
| **BGEO Grup** | 0.0021802 | (0.0003877) | - 0.26% | -7% |
| **Sberbank CIB** | 0.0008607 | (0.0012273) | - 0.21% | -5% |
| **Secure Trust Bank** | (0.0036095) | (0.0514037) | - 4.78% | -6% |
| **Shawbrook Bank** | 0.0124216 | (0.0673219) | - 7.97% | -27% |
| **Virgin Money Holdings** | 0.0051016 | (0.0483445) | - 5.34% | -33% |

*Source: own computation*

As can be seen in Table 2, except HSBC Holding PLC which had a positive variation of 0.28%, all the institutions have recorded a decrease on their daily returns. The fact that Lloyds, Royal Bank of Scotland, Barclays or Aldermore have significant percent of government influence, being concentrated in the UK has broaden the negative effects. Beside HSBC, Standard Chartered is another bank whose home market is not United Kingdom, mitigating the magnitude of the announcement. (Hong Kong for HSBC; India and Africa for Standard Chartered).

The fourth Graph is presenting the values of the abnormal returns in the first ten days after the referendum. The trend is not constant, the variations illustrating the market reaction. Even the FTSE100 index has been affected by the BREXIT news, price decreasing with 1%. Taking into consideration that it is formed by the biggest 100 companies, with the majority of the businesses overseas, using USD or EUR as currency, the light fluctuation has been expected.

***Graph 4 – Abnormal returns in post – event window***



*Source: own computation*

As per BBA press release, the lending market has absorbed the news on a very optimistic and unexpected way. The mortgage and consumer loans have remain constant in the June-July period at 3% and 6%. The figures are not alleviating the public concerns regarding this topic because of the very short time frame. The real effects on the borrowing sector will be measured after a few months, mostly due to the complex process of approval and fund assignation.

In the following month, The Bank of England has tried to maintain the interest rate at a constant value, restarting the program `quantitative easing` through which additional funds are making to the economy by bonds acquisition. In the last Financial Stability report, the core issues are represented by risk minimization, accentuating the 100% involvement in the recovery process of UK economy. The main financial aspects will be the capital and liquidity buffers, used for the mitigation of the markets shock and a regulatory framework oriented to risk and liability contraction.

Regarding the M&A market, the falling of the GBP has made everything cheaper for the foreigners' acquirers. The real effects will be assessed after the third quarter though. The lack of the business confidence has been enhanced by the confusion and unpredictability of the market. There are still a lot of rumors and scenarios related to the next period of time: the possibility of the Scottish independence, the triggering of the Articles 50 of the Lisbon treaty, the pullback of the banking passports, the political tensions, or the world pressures. The event can be considered a precedent in the economic history of the world, the UK facing one of the biggest challenges from the latest centuries.

## 5. CONCLUSION

For many years the United Kingdom has been a very important financial center for Europe, being involved in the majority of the retail and corporate business areas. Compared to France or Germany who have contributed to the European financial landscape with 9%, the UK involvement has been double.

The main objective of the study was to determine the impact of BREXIT announcement over the banking system. Even if the majority of the England citizens have been in line with the countries exit, the event had triggered negative effects over the economic functionality and stability. The event study has focused on 11 banks, all listed on the London Stock Exchange. In post event window, the abnormal and cumulative abnormal returns values have dropped significantly, meaning that there has been no gain for the market. The decrease of the stock prices and the market movements are confirming the results. On short term, the challenges have been consequential; the true test will be though at the end of the negotiations. The small banks will rather be more affected by the economic changes, especially the ones which focus on the mortgage lending small and medium enterprises` financial services.

Given the amount of time, only the short term effects have been identified. For sure, the uncertainty in the England economy will be elevated for the years to come, affecting the investors' behavior on global scale. BREXIT was the trigger of a systemic shock, which will extend over a long period of time. The politicians say that the negotiation will continue until 2018, but this is the best case scenario. With Greenland, which is far away less complex as UK, the arbitration took three years. However, this process is crucial for the wellbeing of United Kingdom economic, political and social environment, assessing their functionality as a non-member of European Union. Nonetheless, the crucial role of advisor, leader or active participant on the international markets will remain pretty strong despite the present uncertainty. The real challenge for UK was not the recovery following the referendum day; the real challenge will come after the leaving EU day, when all the legal and economic requirements will be established.

**Acknowledgment**

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# A COMPARATIVE ANALYSIS OF SUSTAINABLE DEVELOPMENT IN ROMANIA AND MOLDOVA FROM AN INSTITUTIONALIST PERSPECTIVE

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**Abstract:** *This paper takes an institutional perspective and puts forward the idea that ensuring sustainability, in all its three dimensions – economic, social and ecological, mainly depends on the rules of the game that guide human behavior. In other words, it is the right mix of formal (such as, well-defined and enforced property rights) and informal (for example, norms of reciprocity of trust, involvement, tolerance etc.) institutions that provides proper incentives for the individuals to take responsibility rather than make compromises for fear of being sanctioned. Using indicators on sustainable development and the quality of institutional framework, the paper provides a comparative analysis of Romanian and Moldova regarding these issues and discusses the potential of Romania and Moldova to reach sustainability.*
**Keywords:** *sustainable development, formal and informal institutions, Romania, Moldova, progress, challenges.*

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## 1. INTRODUCTION

This paper takes an institutional perspective and puts forward the idea that ensuring sustainability is mainly a matter of good governance at formal level supported by certain values shared by the people, at informal level. All three dimensions of sustainable development – economic, social and ecological, are related to the rules of the game that guide human behavior. In other words, it is the right mix of formal (such as, well-defined and enforced property rights) and informal (for example, norms of reciprocity of trust, involvement, tolerance etc.) institutions that provides proper incentives for the individuals to take responsibility rather than make compromises for fear of being sanctioned.

This paper is organized as follows: the next section sets the background for the analysis. Drawing on the existing literature, this section identifies several formal and informal institutions proven to have supported the implementation of sustainable development practices. Section 3 provides an overview on the existing situation in Romania and Moldova in terms of sustainability in its three dimensions - economic, social and environmental. Sustainable Society Index (SSI) released by Sustainable Society Foundation and several socio-economic indicators from international databases are used to sketch the profile of the two countries, depicting both the existing situation and their evolution in time. The SSI aggregates 21 indicators of the three dimensions of sustainability – human, environmental and economic wellbeing. The SSI ranges from 1 (not sustainable) to 10 (sustainable). Section 4 deals with the institutional issues affecting sustainability in Romania and Moldova. It provides a comparative analysis of the formal and informal institutions identified in Section 2 as being related to sustainability. Governance indicators released by the World Bank are used to capture the quality of formal institutions while several values from World Values Survey are identified to show the prevalence of certain informal rules. The last part of this paper presents an example of a sustainable business in Moldova and summarizes the conclusions.

## 2. INSTITUTIONS FOR SUSTAINABLE DEVELOPMENT

The relationship between institutions and sustainable development is a largely acknowledged one both in scientific literature and in international development agenda. More and more studies and official documents point out to the role good institutions play in implementing sustainable development objectives. Veeman & Politylo (2003, 317) consider institutions and mainly property rights and pricing systems for natural resources as “pivotal in achieving growth and improved distribution of income and wealth, in understanding environmental degradation, and in seeking improved policy”. Anderson & Huggins (2003) argue that “sustainable development (…) is only possible in a legal system where property rights are well-defined, enforced, and transferable”. Other authors point to the role of the Rule of Law, considered “the bedrock of sustainable development” (Ozanian, 2015). Other studies on the issue of the relationship between economic freedom, as a measure of institutional quality, and sustainable development empirically proved that property rights, business freedom and freedom from corruption (from the Heritage Foundation/Wall Street Journal Index of Economic Freedom) are significantly correlated with components of sustainable development and also that those countries with a higher degree of economic freedom have a better socio-economic situation (Iacobuță & Gagea, 2010a).

Besides the above mentioned formal institutions, implementing sustainable development objectives requires a certain quality of informal institutions, i.e. certain values shared by the members of a community, which affect and orientate their behavior. Several attempts have been made to define those values which make human efforts and human cooperation possible, which reduce human greed and transaction costs and support the sustainability path designed in all sorts of formal strategies. Westing (1996, 218) considers the norms of sustainable development as “an amalgamation of core social values and core environmental values". United Nations Millennium Declaration (2000, 2) identifies six fundamental values of sustainability in the twenty-first century: freedom, equality, solidarity, tolerance, respect for nature and shared responsibility.

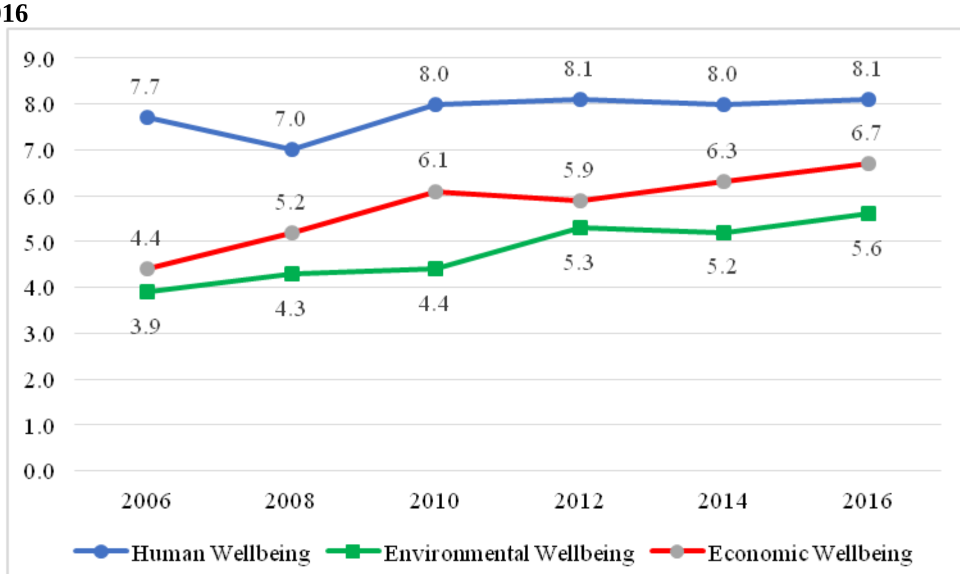
Previous work in this field has shown significant positive correlations between sustainable development and individual values such as trust, responsibility, tolerance and respect for other people, the importance of democracy, independence and negative relationships between sustainability and religious faith and obedience (Iacobuță & Gagea, 2010b). Concluding on the absence or low representation of sustainable development values (such as, solidarity or tolerance) in Czech Republic, the study carried out by Janoušková & Hák (2013) points out to the need of considering the role of values in improving policy making.

Although all the concepts are multifaceted and with complex meanings, to sum up, the institutional framework of sustainable development requires a complementarity between the formal rules (property rights, rule of law etc.) and the values people embrace (solidarity, responsibility, freedom, tolerance etc.).

## 3. COUNTRIES' SUSTAINABILITY PROFILE

Both Romania and Moldova have made significant progress on their ways towards sustainable development. Figure 1 shows Romania's evolution in terms of human development, economic growth and environmental wellbeing. Out of the three dimensions the lowest scores are in terms of environment protection showing that more attention should be paid to this issue.

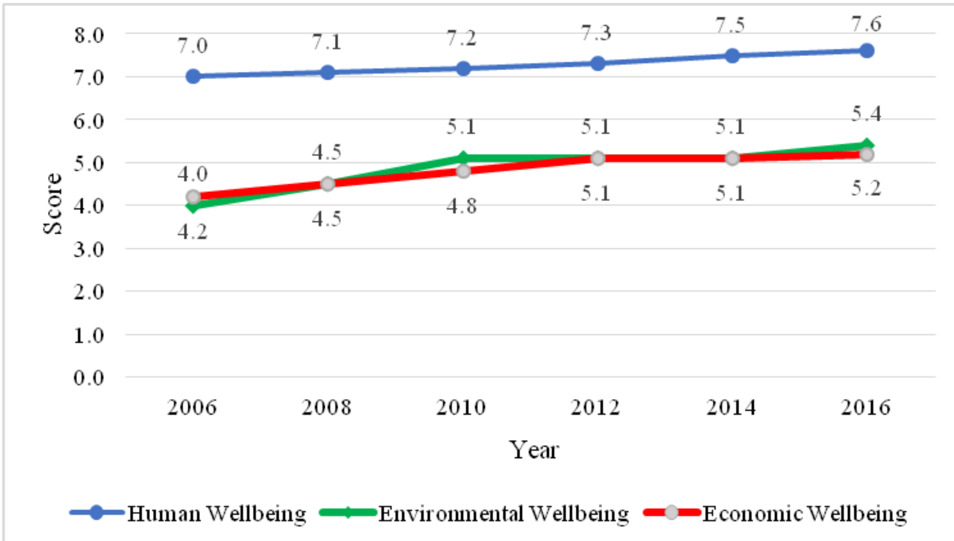
**Figure 1 The evolution of the scores calculated for the three dimensions of sustainability, in Romania, 2006-2016**




Source: Authors' presentation based on data from Sustainable Society Foundation, Sustainable Society Index 2016, http://www.ssfindex.com/data-all-countries/

Figure 2 shows Moldova's evolution towards sustainable development. The situation resembles the one in Romania in terms of progress but it also should be noticed the fact that economic wellbeing is lower in Moldova, confronted with high rates of poverty, high rates of migration, macroeconomic, financial and political instability.

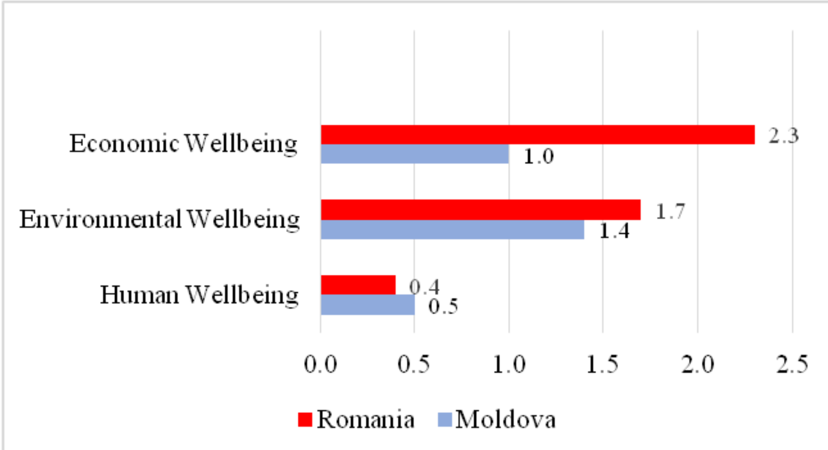
**Figure 2 The evolution of the scores calculated for the three dimensions of sustainability, in Moldova, 2006-2016**




Source: Authors' presentation based on data from Sustainable Society Foundation, Sustainable Society Index 2016, http://www.ssfindex.com/data-all-countries/

A synthetic image of the progress made by the two countries is presented in Figure 3. Out of the two, Romania is the performer in terms of economic and environmental wellbeing, due to the reforms implemented and to the adhesion to EU and adoption of EU strategies, while Moldova has better results in terms of human wellbeing.

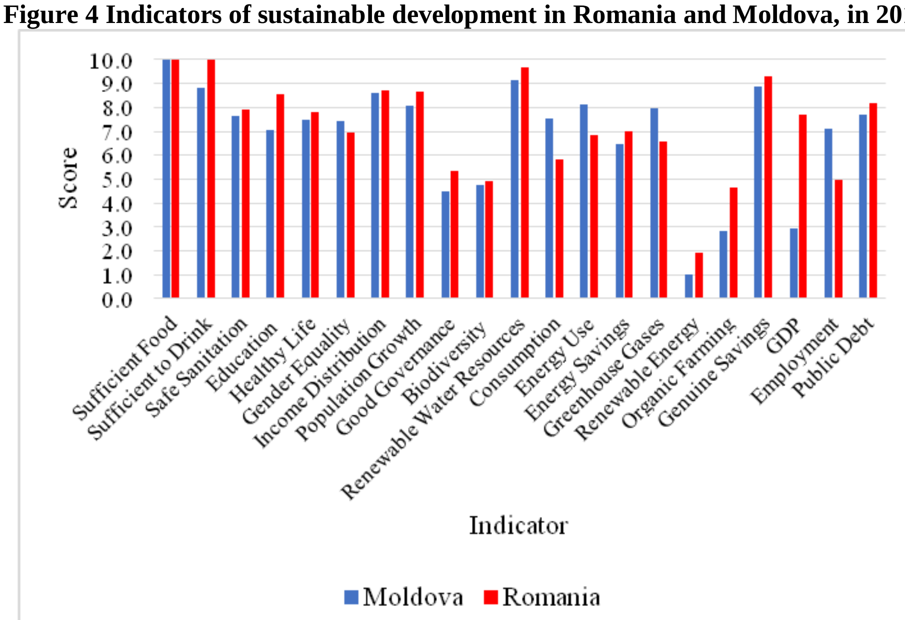
**Figure 3 The overall progress 2006-2016 in the three dimensions of sustainability**




Source: Authors' presentation based on data from Sustainable Society Foundation, Sustainable Society Index 2016, http://www.ssfindex.com/data-all-countries/

To provide a more comprehensive image of sustainable development issues in the two countries, Figure 4 below presents all the 21 indicators included in the SSI, in a comparative perspective.

**Figure 4 Indicators of sustainable development in Romania and Moldova, in 2016**




Source: Authors' presentation based on data from Sustainable Society Foundation, Sustainable Society Index 2016, http://www.ssfindex.com/data-all-countries/

The most significant five sustainability problems are: for Romania – renewable energy, organic farming, biodiversity, employment and good governance and for Moldova – renewable energy, organic farming, GDP (which stands for poverty), good governance and biodiversity. If we overlap the two situations, we can conclude that both countries have four major problems in common namely, renewable energy, organic farming, biodiversity and good governance.

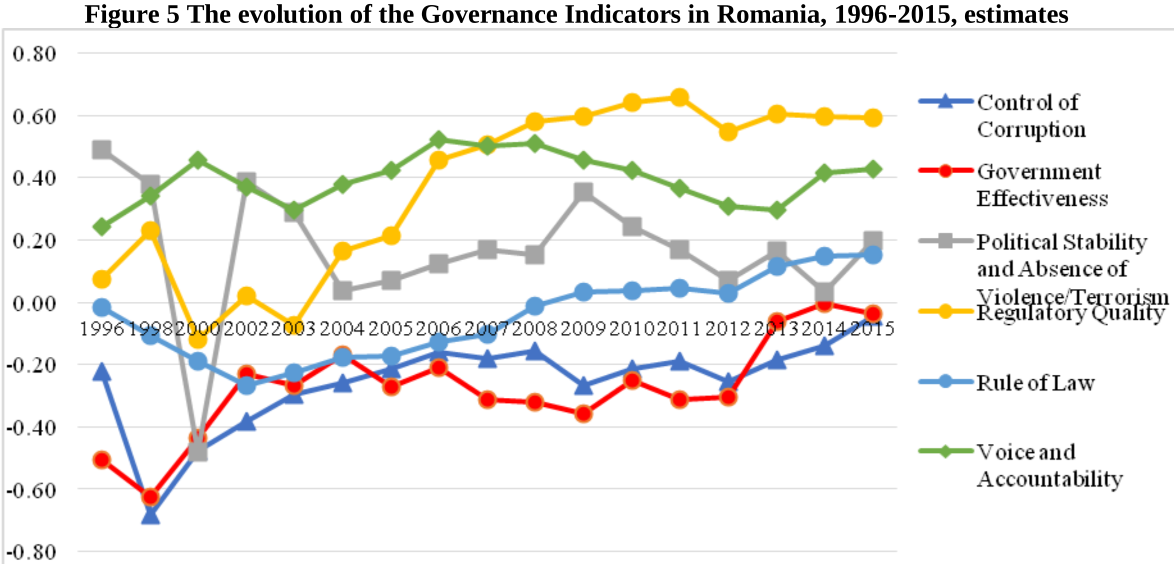
Considering good governance as a key element for sustainability and entirely adhering to the idea that "measurable and sustained progress on all of the Sustainable Development Goals will only be achieved in those countries that have sufficient enabling conditions in place, such as transparent, participatory and accountable institutions governed by the rule of law and predictability in legal and regulatory frameworks, including clear and secure property rights, well-managed public administration and services and functioning judicial systems", as stated by United States Council for International Business (USCIB) (2015, 2), the next part of the paper briefly analyses the evolution of several formal institutions indicators and also several values people share in Romania and respectively, Moldova.

## 4. MAIN INSTITUTIONAL ISSUES AFFECTING SUSTAINABILITY

As shown in Figure 4 above, both Romania and Moldova are characterized by low scores for the indicator Good Governance (5.4 and respectively, 4.5).

As for the three dimensions of sustainable development analyzed above, progress has been made in both countries but a very slow and unsustainable one. To support this statement, we rely on the six governance indicators released by the World bank which are a measure of governance.

**Figure 5 The evolution of the Governance Indicators in Romania, 1996-2015, estimates**

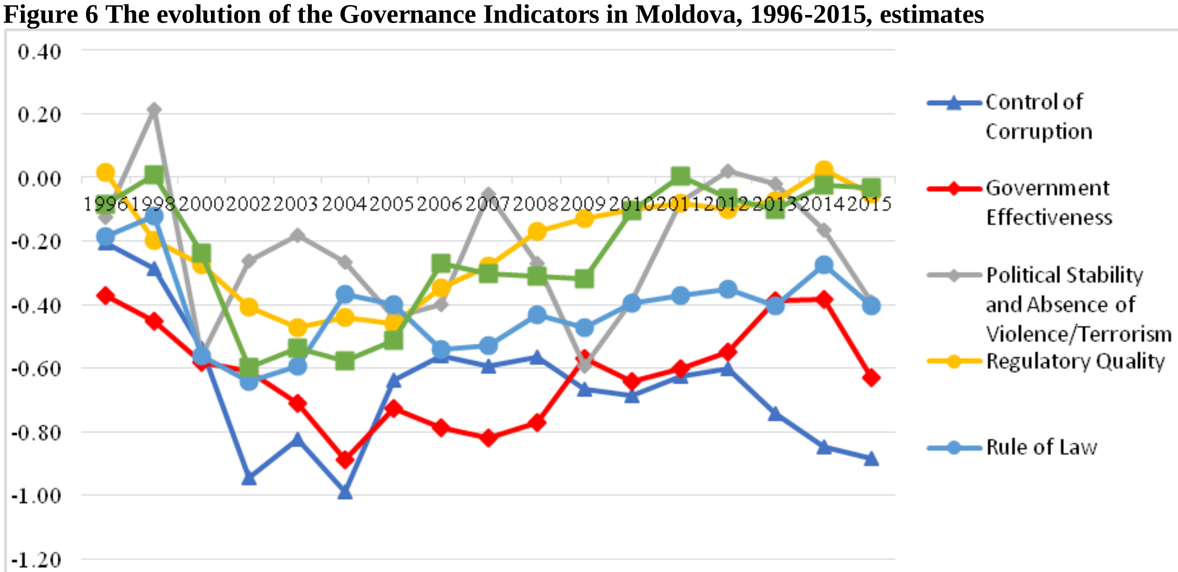



Source: Authors' presentation based on data from World Bank Group, Worldwide Governance Indicators, https://data.worldbank.org/data-catalog/worldwide-governance-indicators

Figure 5 shows progress on good governance in Romania, between 1996-2015. Since all these indicators range between -2.5 and +2.5, there can be noticed that there is a long way ahead to reaching good governance in Romania. The biggest issues remain corruption and the lack of effectiveness in government's activity. Also, the very low progress and score for the Rule of Law is worth mentioning.

Figure 6 presents the evolution of the same indicators for Moldova. In this case, the situation is much worse than in Romania, all governance indicators having negative values in 2015 and for most of the analyzed period. None of the attributes of good governance was reached

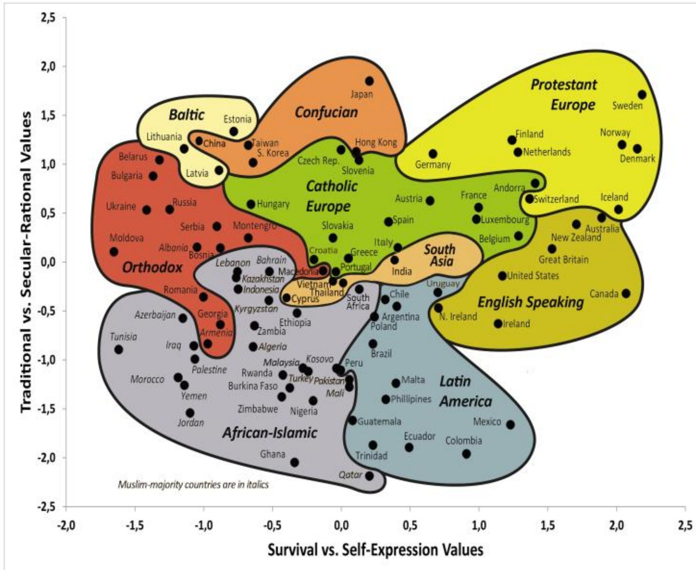
**Figure 6 The evolution of the Governance Indicators in Moldova, 1996-2015, estimates**




Source: Authors' presentation based on data from World Bank Group, Worldwide Governance Indicators, https://data.worldbank.org/data-catalog/worldwide-governance-indicators

In terms of informal institutions, highlighted by the values people share, both countries are considered rather traditional, people being mostly oriented to survival values rather than modern self-expression ones. Figure 7 below shows their positioning on the Inglehart–Welzel Cultural Map.

**Figure 7 Inglehart–Welzel Cultural Map**




Source: World Values Survey (WVS) wave 6 (2010-2014),
http://www.worldvaluessurvey.org/WVSContents.jsp?CMSID=Findings

In the traditionalist society, people' priorities are oriented to the satisfaction of the basic needs, things happen "as God wishes" or as "the chief ordered", the society in general is more religious, more inclined to obedience and respect for authority, work is seen as an obligation to society; inertia is very high, there is no concern for the future and passivity and lack of involvement prevail (Voicu&Voicu, 2005, 17; Baciu et al., 2009, 46-47).

To provide a more comprehensive image of the sustainability values (as identified in the existing literature) in the two countries, we have selected several items from the World Values Survey database. The selection is presented in Table 1.

*Trust* is measured by the respondents' agreement to the statement "Most people can be trusted", *democracy* by "Importance of democracy" namely by the percentage of people considering democracy as "absolutely important", *involvement* is measured with the items "Membership in an environmental organization" and "Membership in a political party and all other variables are selected from the list of qualities that children can be encouraged to learn at home (*responsibility, tolerance, independence, determination* and *thrift*).

**Table 1 Several shared values related to sustainability, in Romania and Moldova**

| Value | Romania (2005) - % | Romania (2012) - % | Moldova (2006) - % |
|---|---|---|---|
| *Responsibility* (as a quality that children can be encouraged to learn at home) | 68.8 | 70.4 | 69.6 |
| *Tolerance* (as a quality that children can be encouraged to learn | 58.6 | 65.2 | 66.5 |

| | | | |
|---|---|---|---|
| at home) | | | |
| *Independence* (as a quality that children can be encouraged to learn at home) | 29.1 | 42.2 | 44.9 |
| *Determination/perseverance* (as a quality that children can be encouraged to learn at home) | 30.3 | 29.9 | 25.2 |
| *Thrift saving money and things* (as a quality that children can be encouraged to learn at home) | 53.0 | 39.4 | 53.2 |
| *Trust* (agreement with "Most people can be trusted") | 19.3 | 7.7 | 17.6 |
| *Membership in an environmental organization* (not a member) | 99.2 | 95.5 | 92.8 |
| *Membership in a political party* (not a member) | 96.0 | 91.6 | 91.0 |
| *Importance of democracy* ("Absolutely important") | 47.5 | 56.2 | 25.0 |

Note: Moldova was not included in WVS wave 6.
Source: Authors' presentation based on data from World Values Survey (WVS) wave 6 (2010-2014) and wave 5 (2005-2009), http://www.worldvaluessurvey.org/WVSOnline.jsp

The figures presented in Table 1 confirm the traditionalism of the two societies but also a low representation of sustainability values. In Romania's case, we notice a slight evolution in terms of responsibility, tolerance, independence, involvement and democracy but also a decrease in the percentage of Romanians appreciating thrift and determination and declaring their trust in people. The same situation is present in Moldova, but with a striking difference in terms of the importance of democracy. Very few respondents considered democracy as "absolutely important" for them (25%).

Romania was included in last two waves of the study (2005-2009 and 2010-2014) which allows the discussion regarding the value change in time while Moldova was not considered for the last wave. However, this is only a small impediment because individual values are relatively stable in time and they change very slowly, so even if the data seem old, the situation is pretty much the same in the present. The conflict between the European sustainability values and the traditional ones is as present today as ever, a very narrow segment of the population embracing the first ones. Opinions expressed in recent articles from Moldova support this idea: "The perpetuated disappointment in the pro-European political parties (2009-2017) and the high poverty level at which many Moldovans live make the European integration and, respectively, the European values, to be associated with something elitist or imaginary, for now inaccessible" (Cenusa, 2017).

## 5. DISCUSSION AND CONCLUSIONS

The purpose of this paper was to comparatively analyze the progress reached in sustainable development in Romania and Moldova, in relation with the progress in good governance and sustainability values and to point out the main factors which hamper this process.

Both countries have a long road ahead but data analysis shows certain, even though low progress in all three dimensions of sustainability and in consolidating the formal and informal rules of the sustainability game. There are strategies for sustainable development, there is declared commitment to these strategies and best practices at microeconomic level have been implemented in both countries.

Since Moldova is less “fortunate” at the chapter of good governance, and this is “an essential attribute of a profitable, sustainable and responsible business enterprise” (USCIB, 2015, 2) an example of sustainable business is worth to be provided here. The Italian company “La Triveneta Cavi Development” has recently started its activity in Balti, with an ambitious goal of employing 200 people in the near future and bringing to Moldova its long experience, its know-how, technologies with new environmental standards, elements of entrepreneurial responsibility. This confirms the role of involvement, motivation and willingness to change things into a certain direction. It also confirms the role education and internalization of best practices play in getting on the sustainability path.

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# EFFECTIVENESS OF MONETARY POLICY IN ROMANIA

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**Abstract**: *The efficiency of monetary policy at macroeconomic level presupposes the study of Taylor's relationship: the change in the interest rate leads to changes in the current and estimated inflation rate as well as in actual and potential GDP. This article studies the effectiveness of monetary policy in Romania, between 2005 and 2017, both monthly and quarterly, with the help of the ARDL methodology. The results show that monetary policy has been adaptive over the last 20 years; over the years the interest rate cut has led to lower inflation and GDP cuts, with equilibrium interest rates lower than Taylor's interest.*
**Keywords**: *interest rate, inflation, GDP, monetary policy*

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## INTRODUCTION

The Taylor monetary policy rules appeared in 1993 and have been widely used as a tool for assessing the monetary policy of the different countries, whether independently or in comparison with other monetary policy rules or guidelines. The use of such rules to such an extent was determined on the one hand by the high capacity to characterize monetary policy actions and, on the other, by the simplicity of their use in economic models.

The Taylor Rule (1993) is a simple monetary policy rule that mechanically links the monetary policy rate to inflation deviations from the inflation target and GDP versus its output gap. It was originally proposed by academic literature as a simple illustration of the desirable monetary rule for the United States of America, but later became a popular tool for assessing monetary policy stance in both advanced economies and emerging economic markets.

This article looks at the Taylor monetary policy model for Romania, a Central and Eastern European state with an independent monetary policy that will join the European Monetary System (EMU) in the future. Romania has assumed and applied directly and explicitly an inflation targeting strategy, and under these circumstances the analysis of the Taylor monetary model is of particular importance.

Currently, in most countries, the main purpose of monetary policy is to ensure Price stability, without neglecting other important goals, such as economic growth, full employment or exchange rate stability. However, the priority of price stability over other monetary policy objectives is typically stipulated in the legislation of central banks in most countries (Loayza and Schmidt-Hebbel, 2002). There are two important economist views on how the central bank can achieve price stability: it can be achieved by using monetary policy rules by reducing policy errors, increasing the transparency of monetary policy, and preventing political influence on policy-makers; Discretionary monetary policy, without the need to implement Rules or considering that the rules are impractical.
The rest of the study is made up of four sections: Section 2 gives an overview of the literature, Section 3 provides the theoretical model, and Section 4 presents the data, methodology and empirical results. Section 5 summarizes the main findings and draws some political implications.

## LITERATURE REVIEW

Since the development of the Taylor model (1993), many studies have attempted to test the validity of the rule for other economies and time. Monetary policy focuses on the choice of political instruments that are transmitted by interest Rate and monetary base. The concept of monetary policy reaction function (MPRF), motivated by Taylor's 1993 article emphasizes the inverse coefficient of the Philips equation while explaining how central banks react to macroeconomic conditions by changing the interest rate. In the fundamental work Taylor's monetary policy response function, a linear trend was used to measure GDP potential, and the estimated inflation was 2% (Taylor, 1993), the reason being that this rule may stimulate the rate Nominal short-term nominal value of the United States. Policy rule Taylor specifies that the central bank's interest rate therefore increases if inflation rises above the target inflation rate or GDP rises above the potential GDP, and vice versa. The central bank's policy rates, on the other hand, decrease if which inflation is below the target rate or real GDP falls below potential GDP.

Recent studies have extended Taylor rules almost to all existing countries in an attempt to validate a globally applicable rule. Moreover, several recent papers extended Taylor's rule to countries in Central and Eastern Europe: Angeloni (2007) studied Czech Republic, Poland and Hungary for the period 1999-2004 and concluded that the respective central banks respected The fundamental objective of price stability; Paez-Farrell, 2007, studied the four Visegrad countries in 1998-2006, taking into account the exchange rate and concluding that for the three more developed countries this indicator is important.

The first study targeting Romania was made by Frommel and Schobert, 2006 by expanding the traditional analysis group (Czech Republic, Poland, Slovakia and Hungary) to Romania and Slovenia by introducing the exchange rate as a supplementary explanatory variable. The period 1994-2005 was analyzed, and the authors conclude that the Taylor rule is not respected for these countries; later in 2011, the mentioned authors also took into account the changes of the foreign exchange regimes, the results being much improved.

Vascek (2009) analyzes the 12 eastern European countries for the period 1994-2007, but improves model variables (effective exchange rate, money supply, long-term interest rate, external interest rate and asset prices). The author concludes that Taylor's policy is not always in line with the official monetary policy rule.

Căpraru & Radulescu (2016) analyzes Romania for the period 2005-2015, taking into account the anticipation of the NBR, and concludes that the Taylor rule applies in our country.

Popescu (2005) analyzes the 12 Eastern European economies, using 3 models derived from Taylor Rule, introducing additional variables related to financial stability. The author shows that the rule is kept to their fundamental price stability goal, but in parallel with the stabilization of real economic activity and the exchange rate. However, changes in nominal short-term interest rates closely follow changes in the nominal short-term interest rate in the euro area, while the inclusion of asset price developments indicates a heterogeneous situation among selected CBs.

## METHODOLOGY

The best known example of the instrumental rule is Taylor's rule (1993):

$$i_t = i + 1.5(\pi_t - 2) + 0.5y_t$$

where $i_t$ is the interest rate level in period t (in the original wording Fed quarterly refinancing rate (Fed quarter rate funds) is the target rate of interest rate, $\pi_t$ is the inflation rate, and $y_t$ is the output gap level (the difference between current and potential GDP). According to Taylor's rule, the interest rate level responds to inflation and output gap variations.

In a general form, a Taylor type rule can be written like this

$$i_t = i + \alpha(\pi_t - \pi^*) + \beta y_t$$

Depending on the values that the coefficients α and β take, the type rules Taylor can describe the central bank's behavior as a benchmark for assessing monetary authority behavior, such as Ball (1997) and Weymark (1999), in strategies to target inflation, nominal yield or other strategies.

If inflation and GDP values are predetermined, the Taylor rule is a predetermined rule, as in the examples above. If inflation and GDP are forward-looking, the rule becomes an equilibrium condition (the default rule).

$$i_t = i + \alpha\ (\pi_{t+1}/t - \pi^*) + \beta\ y_t{+}1/t$$

In estimating the model, I used the following variables:

1) Inflation (infl_proc) denoted by pt is presented as monthly consumer price growth (monthly inflation rate as shown in BNR reports and bulletins). The percentage inflation that was used in estimates was determined by dividing the value in monthly bulletins to 100.
2) Gross domestic product was replaced by monthly industrial output ($y_t$) due to the lack of monthly gross domestic product data. As in the BNR reports and bulletins, industrial production appears in the form of real monthly variations, and within the model industrial output appears in absolute values, we obtained the series of real monthly industrial production values taking as a basis the level of January 2005, and dividing by index of industrial production with fixed base in the respective month. The fixed base index was determined as the product of the chain-based indices. Within the model, the gap was considered as a deviation from the trend, and appears as a logarithm. The trend was determined by applying a Hodrick-Prescott filter to industrial logarithm series. Besides this method was attempted to establish a target level of industrial production, as a benchmark month, as a peak for the calculation period and as an average, but the results obtained by using the differences from these reference values resulted in unsatisfactory results.
3) the real interest rate ($i_t$). For the interest rate, the data on active interest for non-bank clients available in the NBR reports and bulletins were used. Using rate assets was determined by the fact that the interest rate on loans is the main factor influencing the investments, and the interest rate appears within the aggregate demand equation. Due to the fact that the values in the database indicated the annual interest rates, we proceeded to calculate the corresponding monthly interest rates using the compound interest rate formula:

$$Il_{yearly} = (1 + i_{monthly}/100)12$$

Real interest was calculated using Fisher's formula:

$$i_{real} = (1+i_{nominal})/(1+r_{infl}) - 1$$

Where $r_{infl}$ is the month-on-month rate of inflation.

The Philips inflation equation will be calculated as follows:

$$\pi_{t+1} = \alpha_1 + \alpha_2 \pi_t + \alpha_3 y_t + \alpha_4 \text{dummy}$$

The dummy variables corresponding to the months of 2008 capture the shock of inflation generated by the economic crisis.

**RESULTS**

The econometric estimates are based on a sample covering the period from January 2005 to March 2017. The sources of data are the annual reports and monthly bulletins of the NBR.

**Tabel 1 Descriptive statistics**

| | Exchange rate | Interest_NBR | Inflation | inflation Target | IPI | IPI Potential | GDP | GDP Potential |
|---|---|---|---|---|---|---|---|---|
| Mean | 4.098 | 6.268 | 4.327 | 3.593 | 107.758 | 107.758 | 32866.48 | 31728.21 |
| Median | 4.272 | 6.250 | 4.450 | 3.000 | 108.500 | 105.265 | 33075.65 | 32852.26 |
| Maximum | 4.558 | 17.310 | 10.100 | 7.500 | 130.000 | 129.742 | 43120.50 | 41355.93 |
| Minimum | 3.133 | 1.750 | -3.000 | 2.500 | 77.400 | 75.965 | 18321.00 | 17209.64 |
| Std. Dev. | 0.413 | 3.158 | 3.300 | 1.384 | 14.270 | 13.738 | 6079.242 | 6203.746 |
| Skewness | -0.706 | 0.469 | -0.240 | 1.773 | -0.342 | -0.274 | -0.596 | -0.654 |
| Kurtosis | 1.938 | 3.376 | 2.059 | 5.518 | 2.354 | 2.456 | 2.937 | 2.705 |
| Jarque-Bera | 18.983 | 6.236 | 6.783 | 115.113 | 5.388 | 3.624 | 2.851 | 3.595 |
| Probability | 0.000 | 0.044 | 0.033 | 0.000 | 0.067 | 0.163 | 0.240 | 0.165 |
| Sum | 598.314 | 915.220 | 631.8000 | 524.600 | 15732.70 | 15732.70 | 1577591. | 1522954. |
| Sum Sq. Dev. | 24.748 | 1446.610 | 1579.790 | 277.813 | 29527.90 | 27369.87 | 1.74E+09 | 1.81E+09 |
| Observations | 146 | 146 | 146 | 146 | 146 | 146 | 48 | 48 |

In order to check the possibility of applying the least squares method, we tested the stationarity of the series used. As can be seen from Table 1, the ten series used are stationary with a probability of 5%.

**Table 2 Augmented Dickey Fuller Unit Root Test results**

| | In Levels | Order of Integration | In First Difference | Order of Integration |
|---|---|---|---|---|
| Interest NBR | -9.749<br>0.000 | I(0) | | |
| Inflation | -6.596<br>0.000 | I(0) | | |
| Inflation Target | -6.565<br>0.000 | I(0) | | |
| IPI | -11.587<br>0.000 | I(0) | | |
| IPI Potential | -3.163<br>0.024 | I(0) | | |
| GDP | | | -3.758<br>0.006 | I(1) |
| GDP Potential | | | -6.459<br>0.001 | I(1) |
| Exchange rate | -8.986<br>0.000 | I(0) | | |
| Interest 1month | -10.867<br>0.000 | I(0) | | |

| | | | | |
|---|---|---|---|---|
| Interest 3months | | | -8.098<br>0.006 | I(1) |

The results of the Zivot and Andrew unit root test are presented in Table 3. These results suggest that we can reject the single root node for IPI and WPI to a significance level of 5%, while we fail to reject the root hypothesis for the rest of the series. This result clearly contradicts the results obtained through the root unit test without structural breaks for these two series.

At the same time, the test identifies the endogenous point of the most significant structural break point (BT in each of the time series examined in this paper.) The breaking date of each time series is shown in Table 3. This also has important implications. As Piehl et al., (1999) points out, knowing the break point is essential for the correct assessment of any program designed to bring about structural changes, such as tax reforms, banking sector reforms and regime exchanges, etc. Generally, 2008, when the country experienced a severe economic crisis, is considered to be the most suitable candidate for a structural break in Romanian data. The results show that seven of the eight series studied testify to the presence of a structural break in 2007-2009.

**Table 3 Zau unit root test results**

| | Zau unit root test | Chosen break point | Zau unit root test | Chosen break point |
|---|---|---|---|---|
| Interest NBR | -5.249<br>0.337 | 2008M01 | -5.511<br>0.077 | 2008Q1 |
| Inflation | -4.587<br>0.281 | 2007M08 | -4.586<br>0.002 | 2010Q3 |
| Inflation Target | -5.460<br>0.005 | 2007M01 | -4.763<br>9.23E-05 | 2013Q1 |
| IPI | -6.833<br>2.21E-07 | 2008M11 | | |
| IPI Potential | -6.694<br>0.000 | 2009M01 | | |
| GDP | -5.566<br>0.000 | 2008M09 | -8.098<br>4.64E-08 | 2009Q1 |
| GDP Potential | | | -6.459<br>0.001 | 2009Q3 |
| Exchange rate | -5.571<br>0.001 | 2008M09 | -5.558<br>0.000 | 2008Q4 |

As you can see, inflation in the current period is explained to a much larger extent by the inflation in the previous period than by the evolution of industrial production. The R2 coefficient shows that the variance of the independent variable is explained to a fairly large extent by the regressors.

From the analysis of the coefficients of the two regression equations we can see that the algebraic signs with which the coefficients enter into equation are in line with those suggested by the economic theory (current inflation is positively influenced by the inflation of the previous period and the increase of the industrial production, while the production Industrial is positively influenced by the previous and negatively to the real interest rate). The values of the estimated coefficients that will be used to deduce the optimal Taylor rule are presented in the table below, together with the associated patch averages.

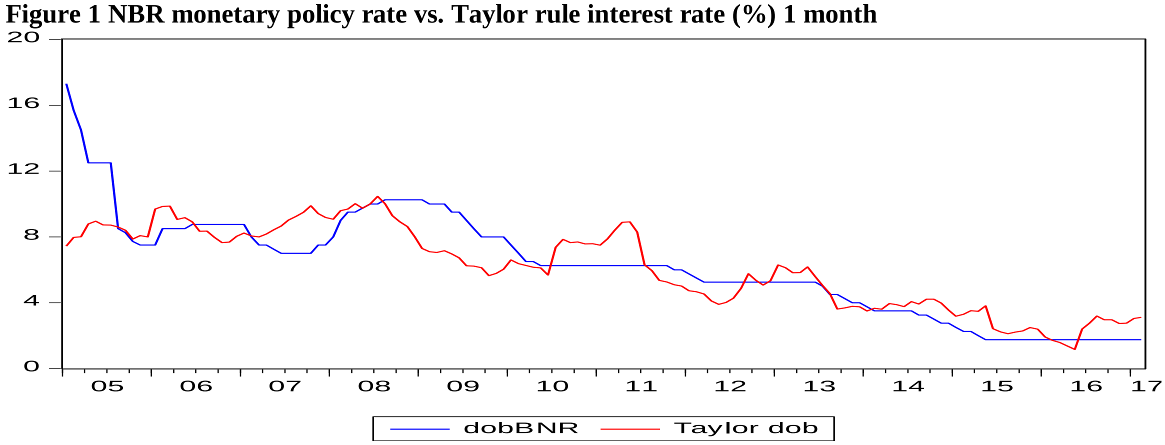
**Table 4 Long Run ARDL Regression Estimate**

| | Coefficients 1 month | Coefficients 3 months |
|---|---|---|
| Constant | 19.829 (0.000) | 18.001 (0.000) |
| Inflation(1)-Inflation Target | 0.5883 (0.000) | 0.488 (0.000) |
| LOG(IPI(-2))-LOG(IPI Potential) | -5.851 (0.202) | 5.7882 (0.116) |
| Exchange rate | -3.444 (0.000) | -2.988 (0.000) |
| Adjusted R-squared | 0.715 | 0.693 |

To be able to use the Taylor rules as a reference for assessing BNR policy, we estimated the Taylor rule model with real data. In this approach I did not take into account the fact that the National Bank of Romania uses monetary money as the main instrument of monetary policy, and instead I assumed that the interest rate is being used, trying to see whether the use of such an instrument would have been efficiency. As can be seen from the estimated regression, the variance of the independent variable is largely explained by the regressors, which is also confirmed by the value close to 1 of the coefficient of determination, but this should be regarded with caution, given that the values of the series that designate the independent variable Also depend on the rate of inflation, which also appears as a regressor equation.

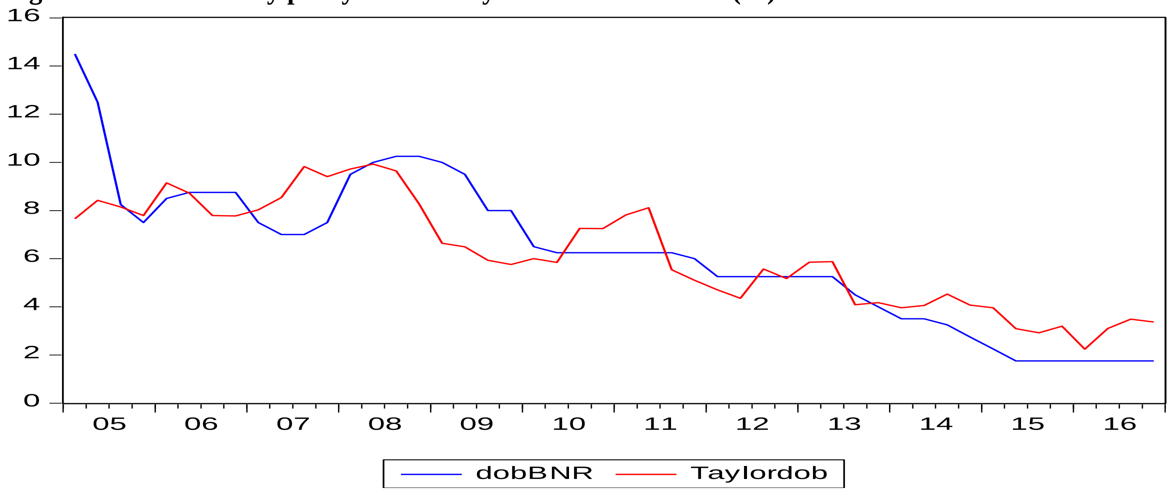
After analyzing the coefficients obtained for the estimated equation we can see that both parameters (output gap and inflation) negatively influence the real interest rate. If inflation is obvious, in the case of industrial production gap, the negative coefficient reveals that an increase in industrial production, even in real terms, has often been accompanied by an increase in inflation, and as a result Leading to rising nominal interest rates to avoid overheating the economy, the simultaneous rise in inflation has made the real interest rate fall.

**Figure 1 NBR monetary policy rate vs. Taylor rule interest rate (%) 1 month**



If, on the other hand, we use as criteria for assessing the possibility that Romania has followed a monetary policy based on a Taylor rule intersections between the estimated parameters of the Taylor rule and the variance ranges for the parameters of the optimal rule obtained by punctual estimation.

**Figure 2 NBR monetary policy rate vs. Taylor rule interest rate (%) 3 month**




As a result, we can conclude that a Taylor rule without any restrictions on coefficients could not have characterized the monetary policy of the NBR in 2005-2017, according to the criteria taken into account.

## CONCLUSIONS

This paper attempts to test whether a rule of Taylor can be used to characterize monetary policy in Romania in the last decade, and whether that rule is effective in relation to a general rule used as a benchmark and determined theoretically.

The evaluation results can be summarized as follows:

- after calculating the confidence interval of 95% for the ratio c of the coefficients of Taylor's function, it was found that both a rule corresponding to the strict pricing target ($\gamma = 0$) and a rule corresponding to nominal income targeting (defined as having $\gamma = 1$) Falls within this range
- for the pure-price rule, the Taylor function coefficients do not fall within the confidence intervals for optimal rule coefficients as punctual estimation, but only by applying the 95%

Because of the very high asymptotic square abnormalities of the optimal rule coefficients, this criterion was considered not relevant enough and it was concluded that a rule consistent with strict price targeting cannot be considered as effective

- for the rule corresponding to the nominal income target, the coefficients determined from the general economic model fall within the ranges corresponding to the optimal rule, both after the punctual estimation and after the intersection of the confidence intervals criterion. It has been concluded that such a policy of monetary policy may under certain conditions be effective and a confidence interval for the loss function coefficient that indicates the relative importance of output stabilization over the importance of stabilizing inflation

- for the econometric determined general rule, the estimated values of the reaction function parameters were outside the optimum range, but the intersection of the 95% confidence interval of these coefficients and that of the optimal rule coefficients was non-widespread. Because it was econometric data, a third criterion was used, according to which the ratio between the coefficients determined by the econometric coefficient of the reaction function had to have a certain value depending on the econometric estimated coefficients for the equations of the Philips curve and the aggregate demand; Because this criterion was not met, it was considered that the estimated rule cannot be effective

However, the results can be seen with some reservations given the following shortcomings:

- the absence of monthly GDP series, which has led to the use of industrial production as the proxy variable
- even for industrial production, the series were available for most of the period considered in the form of rhythm of growth rather than absolute levels, which implied their estimation by calculations
- some coefficients associated with model functions have a probability associated with a high t-statistical test, which could make them irrelevant
- the absence of a sample of data greater than 8 years, which led to the impossibility of estimating the model using annual or even quarterly data, as used in other international studies of this kind
- the reduced coefficient with which real interest is entering the aggregate demand equation, which, by using the value of that coefficient as the denominator of some functions in determining the asymptotic dispersion, resulted in a very high standard deviation, which led to the decrease of the degree of relevance of the intersection of 95% confidence intervals. With all these shortcomings, we believe that the results obtained can be interpreted as relevant, and for future research, the model should be estimated using annual data, while relaxing some assumptions, the most important being the central bank's variable instrument.

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# AN ASSESSMENT OF DISTANCE LEARNING EDUCATION PLATFORM OPTIONS AND OPPORTUNITY

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**Abstract**: *Distance learning in Romania is organized by combining different forms of distance interaction and communication (designed and developed using an e-learning predefined platform) but also face-to-face meetings and tutorial sessions. Danubius University implemented in 2009 such a system based on Sakai e-Learning platform. To evaluate the quality and opportunity level regarding the usage of the e-learning platform and the specific methods and tools, the distance learning department developed a quiz for the students. The content of this questionnaire, based on which the performance assessment is made, approach the flexibility in offering the e-learning support, the communication possibilities and the time saving. All the University's students enrolled in distance learning programs were subjects no matter their degree level or domain. The results of this assessment are managerial tools and decision instruments for future development of the distance learning methods adopted by the university but also for new modules added to the e-learning platform.*
**Keywords**: *distance learning, Sakai, e-learning platform*
**JEL Classification**: D83

## INTRODUCTION

Distance education has experienced lately an impressive evolution, becoming more and more a flexible type of educational category "available to anyone at anytime and at any place" (Subic, A& Maconachie, 2004); more, this system turns into one of the most important global business, following the development of another element, that of internationalization of the educational process.

Also, techniques and methodologies providing distance learning services have developed lately, now exists various LMS platforms in open or paid versions (Subic, A&Maconachie, D., 2004). In addition, an increasingly number of students choose to work during their studies, thereby determining them to choose more flexible version of distance learning than on the conventional form, specific to standard education. Among the advantages of distance learning can also find the flexibility, timesaving orienting and learning resources in multiple environments.

In this sense, the greatest challenge that universities encounter during their effort to provide distance education is to use approaches and technologies particularly suited to educational context, which is attractive to students and to become effective. Thus, the quality of distance learning programs offered by universities is an important factor in attracting students from other regions/countries and, of course, in the consistent involvement of these students in learning through the computer.

## DISTANCE LEARNING: STATE OF THE ART

Starting with 2008-2011, distance education knows a new stage concretized in MOOCs (Massive Open Online Courses), which is a form of providing university education to anyone with access to a computer connected to the Internet (Kurzman, P, 2013). Education providers offering online courses to students (EdX, Coursera, Udacity, etc.) in partnership with educational institutions worldwide are in continuous transformation, adaptation and expansion, and the number of courses they provides follow the same trend. Thus, if in 2013 EdX offered 94 courses from 29 institutions, Coursera offered 325 courses and Udacity offered 26 courses, in January 2016 EdX provide 820 courses, Coursera 1580 courses, while Udacity exceeded 120 courses, according to some sources.

The alternatives to this system began to materialize, so, in 2012 was launched DOCC (Distributed Open Collaborative Courses) which allows to change the theme and courses organization based on the students intervention and, then SPOC (Self-Paced Online Course), which enhance students flexibility in terms of the learning start, the rhythmicity of the study, etc.

In Romania, distance learning system is restricted by certain regulations governing at the national level the organization of this kind university education. So, even if distance learning is based on electronic means of communication, enabling communication with anyone, anyhow, anywhere, some activities remain closely linked to the presence of students in the university campus.

Flexible learning technologies used in distance learning programs can be different, but it matters a lot the manner in which they are used to facilitate communication and interacting with the student for it to be able to acquire specific skills and concepts appropriate to the graduated program.

A list of the references in alphabetical order should be given at the end of the paper using Times New Roman, 10 pts., normal, alignment justify, upper and lower case.

## RESEARCH METHODOLOGY AND RESULTS

Danubius University of Galati chose Sakai platform (https://sakaiproject.org/about) as the learning management system and it seems to be the only university in Romania using this system, although the Sakai community includes over 360 educational institutions worldwide, including Stanford University, Université de

Poitiers, Columbia University, Bradley University, Duke University, University of Notre Dame, The University of North Carolina, etc.

Sakai platform (“Danubius Online”) offers to university students several types of instruments/facilities:

- Tools to support learning through individual study and a flexible tutorial;
- Access to educational resources
- Tools for testing the acquired knowledge;
- The possibility of transmission the projects during the semester to the teachers
- The possibility to discover grades obtained from ongoing evaluation or final evaluation;
- Tools for bidirectional communication (with teachers or peers year) such as: chat, messaging, and forums
- Notification system directly via email account
- The possibility of participating in videoconferences
- Providing information on tutorial activities schedule, exam scheduling, etc.

Also Danubius Online supports teachers, researchers and administrative staff, offering them, among other things:

- The opportunity to open and develop sites;
- Tools for project management, resources distribution, tactical or strategic planning activities, and collaborative activities development;
- Tools for organizing teaching and research

To assess the way in which students appreciate the Sakai platform used by Danubius University we have created a questionnaire structured on three evaluation areas of the e-learning platform performance, namely: flexibility, communication and efficient organization. The collected data were analyzed and the results have led to expressing our conclusions.

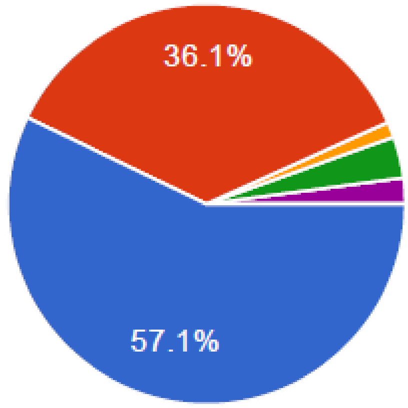
According to the data, 41.6% of students who participated in the survey are enrolled in the Faculty of Law, 40.8% in the Faculty of Economics and 17.6% are enrolled the Faculty of Communications and International Relations.

Regarding academic year, we find that 45% of respondents are in the first year, 29% are in the second year, 19.7% belong to the third year, and for the fourth year (only for the Faculty of Law) are 6.3% of students.

Regarding the evaluation of flexibility generated by the use of the platform, the questionnaire contained three questions.

For the first question students had to answer if it considers that using the e-learning platform leads to improving the way in which they work with teachers. Student responses are leading to the conclusion that they estimate as positive the learning environment based on Sakai tools, since 93.2% of respondents appreciate this in very great extent or largely according to the figure below.

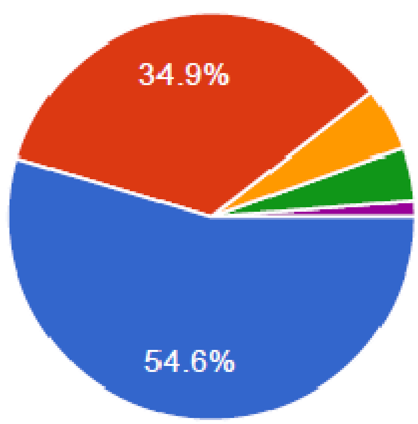
**Figure 1 Appreciation of the learning environment based on Sakai**




Very good 57.1%
Good 36.1%
No answer 1.3%
Satisfactory 3.4%
Unsatisfactory 5 2.1%

Also, regarding the flexibility of the tutorial support that e-learning platform allows you, 89.5% of respondents believe that students can even submit self-evaluation tests during the semester.

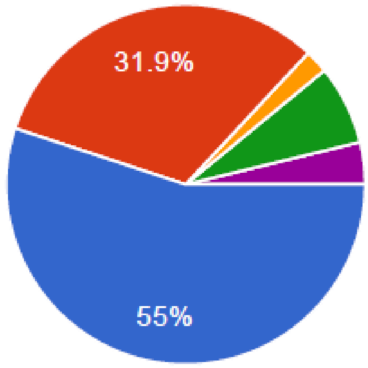
**Figure 2 Flexible tutorials Support**




Very good 54.6%
Good 34.9%
No answer 5%
Satisfactory 4.2%
Unsatisfactory 1.3%

Another aspect analyzed refers to how the Sakai platform can provide two-way communication in distance learning programs between students or between students and teachers, so, according to the questionnaire, 86.55% of participants responded that students can communicate more easily with tools provided by e-learning platform.

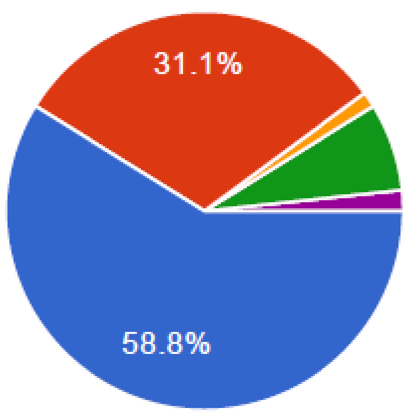
**Figure 3 Facilitating two-way communication**




Very good  55%
Good  31.9%
No answer  2.1%
Satisfactory  7.1%
Unsatisfactory  3.8%

And 98.9% of the students receive information about their meetings with professors through the e-learning platform.

**Figure 4 Getting useful informations**

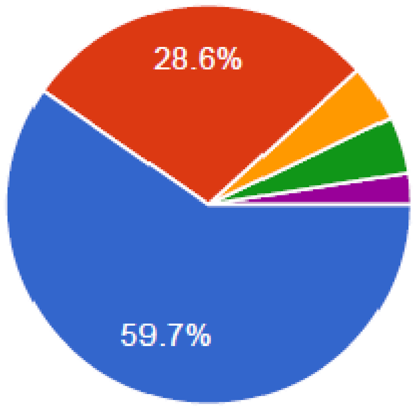



Very good  58.8%
Good  31.1%

No answer 1.3%
Satisfactory 7.1%
Unsatisfactory 1.7%

Also, using the e-learning platform, 88.3% of respondents feel they can submit questions at any time to the teacher.

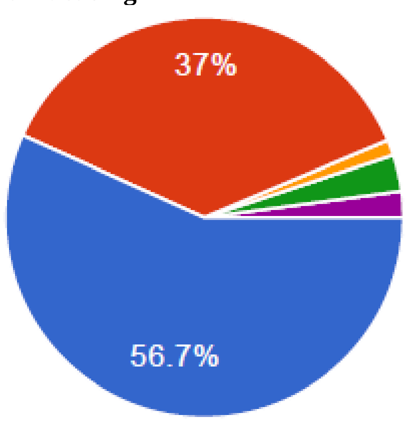
**Figure 5 Continuous interactions between student and professor**




Very good 59.7%
Good 28.6%
No answer 4.6%
Satisfactory 4.6%
Unsatisfactory 2.5%

From the perspective of more efficient activities management and saving time, we see that saving time is one of the most important factors in choosing a distance learning program. Thus, 93.7% of students responded that the e-learning platform is a single point of access to the information required in the learning process.

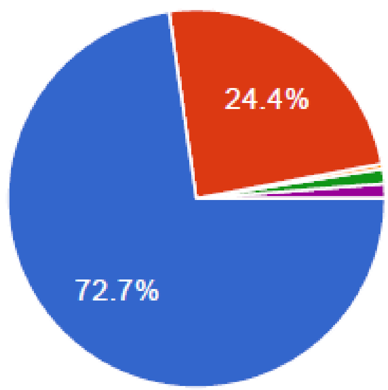
**Figure 6 Time management and time saving**



Very good 56.7%
Good 37%
No answer 1.3%
Satisfactory 2.9%
Unsatisfactory 2.1%

while 97.1 of students believe that the use of the platform enables better management of time, regardless of the location. Thus, distance learning, mediated by the e-learning platform allows the student to save time (by decreasing/eliminating distances to/from the university, obtaining the necessary information faster, etc.).

**Figure 7 Time management**




Very good 72.7%
Good 24.4%
No answer 0.4%
Satisfactory 1.3%
Unsatisfactory 1.3%

## CONCLUSIONS

The data reveals that Sakai platform, used by Danubius University for implementing the distance learning programs, is very appreciated by students. They appreciate tree main characteristics of the e-learning platform, like: flexibility in offering the e-learning support, time saving, and the communication possibilities between students and with teachers. Sakai offers significant advantages to the students, such as: the possibility to work in the same time, the opportunity to have a child, flexible access to the learning materials to enhance their knowledge, they can interact with their teachers and colleagues, etc.

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# FINANCIAL INTEGRATION AND FINANCIAL CONTAGION, A PROBLEM FOR FINANCIAL STABILITY?

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**Abstract**: *The aim of this paper is to highlight the relation between financial integration and financial contagion, with the desire of financial stability. For this purpose we reviewed the literature in this field and then we did an analysis in order to draw relevant conclusions and to provide a clearer picture of the relationship between the two phenomena. For our analysis, we retrieved data from the Eurostat and World Development Indicators (World Bank) including the EU 28 member states over the time span 2000-2014. Our results show that is a significant relationship between the variables considered, and also financial integration and financial contagion are inversely proportional, financial contagion having a negative influence on the financial integration. It is consensual that a higher level of financial integration in partner economies can promote a process of strengthening the domestic markets involved, which is essential for the domestic corporate environment and also contributes to capital accumulation and technological innovation, key elements for economic growth, and the crisis contagion poses a systemic threat to the stability of the global financial system. For these reasons, studies about financial integration and contagion are relevant.*
**Keywords**: *financial integration, crisis, financial contagion, financial stability*.
**JEL Classification**: *F15, F36, G01, G10.*

## 1. INTRODUCTION

It is consensual that a higher level of financial integration in partner economies can promote a process of strengthening the domestic markets involved, which is essential for the domestic corporate environment and also contributes to capital accumulation and technological innovation, key elements for economic growth, and the crisis contagion poses a systemic threat to the stability of the global financial system. For these reasons, studies about financial integration and contagion are relevant.

The financial contagion became more and more the main idea of many studies in this field because it is often associated with the financial crises and it is perceived as a real problem.

Also, financial integration, financial contagion and financial stability are closely linked. This way was supported by the Ms Gertrude Tumpel Gugerell, Member of the Executive Board of the European Central Bank, at the ECB colloquium "European integration and stability" held on the 19th of May 2011. He said that „an integrated financial market is the basis for a smooth and equal transmission of monetary policy, it increases the efficiency and overall welfare of the economy, and enhances the resilience of the financial system from risk diversification. But despite our commitment and our support for financial integration, we also had to learn– with the experience of the past 4 years in mind – that financial integration and financial stability do not always go hand in hand. Indeed we have witnessed that in a financially integrated market risks can spread and spillover to other segments of the financial market, increasing the likelihood of contagion of financial fragilities and systemic risks." (Tumpel- Gugerell, 2011)

The aim of this paper is to highlight the relation between financial integration and financial contagion, with the desire of financial stability. For this purpose we reviewed the literature in this field and then we did an analysis in order to draw relevant conclusions and to provide a clearer picture of the relationship between the two phenomena.

## 2. LITERATURE REVIEW

According to Karunaratne (2002) crisis contagion could be defined as the phenomenon of the currency crisis in one nation precipitating a currency crisis in another nation, often in the same region. He said that because the crisis contagion poses a systemic threat to the stability of the global financial system, the reform of the international financial architecture is matter of utmost importance in order to minimize the occurrence of crises and crises contagion.

Ben Rejeb (2015) aimed in his study to examine the volatility relationship that exists between emerging and developed markets in normal times and in times of financial crises, using the Vector Autoregressive methodology. So, it has been shown that financial liberalization contributes significantly in amplifying the international transmission of volatility and the risk of contagion.

Matos et all (2015) had in their study the purpose to to measure how financially integrated and how strong is the financial contagion in BRIC, one of the most famous acronyms that stands for heterogeneous emerging economies: Brazil, Russia, India and China. According to their result, because we can evidence a contagion effect with Brazilian and Chinese financial markets playing a leading role, the economic linkages and information asymmetry within BRIC may be strong. Their evidence that BRIC establish a mutual relationship of long-term equilibrium and are also under contagion effect is robust to a structural break identified due to the recent global crisis, in 2008.

Armeanu et all (2014) studied the financial contagion of the capital markets, as a result of instability or financial shocks, such as financial crisis, and also the way financial contagion occurs. They find that the contagion issue is more profound, as it expands through many regions, and, therefore, it is important to find correlations between the countries, in order to reduce contagion effects, proving that the financial markets have underestimated this type of risk generated by the interconnections between countries.

Zhaoqi (2009) examined in his phd thesis the evolution of the financial integration and contagion of international stock and bond markets. His main results showed that large (/growth) stock portfolios are more integrated with the world than small (/value) portfolios, financial integration, and for testing contagion, he found that the conditional variance of assets returns and the increased level of integration are excellent variables for identifying the crisis period, focusing on the transmission of price shocks at times of financial crisis.

Burzala (2016) presented in his research the deals with the process of contagion in selected capital markets during the financial crisis of 2007–2009. The research that was carried out indicates that rates of return in the studied European markets react simultaneously to a much greater extent as a result of interdependencies than as a result of mutual contagion.

Frexedas (2005) studied in his paper the financial contagion in times of crisis, one of the consequences of the integration of markets. The autor used the implementation of Spatial Econometrics. According to the results, in each crisis the market more closely controlled by governments show similar channels of contagion, and also the market more dependent on market forces show a distinctive trend.

Mollah et all (2014) studied the phenomenon of financial market contagion using the Dynamic Conditional Correlation-Generalized Autoregressive Conditional Heteroskedasticity (DCC-GARCH) and vector error correction (VEC) models. The empirical results demonstrate the existence of contagion in the financial markets during the global crisis.

Inci et all (2010) used the local correlation is used to examine financial contagion.They have detected contagion from U.S. futures to other futures markets, and also there is no reverse contagion from any of the German, British, Japanese, and Hong Kong spot or index futures markets to those of the U.S.

Bekaert et all (2005) defined contagion as a correlation between markets in excess of that implied by economic fundamentals. They said that, however, there is considerable disagreement regarding the definition of the fundamentals, how they might differ across countries, and the mechanisms that link them to asset returns.

Gencer et Demiralay (2016) analized financial contagion in the emerging markets during the European sovereign debt crisis and the global financial crisis at the aggregate and disaggregate level. At the aggregate level, their results document contagion incidences only during the European sovereign debt crisis. They said that, with regard to the idiosyncratic contagion effects, the real economy sectors are heterogeneous in the sense that they display co-movements at varying magnitudes during both of the crises.

Piffaut and Rey Miro (2016) aimed in their study to detect and capture the spread between the main stock indices in the Europe, Asia and United States markets. Using the Garch model, they noticed that the stock markets were highly corelated during the financial crisis creating a full-fledge contagion process.

Devereux and Yu (2014) said that financial integration helps to diversify risk but also may increase the transmission of crisis across countries. Their results showed that the financial integration leads to a significant increase in global leverage, doubles the probability of balance sheet crises for any one country, and dramatically increases the degree of 'contagion' across countries.

Ye et all (2016) developped a quantile regression model to measure the financial contagion. Their empirical results showed that the contagion existed during the Euro crisis between Greece and all tested European markets and during the US banking crisis between the US and all tested markets.

You et all (2014) tried to explain the phenomenon about how the China stock market exhibited a very different level of performance during the financial crises, using a composite index for the economic integration and a dynamic conditional correlation model to capture the correlations between stock returns of China and those of other important markets around the world.Their results showed a positive influence for the aim of the study.

Devereux and Shuterland (2011) developped a simple two-country model in which financial liberalisation across countries takes place in the presence of credit market distortions within countries. Their main conclusion was that it is necessary to identify the financial structure that most efficiently exploits the trade-off between the cost of financial contagion and the gains of financial market integration.

Gallegati (2012) used a wavelet-based approach to test for financial market contagion. His results indicate that Brazil and Japan are the only countries in which contagion is observed at all scales, because all stock markets have been affected by the US subprime crisis.

Luchtenberg and Vu (2015) studied in their paper the phenomenon of contagion and its determinants during the 2008 financial crisis. They discovered that both economic fundamentals such as interest rates, industrial production, trade structure, inflation rates and and regional effects, and investors' risk aversion contribute to international contagion.

## 3. DATA AND METHODOLOGY

Since the obiective of the study was to highlight the relation between financial integration and financial contagion, we did my analyses by identifying the key definitions, approaches, statistical methods of the two topics, found in the literature regarding analyzed topics. Then we synthesized in this paper some of the key points of view and results found in the literature, and we did an regression analysis in order to draw relevant conclusions and to provide a clearer picture of the relationship between the two phenomena.

Also, empirical studies realised so far on this subject have used methodologies that measured separately the two phenomena, not their relationship or influence on his neighbour. In this regard, the financial integration was measured by CAPM (Zhaoqi, 2009), multivariate cointegration (Matos et all, 2015), two-country model (Devereux, 2010), while the financial contagion was measured by VAR model (Vector Autoregressive) (Rejeb and Boughrara, 2015, Matos et all, 2015, Burzala, 2016, Ye et all,2016) GARCH model (Zhaoqi, 2009, Mollah et all, 2014, Piffaut and Rey Miro, 2016, You et all, 2016), an exploratory spatial analysis (Frexedas and Esther, 2004), wavelet-based aproach (Gallegati, 2012), local correlation analysis (Inci and McCarthy, 2010). I have not attended one of this methodologies because my purpose is to study the relationship between the two phenomena, and not separately.

Our empirical analysis was performed based on a multiple linear regression between the dependent variable and the independent variables, and as econometric software will be used the programs Eviews Statistics and SPSS, which helped us to create a clearer picture on the correlations between variables.

The dependent variable was financial integration, expressed by gross capital formation, and the independent variables will be financial contagion, expressed by unemployment rate, inflation rate, and bank's Z score and government expenditures. We chose these variables because they were used in others studies (Racickas & Vasiliauskait, 2012, ECB, 2005) concerning the two phenomena.

The data used for empirical analysis focuses on the period 2000 - 2014, with an annual frecuency. These informations were obtained from the Eurostat and World Development Indicators databases.

The equations for the regression are expressed by the following formulas:

*GROSS_CAPITAL_FORMATION = C(1) * BANKS _ Z _ SCORE + C(2) * GENERAL _ GOVERNMENT _ EXPENDITURE+ C(3) * INFLATION _RATE + C(4) * PUBLIC_DEBT + C(5)*UNEMPLOYMENT_RATE + C(6)*

*GROSS_CAPITAL_FORMATION = C(1) * BANKS _ Z _ SCORE+ C(2) * GENERAL _ GOVERNMENT _ EXPENDITURE+ C(3) * UNEMPLOYMENT _RATE + C(4)*CRISIS +C(5)*

*GROSS_CAPITAL_FORMATION = C (1) * UNEMPLOYMENT _ RATE + C(2) * GENERAL _ GOVERNMENT_EXPENDITURE + C(3) * BANKS _ Z _ SCORE + C(4) * EUROZONE + C(5)*

## 4. RESULTS

Considering to the literature, we can say that financial integration has led to the financial contagion, especially in times of crisis. Financial integration has both benefits and costs. According to Chiwira and Tadu (2012), the most frequently mentioned benefits of financial market integration include:

- consumption smoothing due to international diversification of risks (reduction of the large country-specific shocks) ;
- the positive effect of capital flows on domestic investment and economic growth;
- improving efficiency of the financial system;
- increasing prudence of financial market agents;
- the attainment of a high level of financial stability.

Conversely the major costs of financial integration include:

- insufficient access to funding at times of financial instability inappropriate allocation of capital flows;
- loss of macroeconomic stability;
- herd behavior among investors;
- financial contagion and high volatility of cross-border capital flows.

So, the most significant cost of financial integration is the risk of financial contagion.

Even if it received a lot of definition in the literature until the present, financial contagion is a very complex and multivariate process, without an accepted definition and an accurate measurement methodology.

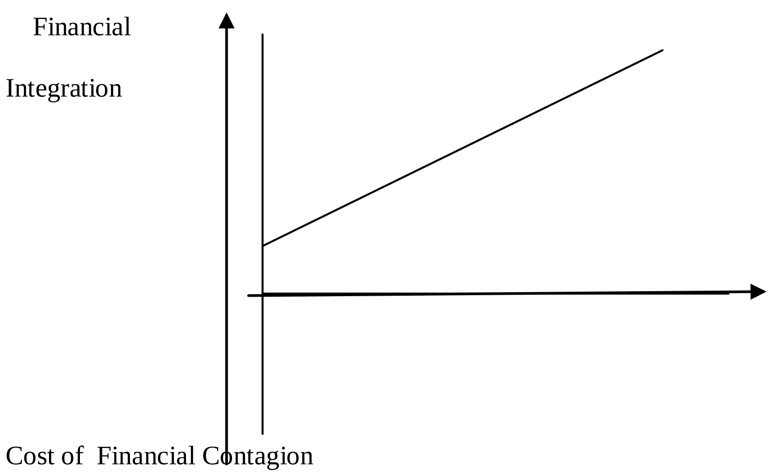
According to Chiwira and Tadu (2012) financial integration can be defined as a transmission of a crisis across borders whose reasons can't be explained by macroeconomic fundamentals.

According to OECD Economics Department (2012), the extent and nature of international banking integration, which led to unprecedented transmission of financial instability, is one important factor that made the recent financial crisis so widespread and deep. The international financial integration led to increase of economic efficiency and growth, but it may also increase the vulnerability to contagion. So, the growth of the cross-border loans of the banks led to a higher risk of contagion.

The hypothesis that financial integration can help the financial stability and as well as extend a financial crisis through financial contagion effects means that it is a "double edge sword". So, the phenomenon of financial integration can move as a mechanism in which a crisis can be transfered, and the financial stability can be attained. This thing lead to the affirmation of the idea that a deeper financial integration lead to a greater cost of financial contagion, implying a concesion between them.

Figure 1 shows the relationship that exists between financial integration and financial contagion in a simplified representation.

**Figure 1. The relationship between financial integration and financial contagion**




Source : Chiwira, O. & Tadu, R., 2013. Financial integration and the risk of financial contagion in Africa : Empirical Review. , 3(4), p. 131.

According to Racickas and Vasiliauskaite (2012), financial contagion could be measured by several indicators:

**Table 1 Indicators of financial contagion**

| Financial contagion indicator | Interpretation |
|---|---|
| | *External sector (current account)* |
| | A measure for the change in international |

| | |
|---|---|
| *Real exchange rate* | competitiveness and a proxy for over(under)valuation. Overvalued real exchange rate is expected to produce higher probability of financial crisis. |
| *Export growth* | An indicator for a loss of competitiveness in international good market. Declining export growth may be caused by an overvalued domestic currency and hence a proxy for currency overvaluation. On the other hand, if export growth slows due to reasons unrelated to the exchange rate, this may cause devaluation pressure. In both cases, declining export growth can be a leading indicator for a sizeable devaluation. |
| *Import growth* | Weak external sector is part of currency crises. Enormous import growth could lead to worsening in the current account and have been often related with currency crises. |
| *Terms of trade* | Increases in terms of trade should strengthen a country's balance of payments position and hence lower the probability of crisis. Terms of trade deteriorations may precede currency crisis. |
| *Ratio of the current account to GDP* | A rise in this ratio is generally associated with large external capital inflows that are intermediated by the domestic financial system and could facilitate asset price and credit booms. Increases in the current account surplus are expected to indicate a diminished probability to devalue and thus to lower the probability of a crisis. |
| | *External sector (capital account)* |
| *Growth of foreign exchange reserves* | Declining foreign reserves is a reliable indicator that a currency is under devaluation pressure. A drop in reserves is not necessarily followed by devaluation, central bank may be successful in defending a peg, spending large amounts of reserves in the process. On the other hand, most currency collapses are preceded by a period of increased efforts to defend the exchange rate, which are marked by declining foreign reserves. Total value of foreign reserves are also used as indicators of a country's financial difficulty dealing with debt repayment. |
| | *External sector (capital account)* |
| *Ratio of M2 to foreign exchange Reserves* | Captures to what extent the liabilities of the banking system are backed by foreign reserves. In the event of a currency crisis, individuals may rush to convert their domestic currency deposits into foreign currency, so that this ratio captures the ability of the central bank to meet their demands. |

| | |
|---|---|
| | *Financial sector* |
| *M1 and M2 growth* | These indicators are measures of liquidity. High growth of these indicators might indicate excess liquidity which may fuel speculative attacks on the currency thus leading to a currency crisis. |
| *M2 money multiplier* | An indicator associated with financial liberalization. Large increases in the money multiplier can be explained by draconian reductions in reserve requirements. |
| *Ratio of domestic credit to GDP* | Very high growth of domestic credit may serve as a crude indicator of the fragility of the banking system. This ratio usually rises in the early phase of the banking crisis. It may be that as the crisis unfolds, the central bank may be injecting money to the bank to improve their financial situation. |
| *Excess real M1 Balance* | Loose monetary policy can lead to currency crisis. |
| *Domestic real interest rate* | Real interest rate can be considered as proxy of financial liberalization, in which the liberalization process itself tends to lead to high real rates. High real interest rates signal a liquidity crunch or have been increased to fend off a speculative attack. |
| *Lending and deposit rate spread* | An increase of this indicator above some threshold level possibly reflects a deterioration in credit risk as banks are unwilling to lend or decline in loan quality. |
| *Commercial bank Deposits* | Domestic bank run and capital flight occur as crisis unfolds. |
| *Ratio of bank reserves to bank Assets* | Adverse macroeconomic shocks are less likely to lead to crises in countries where the banking system is liquid. |
| | *Domestic real and public sector* |
| *Ratio of fiscal balance to GDP* | Higher deficits are expected to raise the probability of crisis, since the deficits increase the vulnerability to shocks and investor's confidence. |
| *Ratio of public debt to GDP* | Higher indebtedness is expected to raise vulnerability to a reversal in capital inflows and hence to raise the probability of a crisis. |
| *Growth of industrial* | Recessions often precede financial crises. |

| | |
|---|---|
| *production* | |
| | Burst of asset price bubbles often precede financial |
| *Changes in stock* | crises. |
| *Prices* | |
| | |
| | The inflation rate is likely to be associated with high |
| | nominal interest rates and may proxy macroeconomic |
| *Inflation rate* | mismanagement which adversely affects the economy |
| | and the banking system. |
| | |
| | High income countries may be less likely to reschedule |
| | their debt than poorer countries since the costs of |
| | rescheduling would tend to be more onerous for more |
| *GDP per capita* | |
| | advanced economies. Deterioration of the domestic |
| | economic activity are expected to increase the |
| | likelihood of a banking crisis. |
| *National saving* | High national savings may be expected to lower the |
| *Growth* | probability of debt rescheduling. |
| | |
| *Unemployment rate* | The unemployment rate is the share of the labor force that is jobless, expressed as a percentage. |
| | |
| *Government* | Are the current spending and investment by central |
| *expenditure* | government and and local authorities on the provision of |
| | social goods and services. |
| | *Global economy* |
| *Growth of world oil* | High oil prices are associated with recessions. |
| *Prices* | |
| | International interest rate increases are often associated |
| | with capital outflows. |
| *US interest rate* | |
| | |
| | Higher foreign output growth should strengthen |
| *OECD GDP growth* | exports and thus reduce the probability of a crisis. |

Source: Racickas, E. & Vasiliauskait, A., 2012. Model of Financial Risk Contagion, 17(1), pp. 95-97.

Of these, we tried to choose three indicators that would correlate with financial integration to see the relationship between the two phenomena. The two indicators are: government expenditure, inflation rate and unemployment rate. We chose these variables because government expenditures are very important to ensure the well-being of the population, and the living standards, which leads to the reduction of migrations and favors economic growth. Also the unemployment rate is an important indicator because it specifies the percentage of the unoccupied population, which requires employment. The employment of the population is very important because it leads to the growth and development of the economy as a whole and to the maintenance of financial stability. The inflation rate is also important because it affects the economy and the banking system. As independent variables, we used also the Banks Z score, which is a measuring indicator of bank's solvency risk, It explicitly compares buffers (capitalization and returns) with risk (volatility of returns), and because of this it can be used as an indicator of financial contagion. Also, as control variable we used public debt, which is a good way for countries to get extra funds to invest in their economic growth. They were the independent variables. The dependent variable was the financial integration, expressed by gross capital formation. For financial integration we used gross capital formation because, according to the literature, this is an important indicator of stock market integration. Also, based on a previous study, we found that it is the most important factor through which financial integration influences economic growth. We created a two dummy variables, crisis, which take the value 0 before 2008 and 1 otherwise, and euro zone, which take the value 0 for the non-euro zone countries and the value 1 for the euro zone countries.

**Table 2 Results of regression estimation of gross capital formation and the independent variables for the EU 28**

| Variables | Model 1 | Model 2 | Model 3 |
|---|---|---|---|
| C | 31.32788***(1.468650) | 36.93665***(1.297653) | 33.72442***(1.246629) |
| Crisis | | | -2.424302***(0.360804) |
| Eurozone | | 0.368169(0.362471) | |
| Bank's Z score | -0.001299***(0.000327) | -0.001612***(0.000357) | -8.29E-05***(2.32E-05) |
| General government expenditure | -0.105075***(0.032512) | -0.267224***(0.026907) | -0.172170***(0.027032) |
| Inflation rate | 0.090488*(0.046827) | | |
| Public debt | -0.049655***(0.006458) | | |
| Unemployment rate | -0.156437***(0.038963) | -0.265005***(0.039548) | -0.204177***(0.039667) |
| R-squared | 0.351851 | 0.253685 | 0.310718 |
| Adjusted R-squared | 0.344023 | 0.246492 | 0.304074 |
| Total panel (balanced) observations | 420 | 420 | 420 |
| Standard error in parentheses, *** p<0.01, ** p<0.05, * p<0.1 | | | |

*Source: Author calculation*

In the table no.2 we can see the results of the regression analysis. In the first model, as it can be seen the variables which refers to financial contagion (unemployment rate, government expenditure, bank's Z score) are significant and negatively correlated with the variable which refers to financial integration (gross capital formation), which means the higher is the level of unemployment rate, government expenditure, or bank's Z score, the lower is the level of gross capital formation, this being demonstrated by the probability of T-test statistic (< 0.05) and the negatives values of the variables coefficients. Also in the first model we can see that the public debt has a significant and negative influence on the gross capital formation, and the inflation rate does not have a significant influence. In the second model, we can see that the dummy variable EUROZONE does not have a significant influence on the dependent variable, so we can say that the independent variables have a greater influence on the dependent variable in the non-euro zone countries. In the third model, we can see that the dummy variable CRISIS has a significant and negative influence on the dependent variable, so we can say that the independent variables have a greater influence on the dependent variable in the post-crisis period. Thus we can say that the two phenomena, financial integration and financial contagion are inversely proportional, financial contagion having a negative influence on the financial integration. Because of this others authors (Chiwira and Tadu, 2012) stated that financial contagion is considered a cost of financial integration.

**Table 3 Pearson's Correlations**

| | | Gross capital formation | General government expenditure | Unemployment rate(% of labor force) | Inflation rate | Public debt | Banks Z score |
|---|---|---|---|---|---|---|---|
| Gross capital formation | Pearson Correlation | 1 | -,383** | -,254** | ,251** | -,537** | -,084 |
| | Sig. (2-tailed) | | ,000 | ,000 | ,000 | ,000 | ,085 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| General government expenditure | Pearson Correlation | -,383** | 1 | -,030 | -,354** | ,565** | -,195** |
| | Sig. (2-tailed) | ,000 | | ,535 | ,000 | ,000 | ,000 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| Unemployment rate(% of labor force) | Pearson Correlation | -,254** | -,030 | 1 | -,065 | ,253** | -,082 |
| | Sig. (2-tailed) | ,000 | ,535 | | ,181 | ,000 | ,094 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| Inflation rate | Pearson Correlation | ,251** | -,354** | -,065 | 1 | -,249** | ,000 |
| | Sig. (2-tailed) | ,000 | ,000 | ,181 | | ,000 | ,994 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| Public debt | Pearson Correlation | -,537** | ,565** | ,253** | -,249** | 1 | -,078 |
| | Sig. (2-tailed) | ,000 | ,000 | ,000 | ,000 | | ,110 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| Banks Z score | Pearson Correlation | -,084 | -,195** | -,082 | ,000 | -,078 | 1 |
| | Sig. (2-tailed) | ,085 | ,000 | ,094 | ,994 | ,110 | |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |

| | | Gross capital formation | General government expenditure | Unemployment rate(% of labor force) | Inflation rate | Public debt | Banks Z score |
|---|---|---|---|---|---|---|---|
| Gross capital formation | Pearson Correlation | 1 | -,383** | -,254** | ,251** | -,537** | -,084 |
| | Sig. (2-tailed) | | ,000 | ,000 | ,000 | ,000 | ,085 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| General government expenditure | Pearson Correlation | -,383** | 1 | -,030 | -,354** | ,565** | -,195** |
| | Sig. (2-tailed) | ,000 | | ,535 | ,000 | ,000 | ,000 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| Unemployment rate(% of labor force) | Pearson Correlation | -,254** | -,030 | 1 | -,065 | ,253** | -,082 |
| | Sig. (2-tailed) | ,000 | ,535 | | ,181 | ,000 | ,094 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| Inflation rate | Pearson Correlation | ,251** | -,354** | -,065 | 1 | -,249** | ,000 |
| | Sig. (2-tailed) | ,000 | ,000 | ,181 | | ,000 | ,994 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| Public debt | Pearson Correlation | -,537** | ,565** | ,253** | -,249** | 1 | -,078 |
| | Sig. (2-tailed) | ,000 | ,000 | ,000 | ,000 | | ,110 |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |
| Banks Z score | Pearson Correlation | -,084 | -,195** | -,082 | ,000 | -,078 | 1 |
| | Sig. (2-tailed) | ,085 | ,000 | ,094 | ,994 | ,110 | |
| | N | 420 | 420 | 420 | 420 | 420 | 420 |

**. Correlation is significant at the 0.01 level (2-tailed).

*Source: Author calculation*

In base of Pearson's correlation coefficient that is the covariance of the two variables divided by the product of their standard deviations, we relate the results of our test. Depending on the size of Pearson between of the six variables, we can see that it is a low negative correlation between the dependent variable, gross capital formation, and the independent variables (general government expenditures, unemployment rate, and public debt) for a risk of 1%. The negative correlation means that as one independent variable increases in value, the dependent variable decreases in value. This justified the earlier claim that financial integration and financial contagion are inversely proportional.

## 5. CONCLUSIONS

Both financial integration and financial contagion are multivariate processes which were strongly debated in the literature until the present. The most authors have dealt with the definition of the two concepts and then with the search of different methodologies to measure separately each phenomenon. The main ideas discovered by the literature were that financial contagion is the most important cost of financial integration, because the financial integration helps to diversify risk but also may increase the transmission of crisis. The crisis contagion poses a systemic threat to the stability of the global financial system.

Because the empirical studies realized so far on this subject have used methodologies that measured separately the two phenomena, not their relationship, we did a regression analysis which suggest the fact that the factors used, have what can be considered as the expected significant coefficient signs, there is a significant relationship between the variables, namely financial integration, expressed by gross capital formation, and financial contagion, expressed by general government expenditure, unemployment rate, bank's Z score, public debt, and also financial integration and financial contagion are inversely proportional, financial contagion having a negative influence on the financial integration. Also, the results show that the independent variables through which financial integration affects financial contagion have a greater influence in the post-crisis period and in non-euro zone countries. So, the fiscal policies should search measures for reduce the risk of crisis transmission (which determines the financial contagion), and for increase the benefits of financial integration, with the desire of financial stability.

The phenomenon of financial integration can move as a mechanism in which a crisis can be transferred, and the financial stability can be attained. This thing leads to the affirmation of the idea that a deeper financial integration lead to a greater cost of financial contagion, implying a concession between them.

We will concentrate the future research directions on this topic to find others methodologies through which can be measured the relationship between the two, phenomena, financial integration and financial contagion.

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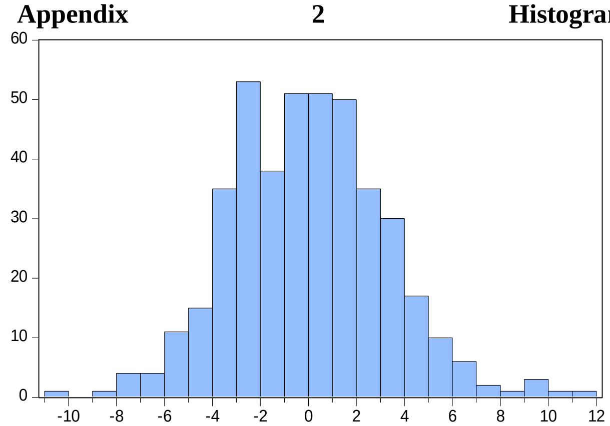
# Appendix

**Appendix 1 Descriptives statistics**

| | GROSS_CAPITAL_FORMATION | BANKS_Z_SCORE | GENERAL_GOVERNMENT_EXPENDITURE | INFLATION_RATE | PUBLIC_DEBT | UNEMPLOYMENT_RATE |
|---|---|---|---|---|---|---|
| Mean | 22.61019 | 169.4352 | 44.54952 | 3.055896 | 54.39952 | 9.000714 |
| Median | 22.12500 | 25.90809 | 44.70000 | 2.450731 | 49.35000 | 7.850000 |
| Maximum | 38.40000 | 4628.803 | 65.30000 | 45.66659 | 179.7000 | 27.50000 |
| Minimum | 10.82000 | -222.2614 | 32.10000 | -4.479938 | 3.700000 | 1.900000 |
| Std. Dev. | 3.988460 | 496.2831 | 6.419925 | 3.630506 | 31.44322 | 4.325412 |
| Skewness | 0.681334 | 5.330456 | 0.075761 | 6.184820 | 0.856701 | 1.419245 |
| Kurtosis | 4.585876 | 35.77721 | 2.500880 | 62.20738 | 4.003134 | 5.315914 |
| | | | | | | |
| Jarque-Bera | 76.50763 | 20790.01 | 4.761392 | 64024.14 | 68.98548 | 234.8585 |
| Probability | 0.000000 | 0.000000 | 0.092486 | 0.000000 | 0.000000 | 0.000000 |
| | | | | | | |
| Sum | 9496.280 | 71162.77 | 18710.80 | 1283.476 | 22847.80 | 3780.300 |
| Sum Sq. Dev. | 6665.373 | 1.03E+08 | 17269.27 | 5522.661 | 414255.3 | 7839.150 |
| | | | | | | |
| Observations | 420 | 420 | 420 | 420 | 420 | 420 |

*Source: Author calculation*

**Appendix 2 Histogram Normality Test**




| | |
|---|---|
| Series: Standardized Residuals | |
| Sample 2000 2014 | |
| Observations 420 | |
| Mean | 1.88e-15 |
| Median | -0.071383 |
| Maximum | 11.98285 |
| Minimum | -10.48501 |
| Std. Dev. | 3.211017 |
| Skewness | 0.251777 |
| Kurtosis | 3.553282 |
| Jarque-Bera | 9.794529 |
| Probability | 0.007467 |

*Source : Author calculation*

**Appendix 3. One-Sample Test ANOVA**

| | Test Value = 0.05 | | | | | |
|---|---|---|---|---|---|---|
| | | | | | 95% Confidence Interval of the Difference | |
| | t | df | Sig. (2-tailed) | Mean Difference | Lower | Upper |
| Gross capital formation | 115,921 | 419 | ,000 | 22,560 | 22,18 | 22,94 |
| General government expenditure | 142,053 | 419 | ,000 | 44,4995238 | 43,883766 | 45,115281 |
| Unemployment rate(% of labor force) | 42,409 | 419 | ,000 | 8,9507143 | 8,535849 | 9,365580 |
| Inflation rate | 16,968 | 419 | ,000 | 3,0059 | 2,658 | 3,354 |
| Public debt | 35,424 | 419 | ,000 | 54,350 | 51,33 | 57,37 |
| Banks Z score | 6,995 | 419 | ,000 | 169,3851771 | 121,784924 | 216,985430 |

*Source: Author calculation*

# THE RELEVANCE OF ENTREPRENEURSHIP EDUCATION TO THE DEVELOPMENT OF MICRO, SMALL AND MEDIUM ENTERPRISES (MSMES) IN NIGERIA

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**Abstract**: *Incorporation of entrepreneurship education as a course and subject into the educational curricular of vocational studies, secondary, tertiary institutions and entrepreneurship agencies has become a globally accepted initiative to address the increasing unemployment rates. This study assessed the state of entrepreneurship education and the impact on the development of Micro, Small and Medium Enterprises (MSMEs) in Nigeria. The study observed an insignificant correlation between the existing Nigerian educational system where entrepreneurship education is optional and restricted to only tertiary institutions and entrepreneurship development. It also observed that the withdrawal of entrepreneurship education from the nation's tertiary educational curriculum would be of little or no effect on the efforts in curbing employment in Nigeria. The paper puts to test, the preceding assertions with the aid of Kruskal Wallis test. From the test, the paper refutes the former assertions on the reasoning that their P-values were less than 5% level of being deemed to be significant. Based on its findings, the study therefore concludes that for entrepreneurship education to be effective in addressing unemployment in Nigeria, it should be incorporated into the nation's educational system right from secondary school.*
**Keywords**: *Educational Curricular, Entrepreneurship Education, Bank of Industry (BOI) Small and Medium Enterprises Development Agency of Nigeria (SMEDAN).*
**JEL Classifications**: A20, E24, E60, I25, I28, I30, J08, J60, J68, O15,

## INTRODUCTION

Unemployment especially among the youths has become a global challenge. There appears to be no country of the world that is not affected directly or indirectly by the challenges of unemployment. The peaceful and prosperous nations suffer from illegal migration and terrorism from nations that are plagued by high unemployment rates and terrorism. Education has always been canvassed as one of the most visible ways out of poverty but this assertion is becoming invalid with the increasing number of unemployed university graduates. It is now obvious that except the citizenry is exposed to the right education, unemployment would remain unabated. One of the ways of ensuring that education assists in addressing national and global unemployment is by incorporating entrepreneurship education in to the curriculum.

Some scholars have provided insights into the concept of entrepreneurship education (Gautam and Singh, 2015; Ramanigopal, Palaniappan and Hemalatha, 2012; Raposo and Paco, 2011; Lee, Chang and Lim, 2005). In their study of the concept, characteristics and implications of entrepreneurship education for teachers, Gautam and

Singh (2015) described entrepreneurship education as the process of professional application of knowledge, attitude, skills and competences that involve creativity, innovation and risk taking.

According to Raposo and Paco (2011), entrepreneurship education prepares the youths to be responsible and enterprising. In similar vein, UNESCO (2008) viewed educational entrepreneurship as all kinds of experiences that give students the ability and vision of how to access and transform opportunities of different kinds.

In essence, educational entrepreneurship provides a platform for youths to transform opportunities to business ventures and to manage those ventures to become a medium for job creation for themselves and others. Enu (2012) argues that the ultimate goal of educational entrepreneurship is all about increasing the student's ability to anticipate and respond to societal changes. In other words, through educational entrepreneurship, students are equipped to deploy their creativity ability for their good and benefits of the larger society. They are also empowered to take initiatives, responsibilities and risks.

Nigeria, arguably the largest and most populous African nation is not exempted from the global challenge of unemployment especially among the youths. It has been battling with increasing rate of unemployment with resultant effects of poverty, terrorism, kidnappings, prostitution and other vices (Adegoke, 2015; Usman, 2015; Nwagwu, 2014; Uddin and Uddin, 2013, Ayansina, 2013). A number of scholars have canvassed for entrepreneurship education as the panacea for curbing unemployment especially among the youths (Okon and Friday, 2015, Efe, 2014; Olorumolu and Agbede, 2012).

This study was therefore aimed at examining the relevance of entrepreneurship education to the development of micro, small and medium enterprises in Nigeria. The study used the Bank of Industry and Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) as case studies.

## LITERATURE REVIEW

Entrepreneurship education is a catalyst for economic development and job creation in any society and it involves rebranding the education culture to the end of guaranteeing a comprehensive educational system re-engineering arising from the obvious deficiencies of the existing educational system (Lee and Wong, 2008). Entrepreneurship education's main focus is to provide the students with requisite skills and capacities needed in the world of work.

A broader definition of entrepreneurship education was provided by Obinna (2014) as the process through which individuals acquire a broad set of competencies that can produce greater social and economic benefits to the individuals. According to Enu (2012), Entrepreneurship education is a form of education that seeks to provide knowledge, skills, attitude and motivation to students for entrepreneurial success in any facet of human endeavours. Enu (2012) further argues that entrepreneurship education equips individuals with the ability to seek investment opportunities and maximize returns from those investments.

According to Brush (2014) and Kuratko (2005), entrepreneurship education within a school generally consists of a nested set of activities, including curriculum, co-curricular activities, and research efforts. In other words, the decisions around entrepreneurship education include everything from learning objectives, topics covered, selection of materials (including cases, exercises, and concepts), pedagogy, and delivery mechanisms Patricia et 'al (2010). In most economies of the world and especially in developed economies, the entrepreneur is the driving force behind the productive activities and in turn the entrepreneur is expected to be driven by relevant education. Therefore, a sound and effective entrepreneurship education that would impact on the larger society evidenced in reduction of unemployment rate would be a function of innovations and risks. Entrepreneurship education has been found to be a vital tool in addressing unemployment where policies are designed appropriately and effectively implemented. For instance, entrepreneurship education was observed by scholars like Álvaro et al., 2008 and, Iyiola, and Azuh, 2014 to assist in creating new businesses, resuscitating challenged businesses and as well as encouraging innovations, competency and improving the standard of living of the generality of the people.

Akhuemonkhan et 'al (2013) examined the entrepreneurship education and employment stimulation in Nigeria. They discovered that entrepreneurship development could be an effective tool for poverty reduction, stimulating employment as well as fast-tracking the realization of universal primary education and promoting gender equality. Despite the prospect of entrepreneurship education, it is faced by challenges such as paucity of funds, ineffective teaching methods, paucity of text-books, and lack of experienced lecturers and a host of other factors. In a similar vein, Olorundare and Kayode (2014) came up with a model of how public and private partnership can be enhanced through entrepreneurship education in Nigerian universities towards national transformation and stressed out that challenges of entrepreneurship education which include inadequate trainers or little knowledge of entrepreneurship by the universities' lecturers, inadequate fund for the program by the universities administrators as well as challenges in the area of curriculum development and implementation.

Self-reliance, self-sufficiency, self-sustainability, self-support culture and self-employment are the end point or the main point of entrepreneurship education and entrepreneurship development to release the government's unfulfilled responsibility of creating and providing employment to it citizenry. It was because of this that Evans-Obinna (2016) examined the relationship among entrepreneurship, entrepreneurship education and self-reliance in the attainment of economic development and highlighted the challenges such as inadequate funding, lack of materials, entrepreneurship teachers among others facing entrepreneurship education in Nigeria. He recommended that the Nigeria government should not only embrace the policy of setting aside 26% of its annual budget for education as suggested by UNESCO but also try and mandate its implementation.

Adeoye (2015) and Adebayo and Kolawole (2013 discussed the evolution and current development of principles and practice of entrepreneurship in Nigeria. They found that entrepreneurship can enhance economic growth and development primarily by generating employment and foster the growth of Micro, Small and Medium Enterprises

(MSMEs) in Nigeria. They further stressed that there should be proper policy coordination and policy stability; reforms in the educational curriculum to prepare students for self-reliance; and fixing the power sector-Nigeria's basic infrastructure because 95% of enterprises depend on constant supply of electricity, such that many vibrant Micro, Small and Medium Enterprises (MSMEs) that would aid gainful employment employments among the populace would be created leading further to wealth creation and poverty alleviation.

In view of the high prevailing unemployment rate in Nigeria, this study has therefore aimed at examining the relevance of entrepreneurship education to the development of MSMEs and reduction of unemployment rate in Nigeria.

## RESEARCH METHODOLOGY AND EMPIRICAL DISCUSSIONS

The case study for this research work was the Bank of Industry and Small and Medium Enterprises Development Agency of Nigeria (SMEDAN). The Bank of Industry is the oldest and highest foreign rated development finance institution in Nigeria. Though it is owned by the Federal Government of Nigeria through the Ministry of Finance Incorporated and the Central Bank of Nigeria, it is a limited liability company operating under the provisions of the Company Allied Matters Act, 1990. The Bank's mandate is to promote industrialization and entrepreneurship development by funding easy to access and cheap funds to MSMEs and large enterprises across the nation. On the other hand, SMEDAN is a government agency charged with the provision of entrepreneurship education to existing and potential MSMEs in Nigeria.

Therefore, the population of interest in this study is the MSMEs of 961 respondents of Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and the Bank of Industry (BOI) located in the six geo-political zones of Nigeria.

The research instrument used was a questionnaire, it was designed and copies of it were administered, the copies of questionnaires were collated and data extracted from them. Due to the Ordinal and non-stringent assumptions nature of the data, Non-parametric test of Kruskal-Wallis of K-Independent sample test was used to test the independency of each hypothesis formulated.

## ANALYSIS OF FINDINGS AND INTERPRETATION

Table 1 below shows that 11 respondents representing 1.15 percent and 43 respondents representing 4.48 percent strongly disagreed and disagreed respectively with the view that the Nigerian educational system is relevant to entrepreneurship development of MSMEs in Nigeria. It can be observed that a total number of 68 respondents were undecided as to the relevance of the Nigerian educational system to entrepreneurship development in Nigeria.

**Table 1: Relevance of the Nigerian educational system to entrepreneurship development of MSMEs in Nigeria**

| Relevance of Educational System | Frequency | Valid Percentage | Cumulative Percentage |
|---|---|---|---|
| SD | 11 | 1.15 | 1.15 |
| D | 43 | 4.48 | 5.63 |
| U | 68 | 7.076 | 12.706 |
| A | 409 | 42.56 | 55.27 |
| SA | 430 | 44.72 | 100 |
| Total | 961 | 100 | |

*Source: Field Survey (2016)*
SD = Strongly Disagree, D = Disagree, U = Undecided, A = Agree, SA = Strongly Agree.

However, 409 (42.56per cent) and 430 (44.72per cent) of the respondents believed that the Nigerian educational system is relevant to entrepreneurship development in Nigeria.

**Table 2: Result of Chi-Square Tests from the Kruskal Wallis Test**

| Kruskal Wallis Test | Value | Asymptotic. Sig. (2-sided) |
|---|---|---|
| Chi-Square | 26.908 | 0.00351** |
| N of Valid Cases | 961 | |

*Source: Field Survey (2016)* * 0.05 = Level of significant

Also, testing the assertion formulated that Nigerian educational system has not been contributing towards entrepreneurship development with the P-value of the Pearson chi-square gotten from 3 independent sample Kruskal Wallis test in table 2 above. Since the P-value = 0.00351 estimated from the test-statistic is less than 0.05 (5% level of significant), the decision rule indicated that the proposed assertion that Nigerian educational system have not been contributing towards entrepreneurship development is invalid. The study shows that the Nigerian educational system has contributed positively to the development of entrepreneurship in Nigeria and this is in consonance with the findings of Raposo and Paco (2011) which shows that entrepreneurship education impacts positively and significantly on entrepreneurial activities.

Table 3 below reveals that only three respondents representing 0.31 percent of the respondents and nine respondents representing 0.94 percent of the respondents strongly disagreed and disagreed respectively unsubscribed to the opinion of introducing and enforcing entrepreneurship as a compulsory subject at both secondary school level and as a compulsory course at tertiary level. The undecided was 3.02 percent of the respondents.

**Table 3: Government inclusion of entrepreneurship education in the nation's educational curriculum**

| Inclusion of Entrepreneurship Education | Frequency | Valid Percentage | Cumulative Percentage |
|---|---|---|---|
| SD | 3 | 0.31 | 0.31 |
| D | 9 | 0.94 | 1.25 |
| U | 29 | 3.02 | 4.27 |
| A | 436 | 45.37 | 49.64 |

| | | | |
|---|---|---|---|
| SA | 484 | 50.36 | 100 |
| Total | 961 | 100 | |

*Source: Field Survey (2016)*
SD=Strongly Disagree, D= Disagree, U=Undecided, A=Agree, SA=Strongly Agree.

On the other hand, 436 respondents (45.37 percent) and 484 respondents (50.36 percent) agreed and strongly agreed that government should introduce and also enforce the inclusion of entrepreneurship education into the nation's education curricular from the secondary school level to the tertiary level. This implies that majority of the respondents representing 95.37 percent at least agreed to the introduction and enforcement of entrepreneurship education into the nation's education curriculum.

**Table 4 Result of Chi-Square Tests from the Kruskal Wallis Test**

| Kruskal Wallis Test | Value | Asymptotic. Sig. (2-sided) |
|---|---|---|
| Chi-Square | 33.678 | 0.0021** |
| N of Valid Cases | 961 | |

*Source: Field Survey (2016)* * 0.05= Level of significant

The Kruskal Wallis test of the inclusion or of entrepreneurship education at the secondary school level as against the current practice where it is being taught optionally at the tertiary education level shows a P-value of the Pearson chi-square gotten from the independent sample of 0.0021 is less than 0.05 (5% level of significant) decision rule. This implies that the impact of entrepreneurship education would be more significant if the youths had earlier exposure to it from secondary and all through to their tertiary education.

## CONCLUSION

The study has revealed that the relevance of entrepreneurship education to the development of the nation's MSMEs and creation of employment opportunities cannot be undermined. The study has shown that there is a direct and indirect relationship between entrepreneurship education, development of MSMEs and job creation in Nigeria. The findings agreed with the position of Awogbenle & Iwuamadi (2010) who had persuasively argued that entrepreneurship education is a positive intervention for resolving youth unemployment in Nigeria. The findings in this study is also in line with Alabi et 'al (2014); Oladele et 'al (2011) and Arogundade (2011) submissions that entrepreneurship education is a panacea for sustainable employment in Nigeria. Furthermore, this study observed that the ability to be employed by the MSMES in Nigeria depends to some extent on the entrepreneurship skill acquired.

Finally, the study recommends that the government through the National University Commission (NUC) and in collaboration with the Ministry of Education at the federal and state levels should ensure that entrepreneurship education is made a compulsory subject to be taught, learnt and passed as one of the subjects required to seek and gain admission to higher institutions.

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# A QUALITATIVE ANALYSIS OF THE GLOBAL IFRS ADOPTION. TRUSTEES PERSPECTIVE

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**Abstract**: *In this article we take a closer look to the possible effects of adopting the IAS / IFRS standards around the globe. The need for a common financial reporting language is not a new idea, being developed since the mid '50 by several scholars of the time. In an international global market, the need for a unified vision on how and what to report is supported especially by the activity of multinationals and their impact in the local host countries. In this respect, the International Accounting Standards Board (IASB) which is the authorized body issuing International Financial Reporting Standards (IFRS) is concerned on the impact of adopting the IFRSs worldwide. In order to determine what is the IASB opinion regarding this impact we turned to the concerns of the trustees. Using 3 interviews conducted with three of the trustees of IFRS on the possibility of creating a global accounting language we realized a content analysis of the responses given. The results obtained after auto coding the responses of the trustees in NVivo, a program used in qualitative analysis highlighted that the standards adoption is an important part of the accounting process in multiple countries, the national experiences being significant to the board of trustees in order to make improvements to standards at a global level.*
**Keywords**: *IFRS, Financial information, adoption impact, Europe, Asia*

## INTRODUCTION

The adoption of IFRS represents an example of accounting standardization among countries with different institutional frameworks and enforcement rules. As a result, the main questions addressed by the researchers in the accounting field is whether the new accounting regulations affected the quality of financial information provided by companies and truly increased the convergence of financial reporting. In fact, these two aspects are the main reasons invoked by IASB – the issuer of IAS / IFRS.

In order to have a complete view about IAS / IFRS and what they represent for the financial world nowadays, we are going to present briefly the idea behind the issuance and the widespread of this set of regulations.

The idea of issuing some international accounting standards respected by companies from every country around the globe aroused in the late 1950s as a response to post World War II economic integration. After 20 years, the idea has materialized with the forming of International Accounting Standards Committee (1973), which became International Accounting Standards Board (2001), an independent international standard setter, responsible for the issuance of International Accounting Standards (IASs) in the previous years and, later, of the International Financial Reporting Standards (IFRSs).

Along with the adoption of IAS / IFRS by multiple countries around the world the academic world, especially researchers in accounting and finance, as well as the financial world, the actors from the capital market, have become interested in the influence that the new set of rules has on the quality of financial information (has the content of financial reports improved?). Of course, IFRSs impact shouldn't be analyzed independently but it should be considered in the light of the usefulness of financial information. Practically, an increased quality concerns more users, especially investors from the capital markets.

As a result, the relationship between IFRS and the quality and usefulness of financial information have become a "hot topic" among financial analysts, investors, national regulation bodies, governments etc. from several countries. In what concerns the European Union, the subject became more debated along with the adoption of the European Regulation 1606/2002 which imposed, starting from 2005, IAS / IFRS in all EU countries in order to "increase transparency in financial reporting (European Regulation 1606/2002)". The adoption of IAS / IFRS required by European Regulation 1606/2002 for all listed companies in the European have been pursued in several studies by researchers, and, in the late period, the subject of IFRS adoption has become a study subject for researchers from other countries.

## 1. DEFINING THE CONTEXT OF THE RESEARCH PROBLEM

The impact of IFRS around the globe was addressed in multiple studies, the results of the researchers varying depending on their approach, mainly the methodology used and the data set considered in the analyze.

According to IASB conceptual framework, the purpose of financial reporting consists in "providing information useful to investors, creditors, and others in order to make decision". Because the number of users interested in financial reporting is increasingly high, IASB gives a special attention to the participants in capital market and, more specifically, to investors. This last category is considered to be the most in need for financial information that cannot be requested directly from the companies and, therefore, want access this kind of information. As a result, the research conducted on IAS / IFRS impact has focused on the link between accounting standards and share price and return in order to identify the best accounting policies.

In the last 15 years, a vast literature on the impact of IAS / IFRS has been created, mainly empirical research on the mandatory adoption of IASB regulation within EU countries. A brief systematization of the most significant studied on this subject has been done by Palea (2013) which identified 18 papers with value-relevance on IAS / IFRS adoption.

After analyzing the 18 papers included in Palea's study, we found out that most researchers had addressed some specific aspects of the topic, mainly:

1. The adoption mode, mandatory and / or voluntary;
2. The single or multi country setting;

3. The period taken into consideration was usually before and after the adoption of the IAS / IFRS;
4. The accounting measures varied across studies, the most used being: book value of equity, earnings per share, book value of assets, book value of liabilities;
5. The methodology used included a quantitative approach of data, regression models being applied as well as different comparisons between book-to-market ratio before and after IAS / IFRS adoption.
6. The results obtained cannot allow generalization. From the eighteen studies taken into consideration, eight shows a positive effect of IAS / IFRS, five indicated no difference after the adoption of the new regulation, three revealed mixed evidence, while two stated minor improvements in the quality of financial information after the adoption of IFRS by several countries.

In our opinion the findings of these studies vary because the data used in the sample come from different countries and refer to multiple period of time. Having these aspects in mind, we consider that the results cannot be generalized, not until an exhaustive study is conducted.

As a consequence, *the mixed results from the financial literature regarding the impact of IAS / IFRS adoption on financial reporting within countries consists the main motive of our research*. While we noticed that there are significant differences between the findings of the researchers we considered that a new study which takes into account an approach more qualitative can be useful in finding new opinions and connections between specific concepts of IFRS.

## 2. RESEARCH AIM AND OBJECTIVES

Providing quality financial information, which represents the most important factor in the process of taking decisions with a low degree of uncertainty, is one of the main conditions for the development of an efficient capital market. As IFRSs adoption has focused on improving the capital markets all around the world our study is focusing on determining which are the biggest concerns regarding IFRS adoption.

IASB, the issuer of IFRS, has a hierarchical structure, being ruled by a Board of trustees from several countries all around the world. They are elected to be part of the IASB in a democratic matter their mandate within the body being for a specific period of time (3 years in the early stages of IASB and for 2 years nowadays). Usually, the decisions regarding the issuance of a new standard or the updates of a standard(s) are following a specific process, in which the data retrieved from the countries which adopted the IFRSs is essential. An important role in the process of adoption is held by the trustees who have to support their decision in an argumentative way. Having this in mind we decided that analyzing the point of view of the trustees regarding the IFRS adoption could be a starting point for further research on the impact of IFRS adoption around the globe.

## 3. METHODOLOGY

The methodology used for conducting this study consists in several points. First, we selected the interviews in which 3 trustees have expressed their vision on the impact of IFRS adoption after they were elected in this position inside IASB. The full content of the interviews is presented in the last section of the paper – Appendices. The interviews have been retrieved from the official site of IASB, http://www.ifrs.org/About-us/IFRS-Foundation/Oversight/Trustees/Pages/Trustee-speeches.aspx, the section dedicated to the trustees.

The method used for analyzing the content of the three interviews is the qualitative analysis in which we employed the dedicated software NVivo Plus.

In the first phase of the analyze we copy-pasted the content of the interviews retrieved from the official page of IASB in 3 text documents and then we introduced them as internal sources in the program. Afterwards we ran word frequencies analysis which counted all the words from the three interviews. This analysis became the starting point for coding the content of the interviews. We then used the function autocode in order to determine the codes which can be attributed to specific segments of the code. After determining the codes and their occurrence within the three interviews we used a matrix coding in order to analyze which codes have appeared in the same time in the three interviews analyzed. Based on that, we were able to determine if the trustees have similar opinions regarding certain subjects. In the end we used the same co-occurrence to find out if they are linkages between the codes identified.

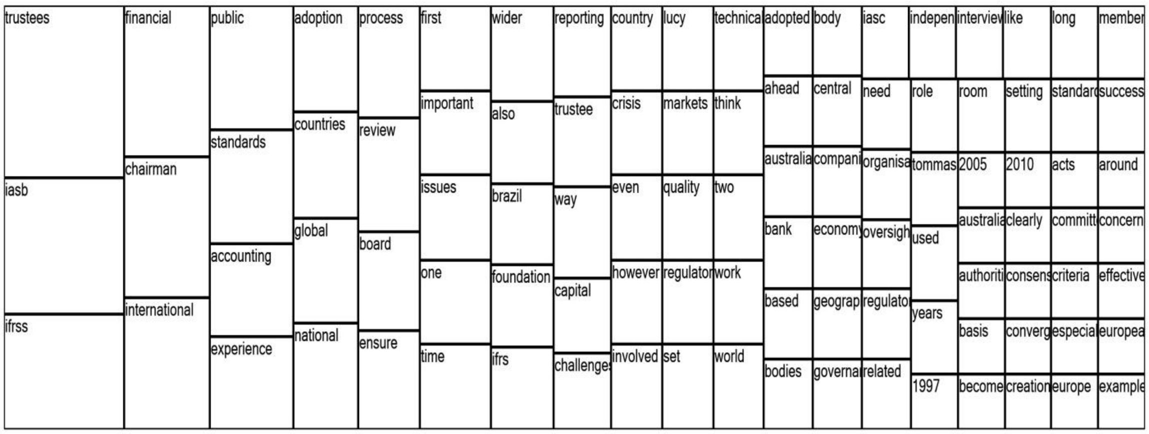
## 4. FINDINGS AND DISCUSSION

In order to illustrate de frequencies of the words encountered in the three interviews analyzed we used the world cloud and tree map view representation from NVivo Plus (Figure 1 and 2).

**Figure 1 World cloud of the most frequent words from the three interviews analyzed**

*Source: author's own processing in NVivo Plus.*

**Figure 2 Tree map view of the most frequent words from the three interviews analyzed**




*Source: author's own processing in NVivo Plus*

According to the summary of the frequencies on which Figure 1 and 2 are based the most words used in the three interviews were: trustees (24 counts), IASB (19 counts), IFRSs (16 counts), financial (15 counts), chairman (14 counts), international (13 counts), public (12 counts), standards (11 counts), accounting (9 counts) and experience (9 counts).

Although the count of the frequencies of the words from the interviews has helped us to identify the most important concepts from the three texts hasn't been very useful in identifying the codes which could be extracted. To solve this matter, we resorted to the auto code function of the NVivo program which has been really helpful in identifying codes in context.

The results obtained, which are highlighted in Table 1 illustrate a total of 33 codes identified in the three interviews conducted.

From this total, 22 codes have been identified in the interview number 1 with Pedro Malan, the Chairman of Brazil, 19 codes in interview number 2 with Tommaso Padoa-Schioppa, the Chairman of Italy, and 13 codes in interview number 3 with Jeff Lucy, the Chairman of Australia.

In order to determine which codes appear in the same time in all three interviews conducted we used a co-occurrence function, the results obtained being highlighted in Table 2.

***Table 1.*** **Codes obtained for the most important concepts**

| | A : Internals\\1st interview | B : Internals\\2nd interview | C : Internals\\3rd interview |
|---|---|---|---|
| 1 : accounting | 1 | 1 | 1 |
| 2 : accounting standards | 0 | 1 | 0 |
| 3 : adoption | 0 | 0 | 1 |
| 4 : body | 1 | 1 | 1 |
| 5 : brand name | 1 | 0 | 0 |
| 6 : chairman | 1 | 0 | 1 |
| 7 : channels | 1 | 0 | 0 |
| 8 : companies | 0 | 1 | 0 |
| 9 : effective | 1 | 0 | 1 |
| 10 : financial reporting standards | 1 | 0 | 0 |
| 11 : functioning | 1 | 0 | 0 |
| 12 : global accounting language | 1 | 0 | 0 |
| 13 : groups | 1 | 0 | 1 |
| 14 : international regulator | 0 | 0 | 1 |
| 15 : issues | 1 | 1 | 1 |
| 16 : market | 1 | 1 | 1 |
| 17 : method | 0 | 1 | 0 |
| 18 : official | 0 | 1 | 0 |
| 19 : organisation | 1 | 1 | 0 |
| 20 : oversight | 1 | 1 | 0 |
| 21 : personalities | 1 | 0 | 0 |
| 22 : process | 1 | 1 | 1 |
| 23 : public authorities | 0 | 1 | 0 |
| 24 : quality | 1 | 1 | 0 |
| 25 : regulator | 1 | 1 | 1 |
| 26 : representation | 1 | 0 | 0 |
| 27 : responsibilities | 1 | 0 | 1 |
| 28 : roles | 0 | 1 | 0 |
| 29 : set | 1 | 0 | 0 |
| 30 : stability | 0 | 1 | 0 |
| 31 : standards | 1 | 1 | 0 |
| 32 : term | 0 | 1 | 1 |
| 33 : tradition | 0 | 1 | 0 |
| Total | 22 | 19 | 13 |

Source: author's own processing in NVivo Plus.

**Table 2. Codes encountered in all 3 interviews**

| | A : Internals\\1st interview | B : Internals\\2nd interview | C : Internals\\3rd interview |
|---|---|---|---|
| 1 : accounting | 1 | 1 | 1 |

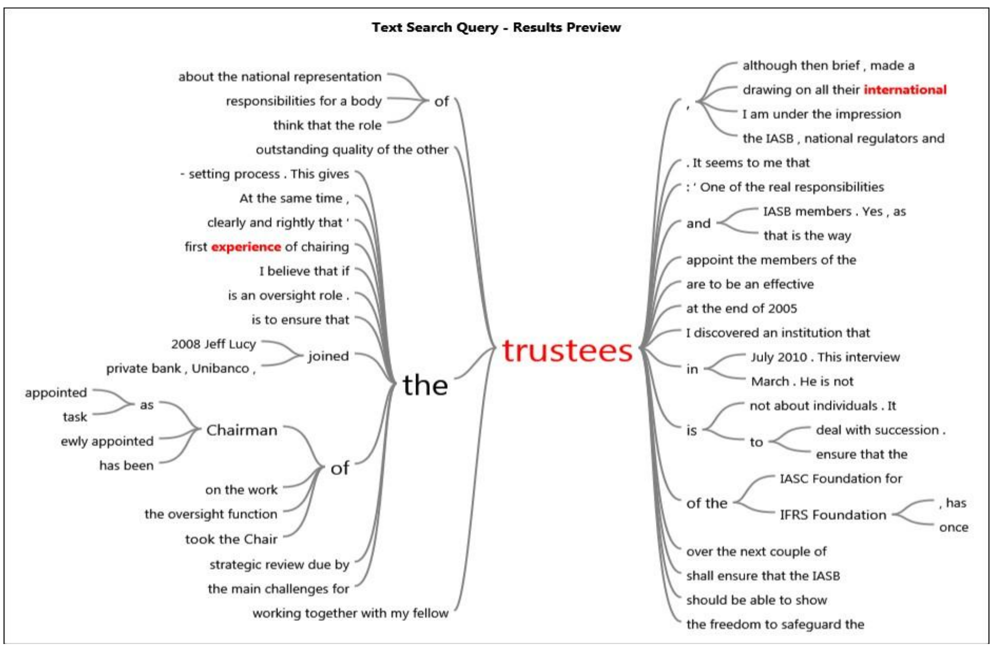
| | | | |
|---|---|---|---|
| 4 : body | 1 | 1 | 1 |
| 15 : issues | 1 | 1 | 1 |
| 16 : market | 1 | 1 | 1 |
| 22 : process | 1 | 1 | 1 |
| 25 : regulator | 1 | 1 | 1 |

*Source: author's own processing in NVivo Plus.*

According to data from Table 2 we notice that there are only 6 codes which appear in the same time in the three interviews and they address questions regarding: accounting, body (as in IFRS), issues (related to IFRS), market (regulation), process (of adopting IFRSS) and regulator (with reference to IASB as a regulator body).

Further we took a closer look to some terms where particular terms occur in content. We selected the words from those which had the biggest frequency of occurrence which were highlighted before (trustees (24 counts), IASB (19 counts), IFRSs (16 counts), financial (15 counts), chairman (14 counts), international (13 counts), public (12 counts), standards (11 counts), accounting (9 counts) and experience (9 counts)).

**Figure 3 Occurrence of the most frequent words in context**

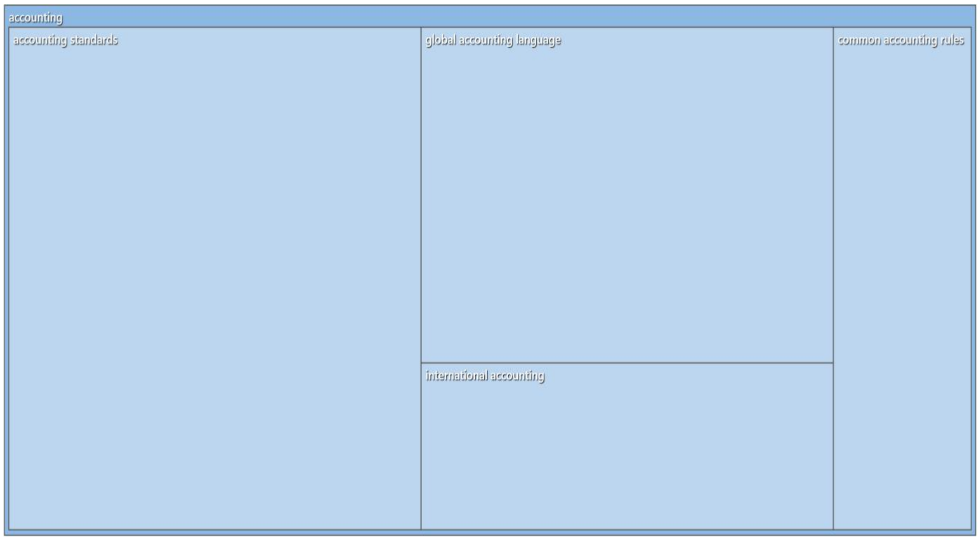



*Source: author's own processing in NVivo Plus.*

The 10 words were cited in 142 places in the texts, their frequency being: 40 counts in the 1st interview, 79 counts in the 2nd interview and 23 counts in the 3rd interview.

Although using co-occurrence is very helpful in identifying the linkages between words grouping certain codes which refer to a specific issue is more appropriate if we take into consideration the number of coding documents.
In the next figures, we illustrated the grouping of several concepts.

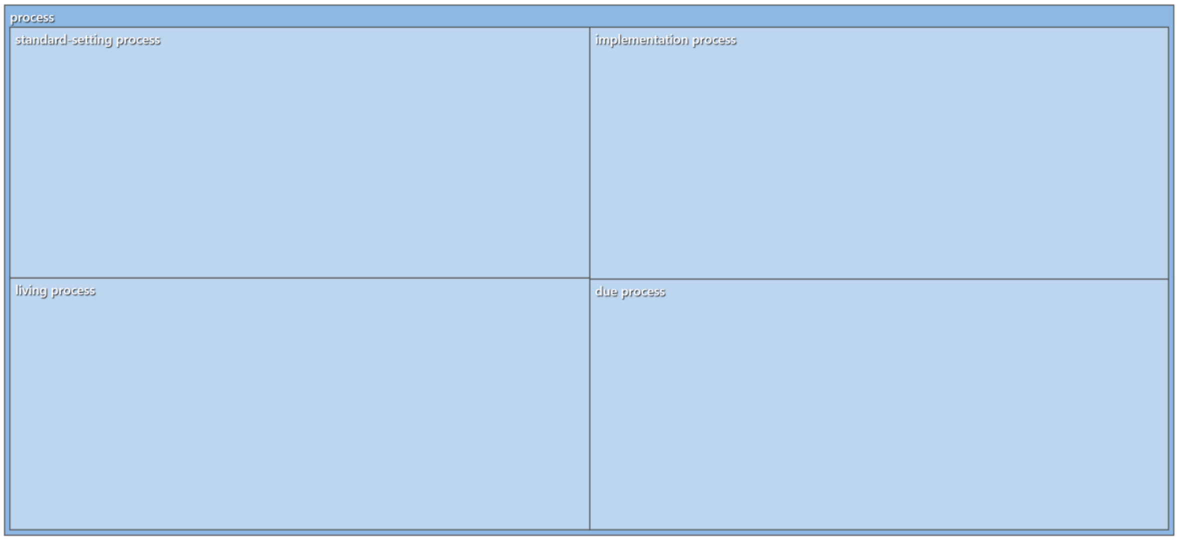
**Figure 4 Nodes compared by number of coding documents for accounting**




*Source: author's own processing in NVivo Plus.*

As we can see from Figure 4 when referring to accounting there are several concepts includes as: accounting standards, global accounting language, international accounting and common accounting rules.

**Figure 5 Nodes compared by number of coding documents for accounting**




*Source: author's own processing in NVivo Plus.*

If we refer to the code "process" we can see that we can have in mind the standard setting process, the implementation process, the due process or the living process. Applying grouping we can find useful linkages between the codes which refer to the same issue.

The analysis conducted can be deepened on higher levels, although this wasn't the purpose of our study. From a global perspective we can say that, based on the analysis conducted, all of the 3 trustees of IFRS have expressed the same concerns regarding IFRS adoption. What does that mean? There is no place for nationalism when developing International Reporting Standards.

## 5. RESEARCH LIMITATIONS AND FURTHER PERSPECTIVES

The research conducted has some limitations. The theme of IFRS adoption impact is very vast and we couldn't take into consideration all the issues addressed in this matter. The number of the interviews analyzed isn't that high so we can't sustain generalization based on just three interviews with the trustee of IASB. Another limitation is due to our experience in using the NVivo Plus program in order to analyze the data. We appreciate that the use of this software has eased our work and we feel strong about using it in the future for further analysis. More than that, we believe that an improvement in our work with the program will help us in conducting more in-depth analysis on the field of IFRS adoption.

In the end, we appreciate that our current findings and future research using qualitative analysis can be useful to formulate some hypothesis for conducting quantitative analysis in our doctoral research.

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# RESEARCH METHODS USED IN STUDIES ON MANAGEMENT AND INTERNATIONAL AFFAIRS

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**Abstract:** *The purpose of this study is to determine what research methods were used in studies on management and international affairs by querying databases. In order to conduct this study, we have chosen the method of documentary research, selecting publications of the past five years. While quantitative methods and qualitative methods come with their own disadvantages, using mixed methods and multiple data sources can result in findings that are both valid and reliable. We have found that this type of study, focusing on the research methods used in management and international affairs, is a relatively rare occurrence. This type of study is useful to researchers, students and professors who are interested in the research methods used in the fields of management and international affairs.*
**Keywords:** *mixed methods, management, international affairs, quantitative analysis, and qualitative research.*

## INTRODUCTION

The quantitative analyses of data by analyzing time series, polls etc. can complement, extend and triangulate qualitative methods in a very efficient manner. Thus, the field of international affairs has long benefitted from qualitative methods (Wilkins, 1970, 1974). Qualitative methods are used to determine the plausibility of quantitative research (Cahill, 1996), while qualitative data focus on ordinary incidents that happen naturally, so that we may have a clear image of what real life means, such data being collected in close proximity to a specific situation (Miles and Huberman, 1994).

This is precisely why the quantitative methods in the field of management fail to put variables into context, leaving out human and social qualities, whereas qualitative research is more suited to the study of information needs in the wider context of human environments and situations (Gummesson, 2006).

In contrast, mixed methods are an excellent way towards obtaining exhaustive, useful, balanced and informative results (Skoko et. al, 2011, pp.290), having a long history and tradition both in social sciences (Creswell, 2009; Jick, 1979; Johnson et. al, 2007) and in management and business research.

Mixed methods are used in research because they offer new perspectives and help towards a better understating of the phenomena surveyed (Skoko et. al, 2011, p 290), so the mixed methods research is mentioned in the specialized literature under various designations: triangulation, mixed research, convergent methodology, integrating research, convergent validation (Denzin, 1978; Jick, 1979 and Johnson et. al, 2007).

Qualitative research is needed in the field of international affairs, as well as in the field of management, primarily because it provides a series of rich and in-depth descriptions of actual phenomena and action situations, thus stimulating deep thinking. Another reason is that if offers the opportunity of discovering several phenomena that are worthy of investigation. However, we should not lose sight of the fact that, once we embark on a qualitative study, we must extend our research practices beyond data collection methods, in such a way as to be able to conceptualize and apply complex methodological frameworks within our research design (Kaczynski et. al, 2014).

Furthermore, with regard solely to the field of international affairs, qualitative research grasps a series of particularities of international affairs that quantitative research cannot capture satisfyingly, such as the differences between countries' cultural and institutional environments, which are difficult to measure quantitatively. Qualitative research methods can also help towards smoothing out the contextual dimension in the field of international affairs, as in the case of the differences between countries (Cheng, 2007).

Going even further, we may say that the qualitative research method is used with the aim of formulating research questions and of generating a wave of fresh ideas (Oesterle, et. al, 2011, pp.747 apud Siggelkow, 2007).

Considering these reasons, we have undertaken to find out what research methods are predominant in the studies on management and international affairs in the past period.

## DISCUSSIONS

The purpose of this study is to determine what research methods were used in studies on management and international affairs by querying databases.

In order to conduct this study, we have chosen the method of documentary research, selecting publications of the past five years. We have resorted to the technique of external sources, namely databases. For an overview of the research methods used for both fields in the period 2011-2016, the query returned a number of 1,316,099 results for the keyword "research methods management" and 296,743 results for the keyword "research methods international affairs."

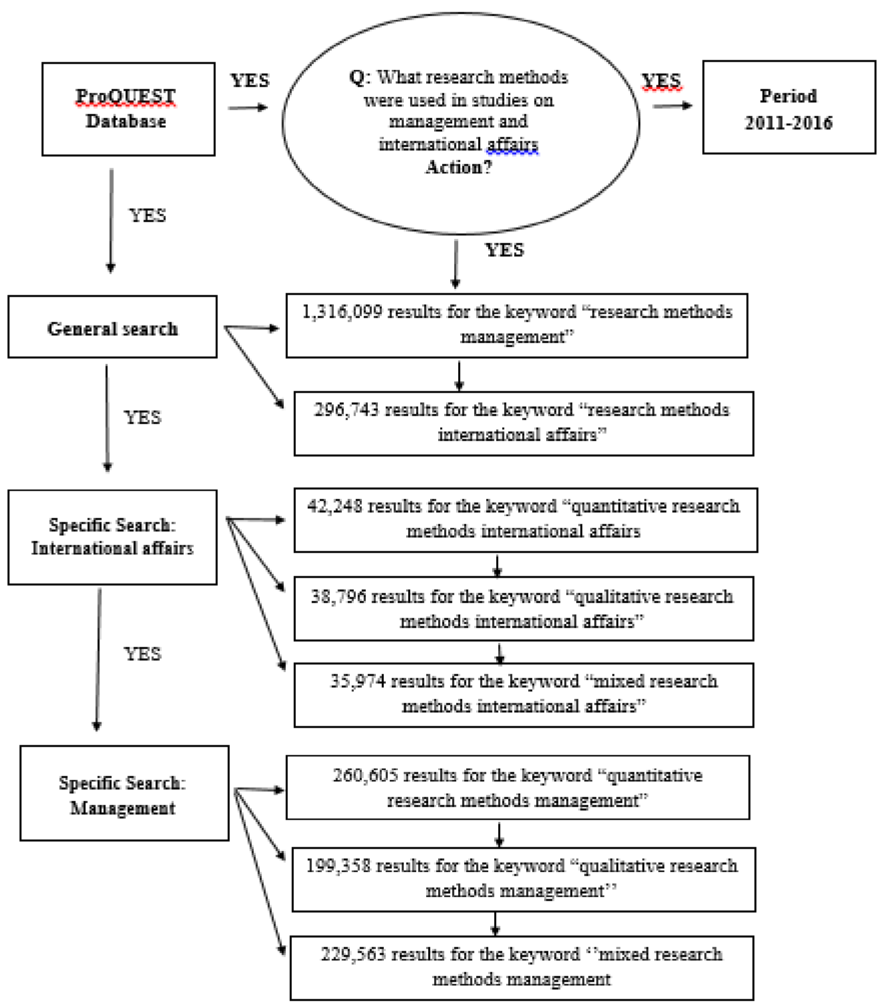
Following the query of the databases, we sought to learn how many results the keywords used would generate for either of the two fields – management and international affairs, respectively – if they were to be further refined into quantitative, qualitative and mixed methods research. Thus, we wanted to observe the positive or negative trends of such research methods.

Therefore, for a clearer perspective on the research methods used in international business, the query of the databases from the period 2011-2016 returned 42,248 results for the keyword "quantitative research methods international affairs," 38,796 results for the keyword "qualitative research methods international affairs" and 35,974 results for the keyword "mixed research methods international affairs."

For the management field, the query of the databases from the same period revealed the following findings: for quantitative research, we used the keyword "quantitative research methods management", which returned 260,605 results; the keyword "qualitative research methods management" returned 199,358 results, while the keyword "mixed research methods management" returned 229,563 results.

For a much clearer visualization of these results, we compiled a synthesis of the results obtained by querying databases in the fields of management and international affairs (see figure no.1).

**Figure no. 1 Synthesis of the results obtained by querying databases in the fields of management and international affairs.**




*Source: Authors.*

Thus, we have selected two studies that reinforce, in our opinion, the results presented. One of them is a study on the research methods used by PhD students conducted by Peter John Miller and Roslyn Cameron (2011) at Southern Cross University, Australia, in the Doctor of Business Administration (DBA) program, 1996-2007 period. The study focused on investigating the methods used by DBA students. Their doctoral dissertations were analyzed and coded into the following categories: purely quantitative, purely qualitative, and mixed with qualitative dominance, mixed with quantitative dominance, mixed with a balance between the qualitative and the quantitative approach. The authors of the study reached the following results: dissertations that used a purely quantitative approach accounted for 31.7% of the total, the ones with a purely qualitative approach accounted for 28.7%, the ones with a mixed approach and a qualitative dominance accounted for 39.6%, the ones with a mixed approach and a quantitative dominance accounted for 10.2% and the ones with a mixed approach and a balance between the qualitative and the quantitative methods accounted for 13.8%. Furthermore, the DBA students explicitly used the triangulation method, which was present in 11.3% of the dissertations. Using triangulation in data collection increases data validity. According to Neuman, triangulation means analyzing a phenomenon from several angles.

The research methods that the DBA students use the most are: the poll, the interview and the case study. Their projects used various methodologies ranging from the theory of economic growth to action research to ethnography and post-structuralism.

The other work that we wish to cite is that by Molina et. al (2014) who made a synthesis of six studies that investigated the research methods used in writing articles in various fields. In the 394 international affairs articles that were analyzed, the distribution of the research methods was as follows: 266 used quantitative methods (68%), 57 used qualitative methods (15%) and 68 used mixed methods (17%).

**CONCLUSIONS**

It is apparent that much more qualitative, quantitative and mixed studies are used in the field of management than in the field of international affairs. This is partly due to the fact that management includes a wider array of subfields, such as human resources management, operations management, strategic management, organizational behaviour and entrepreneurship.

After querying the ProQuest databases using the Anelis software, we found that, in both fields – management and international affairs –, quantitative research is favoured over quantitative and mixed methods research, because it fosters the impression of producing exact results that are comparable to those from physical sciences.

According to the query of the databases, qualitative research methods are the second most preferred by researchers, because they lead to an increase in the originality of the results generated both in the field of international affairs and in the field of management.

The mixed methods research scores the lowest, because, according to a 2014 study entitled Mixed Methods Research: A New Approach, the researcher found that these methods pose various challenges. First of all, there are difficulties in securing the necessary time, money and labour. Another challenge resides in the access to tools and software for storing and rearranging the data, which, in mixed methods research, comes in a vast amount. Nevertheless, "mixed methods research is beginning to become part of the research structure both in the field of business" (Miller et. al, 2011, pp.387, apud Miller and Marchant, 2009) and in management. This is especially true because mixed methods research involves both the philosophical hypotheses part, which concerns data guidance, collection and analysis, and the mixing of qualitative and quantitative data in one study (Johnson et. al, 2007 and Molina, 2014, pp.15), thus providing a better understanding of the research issues compared to the separate use of these methods (Molina, 2014, pp.15).

In closing, we can say that, in any research endeavour, choosing the right methodology is vital in ensuring the validity and the reliability of the results (Qazi et. al, 2015). While quantitative methods and qualitative methods come with their own disadvantages, using mixed methods and multiple data sources can result in findings that are both valid and reliable.

The main limitation of this study lies in that our analysis was conducted exclusively on the management and international affairs fields. We propose that future studies focus on other economic fields such as: accounting, finance, marketing, computational economics and statistics, which should be used to run a comparative analysis between fields and to determine the usage trends for research methods in these fields.

We have found that this type of study, focusing on the research methods used in management and international affairs, is a relatively rare occurrence.

This type of study is useful to researchers, students and professors who are interested in the research methods used in the fields of management and international affairs.

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# IMPACT OF BANK REFORM ON THE QUALITY OF FINANCIAL STATEMENT OF SELECTED NIGERIAN BANKS

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**Abstract**: *The formulation and implementation of policies and reforms by government that will satisfy the conflicting interests of all and sundry will virtually result in an utopian state of nature. Therefore, this study believes that the 2005 reform in the Nigerian banking sector should not have been an exception. This study assessed the impact of the reform on the quality of financial position of the post-2005 banks. Accounting ratios were computed from the secondary data obtained from the 2006–2012 annual reports issued by four (4) judgmentally sampled banks. Correlation and regression analysis were carried out on the data. Results indicated that the post consolidation interest of the stakeholders (shareholders, employees, business contacts, depositors and government) are conflicting; and that all stakeholder interests, except that of the shareholders, have a positive relationship with the employee interest. It is therefore recommended that the management of the banks should mediate carefully among the stakeholders in the allocation of the banks funds to achieve maximization of their firms'* value.
**Keywords**: *Reforms, Financial Statement, Banking Sector, Shareholders*

## INTRODUCTION

Financial markets play a key role in the mobilization and allocation of savings for production, provision of structures for monetary management, and serve as the basis for managing liquidity in the economy. The movement of such funds with medium term and long term maturity is engineered through the capital market while the short term funds are mobilized in the money market (Ikechukwu, 2013). In Nigeria, the platform on which the capital market participants meet is the Nigerian Stock Exchange while the money market participants transact through banks and non-bank institutions.

The Central Bank of Nigeria (CBN) was established in 1958 to oversee and regulate the banking sector, among other statutory functions required of it by the CBN Act of 1958 (Adekunle & Asaolu, 2013). Since then, several reforms have taken place in the bid to uphold customers' confidence in the Nigerian banking sector, and sustain the financial strength of the Nigerian economy (Abdullahi, 2007). One of such recent reforms is the recapitalization exercise of 2005 that required ₦25 billion from all commercial banks in Nigeria.

Since then (2005), the effect of the reform on the Nigerian economy became a theme of interest to the academia and an appreciable number of studies, some of which are reviewed in the Section two of this study, have been carried out. However, this study believes that there is a gap in literature on how the 2005 bank reform has affected the interest of stakeholders in the Nigerian banking industry. The tenet of the stakeholder theory is that the value of a firm is maximized when the interests of all those that affect and are affected in the running of the firm (stakeholders) are given due attention when making corporate decisions. But this notion has been severely criticized in the literature on the ground that is does not produce the envisaged maximum value for the firm. In addition to this, it has also been argued that since the interests of the stakeholders are usually conflicting, it is impossible for a firm to pursue more than one corporate objective at a time. Thus, given the magnitude of the change in the scale of operation in the Nigerian banking industry that was brought about by the 2005 bank reform, this study sought to investigate interactions among the stakeholders' interest in the post 2005 bank reform in the Nigerian banking industry.

## Statement of Problem

The stakeholders in the Nigerian banking sector include regulators, employees, shareholders, depositors, loan and advance seekers, business contacts, government and the general public. The recapitalization exercise resulted in the reduction of the eighty-nine (89) operational banks to twenty-five (25) in 2005 while only twenty-one (21) deposit money banks are operational as at October, 2014. Despite the good side that was promised by the recapitalization exercise, there also exist the possibility of negative effects like that of some employees that lost their jobs; thus suggesting that all stakeholders might not have been affected by the recapitalization exercise in a similar fashion. It therefore becomes imperative to assess how various stakeholder groups have been affected by the recapitalization exercise; lest the negative experience of a minority segment of the bank stakeholders are submerged by the overwhelming applaud of the exercise as a result of the positive experience of the vast majority.

## Research Questions

Based on the research problem, the following research question is raised for the purpose of this study:

What is the nature of relationships that exists among bank stakeholders' interest in the post-consolidation era?

How has the interest of other stakeholder groups affected the employee group?

## Objectives of the Study

The main objective of this study is to assess the impact of bank reform on the quality of financial position on Nigerian banks. The specific objective is to:

determine the nature of relationships that exists among bank stakeholders' interest in the post-consolidation era; and

assess the effect of other stakeholder interests on the employee group.

**Research Hypotheses**

The following hypotheses are formulated and stated in the null form for the purpose of this study:

$Ho_1$: There is no significant relationship among the bank stakeholders' interest in the post-consolidation era.

$Ho_2$: The banks employees' interest is not significantly affected by other stakeholders' interest in the post-consolidation era.

**Justification for the Study**

According to Clementina and Isu (2013), the history of banking in Nigeria reveals that the CBN has had reasons to increase the capital base of Nigerian banks since 1980s; from ten million naira minimum paid up capital in 1988 to two billion naira in 2002 and, then, twenty-five billion naira in 2005. Past literatures identified various reasons for bank reforms. Kehinde and Adejuwon (2011) opined that the series of reforms in the banking and financial sectors were geared towards positioning banks and other financial institutions to play their primary and very crucial role of financial intermediation in the economy as the driving force for generating high savings and investment. However, noting that banking sector reforms have come into play due to banks inability to meet up to required obligations or satisfy their stakeholders which overtime has led to series of bank failure and crises, Olokoyo (2013) posits that bank reforms are not embarked upon only to forestall banking crises or cushion the effects of a recent crises, but banking reforms also occur independent of bank crises.

Studies are usually conducted into the effect of bank reforms on the performance of banks and the 2005 Nigerian bank reform has not been an exception. Prior studies include Abdullahi (2007) that assessed the challenges and prospects of banking sector reforms and bank consolidation in Nigeria, Gunu and Olabisi (2011) that evaluated the performance of consolidated banks in Nigeria using non-financial measures, Mogboyin, Asaolu and Ajilore (2012) that analysed bank consolidation programme and lending performance, and Sakariyahu, Jimoh and Bamigbade (2014) assessment of the post consolidation performance on the Nigerian banking sector. However, Sakariyahu *et.al.* (2014) recommended, based on the findings of their study that subsequent research work should examine how the relevant stakeholders in the Nigerian banking sector have benefited from the recapitalization exercise of 2005. This is furtherance to the argument for the possibility of a small-size stakeholder-groups' interest being submerged by the overwhelming gains made by dominant stakeholder groups within the Nigerian banking sector. Thus, this study fills a gap in literature by using the stakeholder approach to assess the impact of the 2005 bank reform on the Nigerian banking sector. About nine years post-2005 reform, a study like this is worthwhile because it allows a meaningful post consolidation analysis to be made compared to studies that made use of short(er) post consolidation data.

**1.7 Scope of the Study**

This study focuses on the impact of post 2005 bank reform on the employee stakeholder-group in the Nigerian banking sector. This is because the researcher believes that most prior studies have concentrated more on impact of bank reforms on the performance of banks from the angle of profitability. This suggests a preference in research in favour of the shareholders' wealth maximization objective of the firm. Thus, the study adopts the stakeholder perspective to contribute to literature on the effect of bank reforms on the Nigerian banking industry. The study spans from 2006 (the first year post consolidation) to 2012 (the last year for which the audited annual report of sampled banks was accessible). Thus, this study covers seven (7) years post-2005 reform periods.

## LITERATURE REVIEW

This section reviews the previous work that related to the study. It is divided into three sections. The first section reviews the relevant concepts relating to the study, the second section provides the theoretical framework on which this study rests, while the third section reviews the empirical studies that are related to the study.

### Financial Statement

Section 331 of the Companies and Allied Matters Act (CAMA), Cap C20 LFN 2004 states that:

- every company shall cause accounting records to be kept
- the accounting records shall be sufficient to show and explain the transactions of the company and shall be such as to:
- disclose with reasonable accuracy, at anytime, the financial position of the company; and
- enable the Directors to ensure that financial statements prepared comply with the requirements of the Act with regard to form and content.
- the accounting records shall, in particular, contain:
- entries from day-to-day of all sums of money received and expended by the company, and the matters in respect of which the receipts and expenditure take place, and
- a record of assets and liabilities of the company

It the business of the company involves dealing in goods, the accounting records shall contain:

- statements of stock held by the company at the end of each accounting year of the company;
- all statements of stock takings from which any such statement of stock has been or is to be prepared; and
- except in the case of goods sold by way of ordinary retail trade, statement of all goods sold and purchased, showing the goods and the buyers and sellers in sufficient detail to enable all these to be identified

Section 334 of CAMA further states that:

In the case of every company, the directors shall in respect of each year of the company, prepare financial statements for the year.

The financial statements required shall include:

- Statement of accounting policies;
- The balance sheet as at the last day of the company's financial year
- A profit or loss account or, in the case of a company not trading for profit, an income and expenditure account for the year;
- Notes to the accounts
- The auditors' report
- The directors' report
- The audit committee's report
- Cash flow statement
- A valued-added statement for the year
- A five-year financial summary; and
- In the case of a holding company, the group financial statement

The financial statements of a private company need not include the matters stated in (i), (vii), (viii), and (ix) in sub-section (b) above

**The Nigerian Bank**

There has been a wave of restructuring and consolidation of the banking sector around the globe, particularly in the developed and the emerging market economies. This has been driven mainly by globalization, structural and technological changes, as well as the integration of financial markets. Banking sector consolidation has become prominent in most of the emerging markets, as financial institutions strive to become more competitive and resilient to shocks. It is also promoted by the desire to reposition corporate operations to cope with the challenges of an increasingly globalized banking system. It was based on the above premise that banking sector consolidation, through mergers and acquisitions, was embarked upon in Nigeria from 2004.

According to Anyanwu (2010), following the banking sector consolidation, notable achievements were recorded in the financial sector among which was the emergence of 25 well capitalized banks from the former 89 banks. The banks raised N406.4 billion from the capital market. In addition, the process attracted foreign capital inflow of US$652 million and £162,000 pound sterling. The liquidity engendered by the inflow of funds into the banks induced interest rate to fall significantly, while an unprecedented 30.8 per cent increase was recorded in lending to the real sector in 2005.

**Bank Reform**

Lemo (2005) opined that reforms are designed to enable the banking system develop the required resilience to support the economic development of the nation by efficiently performing its functions as the fulcrum of financial intermediation. According to Kolawole (2006) as cited in Abdulraheem (2007), reform implies improvement on the prevailing state of affairs usually brought about by series of policy-driven actions geared towards eliminating waste and attaining efficiency. Also, Kehinde and Adejuwon (2011) stated that financial sector reforms seek to develop an efficient framework for monetary management. The study also noted that "this encompasses efforts to strengthen operational capacities of the banking system, foster efficiency in the money and securities markets, overhaul the payments system, and ensure greater autonomy to the central bank in formulating and implementing macroeconomic policies" (Kehinde & Adejuwon, 2011, p.329).

Olokoyo (2013) commented that most of the bank reforms are necessitated by the need to respond to banking crisis. The author noted that a banking crisis can be triggered by weakness in banking system characterized by persistent illiquidity, insolvency, undercapitalization, high level of non-performing loans and weak corporate governance, and if these happen, it becomes difficult for banks to meet its financial obligation to stakeholders. However, the study also noted that bank reforms are also implemented when there are no crises. If this happens to be the case, then the reform is aimed at ensuring a diversified, strong and reliable banking industry where there is safety of depositors' money and positions banks to play active developmental roles.

## THEORETICAL FRAMEWORK

### Stakeholder Theory

This study is hinged on the stakeholder theory. In the mid-1980, a stakeholder approach to strategy came up. One of the focal points in this movement was the publication of Richard Edward Freeman in his 1984 work and he is widely referred to as the "father of the stakeholder concept". The traditional definition of a stakeholder is "any group or individual who can affect or is affected by the achievement of the organization's objective" (Freeman, 1984). In Freeman (2004) stakeholders were defined as "those group who are vital to the survival and success of the corporation". It propagates that the best way to maximize the shareholders wealth by the corporate managers is to ensure that the interest of other stakeholders is considered. If this is done, apart from maximizing the shareholders wealth, it increases the total value added and thus, makes commercial sense.
Bank reform like any other government policy affects people in different fashions. Even when the vast majority applaud a policy as having a positive influence on them, there are usually a few groups that pay the price of change. Thus, this study seeks to investigate the relationship between the interests of the various stakeholders in the Nigerian banking sector post 2005 bank reform in order to gain insight into the possibility of a preference of banks to satisfy a particular stakeholder interest.

## EMPIRICAL EVIDENCE

Whenever there in bank reform, research is usually conducted on the impact of the reform of economic variables. For example, Fu and Heffernan (2009) investigated the relationship between market structure and performance in China's banking system from 1985 to 2002 (a period which was subjected to gradual but notable reform). Panel data estimation technique was used to test market-power and efficient structure hypotheses. It was found that the reforms has little of no impact on the structure of China's banking sector, though the joint stock banks became relatively more X-efficient. However, Andries, Apetri and Cocris (2012) analyzed the impact of the banking system reform in five (5) states in Central and Eastern Europe on the performance of registered banks between 2001 and 2008. The results of the analysis showed that during the analysed period, both the financial reform index and the banking reform index have a positive impact on the bank performance indexes.

Empirical evidence from previous studies on bank reforms in Nigeria mostly suggests that the benefits envisaged from the bank reforms were actually achieved. These studies include the Onikoye (2012) study that employed ratio technique and inferential statistics tools to evaluate the impact of mergers and acquisitions on the performance of banks in Nigeria. Pre-merger and post merger financial statements of two consolidated banks were obtained and the result revealed that all the two groups produced additional operational and relational synergy with financial gains far more than the 2+2 = 5 synergistic effects. Narrowing in to the effect of bank consolidation programme on the lending performance in Nigerian banking system, Mogboyin, Asaolu and Ajilore (2012) utilized cross-sectional data sourced from the 89 pre-consolidation banks and the 25 post consolidation banks in Nigeria and the Engle-Granger approach to error correction estimating techniques on a model for bank credit performance. The results from the panel data analysis provided evidence that consolidated-induced changes in banks structure in terms of size and capitalization positively influence bank lending performance in the Nigerian banking industry. Clementina and Isu (2013) also examined the effects of capital structure of banks on the performance of commercial banks in Nigeria using data from 1970 to 2010. The result from ordinary least square regression showed a long run positive relationship between capitalization and profitability. The result of Granger Causality also indicated a significant relationship between capitalization and profitability is bi-directional, implying that increase in capital leads to increase in profitability and vice versa.

However, despite the plethora of empirical evidence available to support the positive impact of the capitalization on the performance of the Nigerian banking industry, Sakariyahu, Jimoh and Bamigbade. (2014) suggested, based on empirical analysis, that research into how the various stakeholders in the Nigerian banking industry are affected by bank reforms is pertinent to avoid a situation where the overwhelming majority subdues the negative effect of the reform on infinitesimal stakeholders group(s). To this end, this study assesses the impact of the 2005 bank consolidation on the employee stakeholder group viz-a-viz the relationship between their interest and other stakeholders' interest post 2005 in the Nigerian banking industry.

### Contribution to Knowledge

This study contributes to the body of existing knowledge in understanding the possibility of satisfying multiple stakeholder objectives in the bid to maximize the value of the firm. Findings from this study provides insight into the relationship between the satisfaction of different stakeholder interests within the Nigerian banking industry in the post 2005 bank reform era. It makes it possible to answer questions such as: will the interest of a stakeholder group be possible to get satisfied without being at the expense of one or more other stakeholder interest(s).

## METHODOLOGY

### Model Specification

Based on the variable measurement set out in Section 3.2, the multiple regression model for this study is specified thus:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon \qquad \ldots\ldots\ldots.\ equation\ 1$$

Where: $Y = E_{ij}$; $\alpha$ = y-intercept; $X_1 = S_{ij}$; $X_2 = BC_{ij}$; $X_3 = G_{ij}$; $X_4 = D_{ij}$; and $\varepsilon$ = stochastic error term.

**Variable Measurement**

This study modeled the relationship between six (6) stakeholder groups in the Nigerian banking industry. These groups are:

- The employee group (E)

This group is made up of all the human resources that is used by the banks in creating values. As a consideration for the services rendered to the bank, they become entitled to both financial and nonfinancial employment benefits. These employee benefits are generally represented in the financial statements as staff costs. Therefore, the extent to which their interest is catered for can be measured through the proportion of the total earnings that is paid in any financial year as staff cost.

- Depositor group (D)

These are individuals and corporations that keep their surplus funds in banks' custody. A major interest of this group is the extent to which their funds are safe and will be made available on demand when they need to make withdrawals.

- Shareholder group (S)

These are the providers of the finance for running the banks. They are the owners of the banks. Their interest covers issues relating to dividend payments and safety of their investments. They are the risk takers in the banks' business ventures.

- Business contact group (B)

This group is typically made up of the renders ancillary services to the banks to make the operations flow. Their interest in the banks is the prompt payment of their bills. Their interest is usually captured in management expenses in the financial statements of banks.

- Government (G)

The major interest of the government in the banks is captured in the tax expenses incurred by the banks during any financial year. Thus, it will be in the interest of the government for the banks to generate more revenue at reduced (staff and overhead) costs so that the tax liability of the banks will be high.

- Loan and advances seeker group (L)

This group is made up of various categories of loan and advances seekers. They have deficient funds and seek the banks' intermediation function to assess the surplus funds that have been provided by both the shareholders and the depositors.

For the purpose of this study, the following financial statement ratios were used to proxy the interest of the stakeholders.

**Dependent Variable**

This study assesses the relationship between the interest of bank employees in the Nigerian banking industry and those of other stakeholders in the post 2005 banking reform. Thus the dependent variable is employee interest (Eij). The proxy adopted for this variable is the percentage of Staff Cost ($SC_{ij}$) to Gross Earnings ($GE_{ij}$) in a year (i) by a bank (j). Thus,

$$E_{ij} = \frac{SC_{ij}}{GE_{ij}} \times 100\% \qquad \ldots\ldots\ldots.equation\ 2$$

This is considered adequate as empirical evidence has supported capitalization to affect profitability and invariably, Gross Earnings. Thus as a priori, the employees are expected to seek a maximum portion of the Gross earnings as employee remuneration.

**Independent Variables**

There are five (5) independent variables in this study that are expected to affect the employees' interest with each representing other classes of stakeholder groups. The first independent variable is the shareholder interest (Sij) and the proxy for this is the percentage of Profit for the year (Pij) to the Gross Earnings (GEij) in a year (i) by a bank (j). Thus,

$$S_{ij} = \frac{P_{ij}}{GE_{ij}} \times 100\% \qquad \ldots\ldots\ldots.equation\ 3$$

The second independent variable is the Business Contact interest (BCij) and the proxy for this is the percentage of Management Expenses less Staff Cost (MEij) to the Gross Earnings (GEij) in a year (i) by a bank (j). Thus,

$$BC_{ij} = \frac{ME_{ij}}{GE_{ij}} \times 100\% \qquad \ldots\ldots\ldots.equation\ 4$$

The third independent variable is the Government interest (Gij) and the proxy for this is the percentage of Tax (TAXij) to the Gross Earnings (GEij) in a year (i) by a bank (j). Thus,

$$G_{ij} = \frac{TAX_{ij}}{GE_{ij}} \times 100\% \qquad \ldots\ldots\ldots.equation\ 5$$

The fourth independent variable is the Depositors interest (Dij) and the proxy for this is the percentage of the balance of Shareholders' Fund (SHFij) after the settlement of Deposit liability (DLij) to the Shareholders' Fund (SHFij) in a year (i) by a bank (j). Thus,

$$D_{ij} = \left(\frac{SHF_{ij}}{DL_{ij}}\right) \times 100\% \qquad \ldots\ldots\ldots.equation\ 6$$

Where there are missing variables the average of the preceding and the next years' figures was adopted; while where the ratios computed are considered to be outliers, a value of zero (0) was adopted.

**Research Design**

The data used for the purpose of this study was collected from the audited annual reports and accounts of eight (8) post consolidation banks that were operational from 1999 – 2012. Thus, the research design combines both cross-sectional and time series properties; which makes it a panel study.

**Population of the Study**

The population of this study is made up of Deposit Money Banks in Nigeria. Based on the information available on the official website of the Central Bank of Nigeria (CBN), there are twenty one (21) of them in operation as at November 30, 2014. However before the 2005 consolidation, there were eighty-nine (89) of them in operation. Post consolidation, all the twenty-one (21) banks in existence have a minimum capital base of ₦25 billion. Thus, in terms of capitalization, they constitute homogeneous population.

**Sampling Technique**

This study employed a judgmental sampling technique. The criterion was met by any of the twenty-one (21) post consolidation banks to be part of the study sample is that both the date licensed and the date registered of the bank based on the CBN's record must be on or before 2006 (the first year for which data is required in this study). It should be noted that the 2005 bank reform exercise brought about series of mergers and acquisitions between (or among) the then existing 89 banks in the bid to meet the then deadline set by the apex bank. In addition to this, the audited annual reports of the banks must be available in the database provided by InvestinginAfrica.com; thus, making use of convenience sampling method. Thus, based on these criteria, only four (4) banks were sampled from the sampling frame in Table 1.

**Table 1: Sampling Frame for the Study (List of Deposit Money Banks in Nigeria)**

| S/No. | Name of Deposit Money Bank | Date Registered | Date Licensed | Comment |
|---|---|---|---|---|
| 1. | Access Bank | 01/17/1990 | 01/17/1990 | Sampled |
| 2. | Citibank Nigeria Limited | 10/11/2004 | 10/08/2004 | Not Sampled |
| 3. | Diamond Bank Plc | 12/31/1990 | 12/31/1990 | Sampled |
| 4. | Ecobank Nigeria Plc | 04/24/1989 | 04/24/1989 | Not Sampled |
| 5. | Enterprise Bank | 01/03/2006 | 01/03/2006 | Not Sampled |
| 6. | Fidelity Bank Plc | 01/02/2006 | 01/02/2006 | Not Sampled |
| 7. | First Bank of Nigeria Plc | 01/29/1979 | 01/29/1894 | Not Sampled |
| 8. | First City Monument Bank Plc | 11/11/1983 | 11/11/1983 | Sampled |
| 9. | Guarantee Trust Bank Plc | 01/17/1990 | 01/17/1990 | Sampled |
| 10. | Key Stone Bank | 05/02/2001 | 05/02/2001 | Not Sampled |
| 11. | MainStreet Bank | 01/03/2006 | 01/03/2006 | Not Sampled |
| 12. | Skye Bank Plc | 01/03/2006 | 01/03/2006 | Not Sampled |
| 13. | Stanbic IBTC Bank Ltd. | 01/02/2006 | 01/02/2006 | Not Sampled |
| 14. | Standard Chartered Bank Nigeria Ltd. | 12/01/2004 | 06/09/1999 | Not Sampled |
| 15. | Sterling Bank Plc | 01/25/1999 | 11/25/1960 | Not Sampled |
| 16. | Union Bank of Nigeria Plc | 01/02/2006 | 01/02/2006 | Not Sampled |
| 17. | United Bank for Africa Plc | 01/02/2006 | 01/02/2006 | Not Sampled |
| 18. | Unity Bank Plc | 01/02/2006 | 01/02/2006 | Not Sampled |
| 19. | Wema Bank Plc | 01/18/1965 | 01/17/1945 | Not Sampled |
| 20. | Zenith Bank Plc | 09/13/2004 | 06/20/1990 | Not Sampled |
| 21. | Heritage Banking Company Ltd. | 01/01/1900 | 12/27/2012 | Not Sampled |

*Source: Central Bank of Nigeria (2014)*

**Method of Data Analysis**

The model in equation 1 was used to analyze the post 2005 financial data obtained from the various issues of the audited annual reports and accounts of the four (4) sampled banks. In order to test the two hypotheses of this study, the post consolidation data was used to establish a multiple regression equation after conducting a correlation analysis. Subsequently, inference was drawn from the pattern of the signs of the coefficients of the independent variables to form the basis for conclusion on how the bank reform of 2005 has affected the Nigerian banking sector from a stakeholder perspective.

## DATA ANALYSIS

This section presents a descriptive analysis of the data used to test the hypotheses of this study and the result of the test of hypotheses. STATA statistical package was used for the purpose of analysis. Correlation and Regression analysis was used to test the hypothesis. The result of the analysis is presented in the following sub-sections.

### Descriptive Analysis

**Table 2: Descriptive Statistics**

| Variables | Minimum | Maximum | Mean | Standard Deviation |
|---|---|---|---|---|
| E | 6.61 | 69.58 | 22.5525 | 12.437 |
| D | 13.04 | 52.52 | 29.297 | 10.380 |
| S | -89.64 | 74.85 | 24.988 | 29.625 |
| BC | 16.8 | 137.12 | 42.540 | 24.381 |
| G | -3.19 | 35.34 | 9.191 | 8.396 |

*Source: Results obtained from data analysis using Stata 11 statistical package*

Table 2 explored the descriptive statistics of variables used for the study. It shows that the bank average for employee interest (E) was 22.55% and the standard deviation from mean was 12.44%. The minimum value of overall employee interest was 6.61%, while the maximum value was 69.58%. The bank average for depositor interest (D) was 29.30% and the standard deviation from mean was 10.38%. The minimum value of overall depositors interest was 13.04%, while the maximum value was 52.52%. The bank average for shareholders interest (S) was 24.99% and the standard deviation from mean was 29.63%. The minimum value for overall shareholders interest was -89.64% (reflecting the risk taker interest in the banks who suffers the most in events of adverse profitability), while the maximum value was 74.85% (enjoying the most in event of rosy returns). The bank average for business contact interest (BC) was 42.54% and the standard deviation from mean was 24.38%. The minimum value for overall business contact group was 16.8%, while the maximum value (reflecting periods of adverse operating results) was 137.12%. The bank average for government interest (G) was 9.19% and the standard deviation from mean was 8.40%. The minimum value for overall government interest (reflecting the banks negative disposition to tax payment) was -3.19%, while the maximum value was 35.34%.

### Test of Hypotheses

**Hypothesis One**

The pair wise correlation was used to determine the relationship between the stakeholders' interests in the post 2005 reform. Table 3 shows that the employee interest has a negative relationship with the shareholders interest (r = -33.49%) and Depositors interest (r = -27.43%); the shareholder interest is in negative relationship with the Business Contact interest (r = -37.96%) and employee interest (r = -33.49%); the business contact interest is in negative relationship with the depositors' interest (r = -37.96%) and shareholders' interest (r = 13.62%); while the government interest is in negative relationship with only the depositors' interest (r = 14.84%). All other relationships were found to the positively related.

**Table 3: Correlation Statistics**

| | E | S | BC | G | D |
|---|---|---|---|---|---|
| E | 1.0000 | | | | |
| S | -0.3349 | 1.0000 | | | |
| BC | 0.7609 | -0.1362 | 1.0000 | | |
| G | 0.4284 | 0.3150 | 0.3873 | 1.0000 | |
| D | -0.2743 | 0.0074 | -0.3796 | -0.1484 | 1.0000 |

*Source: Results obtained from data analysis using Stata Statistical Package*

## Hypothesis Two

The result of the panel data estimation techniques for each of the models is presented in Table 4. The statistical significance of the Prob-F (0.000) of the fixed effect estimator suggests the inappropriateness of the pooled Ordinary Least Square method (OLS) estimator of the model. The argument between pooled OLS and fixed effect is whether there are specific effects individual to the cross-sectional units. The significance of Prob-F for the fixed effects giving a value of (0.000) signals that there are fixed effects and the cross-sectional units cannot be pooled together. This therefore explains that there are significant individual (banks) effects in the model. In comparison of the fixed effect with the random effect estimator, the probability value of the Hausman test shown in the Table 4 gives a value of (0.0000). Therefore, the result generated from using the fixed effect estimator is used to describe the relationship between banks employees' interest and other stakeholder interest in the post-consolidation era due to the fact that the Haussmann test was less than 5 percent significance level.

The result shows that shareholders interest, depositors' interest and government interest were not statistically significant in explaining the variation in employees' interest ($p > 0.05$) while business contact group were statistically significant in explaining the variation in employees' interest at 1 percent.

Inferring from the result, the Table 4 shows that there is a positive relationship between business contact interest (BC), government interest (G), depositors' interest (D) and employees' interest (E); thus, the average effect of business contact interest on employees' interest is that one percent increase in business contact interest will leads to 41% increase in employee's interest. The average effect of government interest on employees' interest shows that one percent increase in government interest will lead to 14% increase in employees' interest, while the average effect of depositors' interest on employees' interest also shows that one percent increase in depositors' interest will cause an increase in employees' interest by 3.61%.

The result also shows that the only negative relationship is between shareholders' interest and employees' interest as it gives a value of -2.43%. This implies that one percent increase in shareholders' interest will cause a decrease in employees' interest by 2.43%. The $R^2$ lays emphasis on the fitness of the model, the $R^2$ gives a value of 0.8241 percent signaling that the independent variables can only explain 82.41% of the variation in the dependent variable while the minor 17.59% of the factors affecting employees' interest were not included in the model.

The Prob value explains the statistical significance of the model, the table above shows that the model was statistically significant. The result shows that model was statistically fit at 1 percent. The resulting model is thus:

$$E = 3.421 - 0.0243S + 0.4086BC + 0.1412G + 0.03608D$$

**Table 4: Summary Statistics**

| E | Pooled OLS | | Fixed Effects | | Random Effects | |
|---|---|---|---|---|---|---|
| | Coefficient | P-val | Coefficient | P-val | Coefficient | P-val |
| Independent Variables | | | | | | |
| Constant | 9.1847 | 0.126 | 3.421 | 0.430 | 9.1847 | 0.115 |
| S | -0.1475 | 0.005 | -0.0243 | 0.620 | -0.1475 | 0.002 |
| BC | 0.3024 | 0.000 | 0.4086 | 0.000 | 0.3024 | 0.000 |
| G | 0.4584 | 0.019 | 0.1412 | 0.328 | 0.4584 | 0.013 |
| D | -0.000799 | 0.995 | 0.03608 | 0.717 | -0.000799 | 0.995 |
| $R^2$ | 0.7016 | | 0.8241 | | 0.767 | |
| Prob-F | 0.0000 | | 0.0000 | | 0.000 | |
| Hausman Test | | | 0.0000 | | | |

*Source: Results obtained from data analysis using Stata statistical package*

## DISCUSSION OF RESULT

One of the major criticisms of the stakeholder theory has been that it does not provide any suggestion on how the conflicting interests of the stakeholders can be resolved. The result of the correlation analysis (test of hypothesis I) of this study supports this as the employee interest was found to be in negative correlation with the shareholders' interest and the depositors' interest; the shareholders' interest was found to be in negative correlation with the business contact interest while the depositors' interest was found to be in negative correlation with the government's interest. This finding supports the position of previous publications that the interests of stakeholders are indeed conflicting (McTaggart & Kontes, 1993; Jenson, 2001; Sakariyau, Jimoh and Bamigbade, 2014). Thus, management of the post consolidation banks will have to seek a balance amongst these conflicting interests to maximize the value of the post consolidation banks. Furthermore, the result of the multiple regressions (test of Hypothesis II) suggests that all other interests of the stakeholders except that of the shareholders of the post consolidation banks had positive effect on the employees interest. A good reason that can be adduced is that the shareholders that have invested over twenty-three billion naira in additional funds to finance the operations of the post consolidation banks would have only done so with the expectation of the investments yielding adequate returns to justify such amount of huge investment. Consequently as the operations of the post consolidation banks widened as a result of greater investment (Sakariyahu, Jimoh and Bamigbade, 2014), the interests of employees measured by the proportion of gross earnings paid as employee emoluments was positively affected by the interest of business contacts as measured by the portion of gross earnings paid as expenses; the interest of government; and the interest of depositors. This result suggests long run direct relationship between employee interests, on the one hand, and business contact interests, government interests and depositor interests on the other hand. It is therefore evident that the interest of other stakeholders can easily affected in similar fashion since they all constitute deductions from what will be available to the shareholders who have the residual interest in the banks. Definitely, at a higher level of operations, the less the share of earnings that goes to employees, business contacts, government and depositors, the more will be available to the shareholders as the return on their huge investment in the post consolidation banks.

## SUMMARY

This study examined the financial position of Nigerian banks in the post 2005 reform. The two specific objectives sought were to: determine the nature of relationships that exists among bank stakeholders' interest in the post-consolidation era; and assess the effect of other stakeholder interests on the employee group. Secondary data was collected from the annual reports of the four sampled banks selected as a result of judgemental sampling procedure. Relevant accounting ratios were computed from the data generated from the annual reports to proxy each of the stakeholders' interest. Correlation analysis and regression analysis was used to test the hypotheses formulated to achieve the first and second objectives. Results of the analysis provided evidence that the post consolidation stakeholders, interests are conflicting in the first instance. Furthermore, the business contact interest, depositors' interest and government interest were found to positively affect the employee interest. However, the shareholder interest was found to be in negative relationship with the employee interest.

## CONCLUSION

Based on the results of this study, it is concluded that there is subtle evidence in support of the tenets of the stakeholder theory. It is concluded that the stakeholders' interest in the post 2005 bank reform in Nigerian are conflicting. In addition, the shareholders' interest in the post 2005 reform is in negative relationship with the employees' interest; other stakeholders' interests are in positive relationship with the employees' interest.

## RECOMMENDATION

The most likely situation that management of the banks can face in the allocation of the company's resources and earnings is that of the shareholders versus others. It is recommended that:

- Good welfare package should be used to motivate the employees of banks to be more productive;
- The dividend policy of the banks should allow for more dividend payouts in order to assure that the investment in the consolidated banks are worthwhile;
- Adequate compliance with regulatory guidelines by the banks should be encouraged in order to improve depositors' confidence; and
- Banks should adopt an integrated reporting framework in order to disclose how management has been able to trade-off the conflicting interests among the stakeholders during the reporting period.

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# *LAW*

# TWIST AND TURNS OF CROWDFUNDING REGULATION

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**Abstract**: *Crowdfunding has suddenly caught the attention of financial regulators in many jurisdictions. It appears the mark crowd funding is making in the financial services industry within many jurisdictions can no longer be ignored by regulators. Regulators role is to ensure that financial markets in their jurisdictions are fair, efficient and transparent. But most importantly the regulators must protect clients and investors against unscrupulous practices. The hype around crowd funding has really made many regulators to start digging deep into this financial product or services to see exactly what lies underneath. This paper zooms in on measures put in place by some jurisdictions to try and regulate crowd funding activities.*

## INTRODUCTION

Crowdfunding has become a catchphrase for small and medium sized enterprises (SMEs) when it comes to raising capital for their businesses (Curry, 2015). Like any new financial products introduced into the market it is inevitable that some will be skeptical about it and some will see it as a holy grail for financing their business ventures (Young, 2013).

It is every regulator's apprehension that if a new product or service is introduced into the market to ensure that the interests of the clients and investors are well protected at all times (Cunningham, 2016). The questions that linger in the minds of many regulators in as far as crowd funding in concerned are, for example, how crowd funding should be regulated to protect the interests of investors, what systemic risks are being introduced by the product or service into the market, and how the risks can be mitigated, and so forth (Verdonik, 2016). All in all regulators try their best to be alive to all sorts of risks associated with the introduction of new financial products or services into their markets (Marboe, 2016).

Currently there is more than enough literature out there about the benefits and challenges of crowd funding available but not enough on how it should be regulated.

## DEFINING CROWDFUNDING

Crowdfunding is simply defined as the use of small amounts of capital from a large number of individuals to finance a new business venture (Szycher, 2016).

The International Organisation of Securities Commissions (IOSCO)'s *Issues Report on Risks and Benefits of Financial Return Crowd funding,* defines 'crowd funding' as an umbrella term describing the use of small amounts of money, obtained from a large number of individuals or organizations, to fund a project, a business or personal loan, and other needs through an online web-based platform (IOSCO Issues Report on Risks and Benefits of Financial Return Crowdfunding, 2015).

Crowdfunding has its origins in the concept of crowdsourcing, which is the wider concept of individual realising a goal by receiving and leveraging small contributions from many parties (Szycher, 2016). Many communities have always engaged in crowdfunding activities even though they did not actually call it crowdfunding. In rural areas, for example, communities would donate some money to build a small bridge connecting villages, school, church or whatever the case may be is another form of crowdfunding. Who can ever forget the story about the crowdfunding of the Statute of Liberty by the American Committee of the Statute of Liberty for the shortfall of funds due to the fact the then Governor could not use city funds to bankroll the project (Djamchid, 2015). This is of course one of the well-known crowdfunded projects.

As mentioned before every society or community has in one way or the other being exposed to crowdfunding. It can therefore be argued that crowdfunding has been there since time immemorial and arguable will be there for a while whether regulated or not. Crowdfunding has evolved over time now with the advent of new technology and social media it has taken a different form (Vass, 2014). Those who are now engaging in crowdfunding activities routinely use well-known social media sites such as Facebook, Twitter, LinkedIn and others to raise capital for a particular course or business venture (Turban, 2015).

## RISKS AND BENEFITS OF CROWDFUNDING

Crowdfunding today makes use of the easy accessibility of vast networks of friends, family and colleagues through social media websites like Facebook, Twitter and LinkedIn to get the word out about a new business and attract investors (Gunning, 2014). Crowd funding apparently has the potential to increase entrepreneurship by expanding the pool of investors from whom funds can be raised beyond the traditional circle of owners, relatives and venture capitalists (Community Leader, What is Crowdfunding, 2015).

The proponents of crowdfunding model also claim that its portals or platforms assist entrepreneurs to assess the market demand of their product, project or business venture (Adams, 2013). Some authors also argue that crowdfunding provides entrepreneurs with an opportunity to acquire funding for realising their new business ideas (Kemper, 2015).

Many of the crowdfunding platforms operate beyond their jurisdiction and thereby introducing cross border complexities (Weiner, 2014). These cross border complexities are not only limited to cross border enforcement but also broader legal implications. Some authors have singled out costs of capital as one of the challenges associated with crowdfunding model. For example, it is claimed that in Europe on average portals or platforms charge 10% from the capital raised and over and above this they also frequently charge for additional fees for due diligence of projects or insurance reducing uncertainty (Bruntje, 2015).

Data protection and technical problems associated with crowdfunding portals or platforms have also been identified as concerns rose by users or potential users (Damas, 2014).

## TYPES OF CROWDFUNDING

Crowdfunding is an assorted group of schemes geared towards fundraising in an innovative way by entrepreneurs or perhaps even charities (Bruntjie, 2015). There are many types of crowdfunding and different jurisdictions choose to recognise certain types of crowdfunding. For example, in the United Kingdom (UK), the UK Crowdfunding Association officially recognizes donation, debt and equity crowdfunding types (Williams, 2014). The common types of crowdfunding that exists today include the following:

### *3.1 Equity Crowdfunding*

Equity crowdfunding typically comes into play where crowd invests in a venture or project and in return it gets equity (Freedman et al., 2015). For many entrepreneurs, financing their business venture or project through the banks can be frustrating as banks will send them from pillar to post and even after then they will still not be guaranteed the necessary finance (New Approaches to SME and Entrepreneurship Financing Broadening the Range of Instruments: Broadening the Range of Instruments", OECD Publishing, 2015). Equity crowdfunding becomes the only best option for bankrolling their projects and investors are then rewarded with equity for placing their moneys into the project (Laemmermann, 2012). If the project succeeds the investors succeed too and the reverse is true too.

### *3.2 Debt Crowdfunding*

Debt crowdfunding or peer-to-peer lending can come into play where, for example, an investor funds a project and when such a project succeeds he or she gets his or her money back with interest (Stephany, 2005). This kind of funding is highly preferred or sought by inventors and entrepreneurs who more often than not do not have the necessary securities, collaterals or guarantees that banks normally require before they can grant them a loan (Shi, 2015).

### *3.3 Donation Crowdfunding*

Donation crowdfunding sometimes referred to as 'charity crowdfunding' normally comes into effect when members of the community fund a particular project that may have some significance to the community or society at large (Dresner, 2014). Donation crowdfunding can include courses such as paying for medical costs of a child whose parents cannot afford to pay for chemotherapy, building a monument to honor local heroes or even buying books or computers for a library, etc.

Donors, for example, do not expect any return but it makes them feel good that they have contributed to something significant in the community. In some jurisdictions they may use the fact that they donated something to the community for their tax deductions for tax return purposes (Howell, 2014).

## REGULATION OF CROWDFUNDING IN DIFFERENT JURISDICTIONS

### *United States*

According to report the large majority of crowdfunding platforms are found in the United States of America US and they include equity crowdfunding platforms (Lipman, 2016). Crowdfunding has received the attention from policymakers in the US with direct mention in the Jumpstart Our Business Startups (JOBS) Act; which was signed by President Obama into law on 05 April 2012. JOBS Act allows for a wider pool of small investors with fewer restrictions (Ennico, 2016). The US regulations have been set to combat the risks associated with crowdfunding and promote investor protection. Initially when JOBS Act was introduced the fear mongers were misinforming the public that the government was trying to stick its fingers in the crowdfunding pie. However, as we have learnt under JOBS Act anyone who wishes to start or grow a business is allowed to use the online equity crowdfunding platform to raise up to $1000, 000, 00 by selling stock in the company (Wales, 2014).

It has also been reported recently that in the US, for example, the Securities and Exchange Commission (SEC) has on 30 October 2015 adopted rules to allow companies to offer and sell securities through crowdfunding (The Securities and Exchange Commission adopts final rules on crowdfunding, 2015). According to SEC those rules would allow individuals to invest in securities based on crowdfunding transactions subject to certain limits (The Securities and Exchange Commission adopts final rules on crowdfunding, 2015). This is a step towards the right direction in that it provides clarity and certainty.

The New York Stock Exchange has gone so far as to list a few of the crowdfunding platforms on their exchange and by doing this creating a secondary market. The crowdfunding companies listed can also trade (Freedman, 2015).

### *Europe*

Europe also has many crowdfunding platforms, but there is currently no European regulation in force aimed at crowdfunding at a European Union (EU) level yet (Boitan, 2016). Currently the regulators through the European Commission (EC) are looking into ways of regulating crowdfunding. It appears the key issues that the EC would be focusing on with regard to equity crowdfunding include anti-money laundering, advertising, consumer protection and where relevant intellectual property protection (Lloyd, 2017) .

It is, however, noteworthy that individual investments are required to be concluded in full compliance with anti-money laundering laws and the EU Markets in Financial Instruments Directive (MiFID) (Danmayr, 2013). This in a way dictates that platforms must ask the potential investor to provide information regarding their knowledge and experience in the investment field relevant to the specific type of service or product, and check if the investment profile matches the risk proclivity to risk investments, eventually warning the client in case of mismatch (Bottiglia, 2016).

As pointed out currently there is not EU regulation but just some patchwork of national legal frameworks. For example, in Italy the concept of equity crowdfunding is taken much more serious and if any platform wants to facilitate equity crowdfunding activities it has to apply for a licence and only once it has been awarded a licence can such platform become operational (Siclari, 2016). The Italian regulators also have very strict requirements that the platforms will have to adhere to before granting licenses. The licensed equity crowdfunding platforms are considered financial intermediaries. There is a set limit on amount of capital that can be raised by issuers per year through the crowdfunding platforms. The maximum amount that an issuer can raise through equity crowdfunding platforms is €5 million; however, there is no limit in the number of investors (Micic, 2015).

***Singapore***

Singapore, through its authorities the Monetary Authority of Singapore (MAS) has proposed measures to regulate equity crowdfunding also known as securities based crowdfunding (SFC)(Li, 2017). Currently in Singapore, any offer of securities is required to be made in or accompanied by a prospectus unless it qualifies for an exemption under (Part XIII of) the Securities and Futures Act (SFA) (Hu, 2016). Intermediaries that deal in securities, including an intermediary operating an SCF platform which facilitates offers of securities, are required to hold a Capital Markets Services (CMS) license under the SFA, unless exempted (Ying, 2015).

MAS have been studying how to facilitate SCF as it can potentially offer an alternative source of financing for start-ups and SMEs (Nicoletti, 2017). MAS is of the view that there are significant risks associated with SCF investments, which tend to have a high probability of capital loss and are more illiquid compared to traditional securities investment instruments (Djamchid, 2015). As a start, MAS will facilitate SCF offers to accredited investors and institutional investors through the following initiatives (Lin, 2017):

- MAS proposes to ease the current financial requirements for intermediaries that deal in securities, so long as they do not handle or hold customer monies, assets or positions and do not act as principal in transactions with investors. This will allow potential SCF platform operators with lower financial resources to apply for a license to offer SCF investments.
- MAS clarifies that the advertising restriction for restricted offers made to accredited investors (that are exempted from the prospectus requirement) does not prohibit SCF platform operators from advertising their platforms, so long as reference is not made to any specific SCF offer listed on their platforms. This clarification will provide certainty to potential SCF platform operators on the manner in which they can publicize their business.

***Malaysia***

The Malaysia Securities Commission introduced a guideline containing new requirements for the registration of equity crowdfunding platforms (Abdullah, 2016). The guideline provides for among other things that the equity crowdfunding platform operators' board of directors must be fit and proper and have the ability to operate an orderly, fair and transparent market.

As the operator plays a critical role in ensuring confidence in the equity crowdfunding platform, the guidelines entrust the operator with obligations to ensure issuers' compliance with platform rules (Lo, 2016). The operator may deny an issuer access to its platform if it is of the view that the issuer or the proposed offering is not suitable to be hosted on the platform. The operator is also required to ensure that funds obtained from investors are safeguarded in a trust account until the funding goal is met. Under this framework, an eligible issuer may raise up to Malaysian Ringgit, RM3 million within a 12-month period (Bulow, 2016). Issuers will be able to attract investments from retail, sophisticated as well as seed investors, subject to the investment limits as provided in the guideline (Bulow, 2016).

Equity crowdfunding investors are given a 6-day cooling off period, within which they may withdraw the full amount of their investment. In addition, if there is any material adverse change relating to an issuer, the investors must be notified of such change. The investors will be given the option to withdraw their investment if they choose to do so within 14 days after the said notification (Bulow, 2016).

## CONCLUSIONS

IOSCO is an important organization that brings together international securities regulators who work together to set international standards for the securities sector. The organisation, *inter alia*, develops implements and promotes adherence to internationally recognized standards for securities regulation (IOSCO, 2015). One of IOSCO's recent report notes the benefits that might be enjoyed from crowdfunding but at the same time also notes the risks associated with the product. The report states that the greatest challenge when it comes to crowdfunding around the world for regulators is to strike a balance between encouraging crowdfunding and mitigating the risks associated with its growth, while protecting investor interests. IOSCO like many other international organizations is still grappling with the issues relating to crowdfunding.

The Financial Stability Board (FSB)'s mandate is to promote international financial stability. The FSB does this by coordinating national financial authorities and international standard-setting bodies such as IOSCO work toward developing strong regulatory, supervisory and other financial sector policies. FSB fosters a level playing field by encouraging coherent implementation of these policies across sectors and jurisdictions.

The FSB works through its members, seeks to strengthen financial systems and increase the stability of international financial markets. The policies developed in the pursuit of this agenda are implemented by jurisdictions and national authorities.

According to the FSB Report titled "*Financial Stability Board Regional Consultative Group for Asia – Report on Promoting Long-term Investment in Asia*" it appears many regulators in different regions are currently working tirelessly to promote the use of equity Crowdfunding by drafting or revising relevant legislation to assist emerging and growing companies to find investors via the internet.

The biggest challenge that many regulators have to face is to try the balancing act between ensuring sound regulatory framework and ensuring that the regulatory framework does not stifle the economy. With the recent financial downturn or recession around the world regulators have become even more careful and not to let anything slips through their fingers.

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# TAX AMNESTY FOR SOCIAL CONTRIBUTION IN ROMANIAN LEGAL FRAMEWORK

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**Abstract:** *When the state representatives realise that the fiscal liabilities are too hard to comply with and the taxpayers are very temped to avoid the payments, alternative solutions might be used. In order to move on with their daily activities, the taxpayers need to ease tax burden and a solution to rebalance the general budgetary collect/spend mechanism is to consider an amnesty regulation. Some legally stated fiscal liabilities are to be cancelled, in order to facilitate the continuity of the activity of the taxpayers and to insure further payments to the budget, despite the present diminish of the budgetary incomes. The recent Romanian fiscal amnesty is analyzed, starting with its motivations, the applicable procedures and the possible misinterpretations. The fiscal authority role and actions are presented, in comparison with the action of the beneficiaries of the law. Also, the results amnesty generated and the influence on the taxpayers' activity are analyzed, through the relevant case law already generated on the topic. The negative influence of the tax amnesty is pointed out as a result of the research.*
**Keywords:** *contributions, fiscal amnesty, tax regulation*
**JEL classification**: *K22, K31, K34*

## INTRODUCTION

The public budget policy is an exclusive state prerogative, both for the incomes and for the expenditure actions. The state, through its representatives, has to collect money and is entitled to spend them, in accordance with the current necessities and its current governing program. Considering the direct effects and its particular importance, tax policy has to be transposed in normative acts, in order to generate mandatory liabilities for the taxpayers. The fiscal amnesty is a method for the state legislative authority to cancel particular tax liability, when justified motivation demands it. It is a measure of short time loss, in favour increasing, in long time perspective, the budgetary incomes. Despite its reasonability, it is an extra-ordinary measure, mainly because of the possible side effect of discouraging the conduct of the honest taxpayers. Therefore the regulation for tax amnesty should be wisely and prudently adopted.

The social contributions hold an important role in the system of the resources for the public budget. In the present context, social contributions influence the mobility of the human resources and determine political attitudes. When they determine high pressure on the taxpayer, the objectives of social contribution regulation is misunderstood and generates social insubordination. The role of executive is to observe and to correct such conduct, proposing the right solution for reinstalling the rule of law.

## LITERATURE REVIEW

Naturally, fiscal policy should reflect the critical point of view of political power of the state concerning taxes and implicitly, the direction of action for the government, triggering options regarding the criteria for determining tax contributions and specific techniques of taxation as those related to spending for public, economic and social actions. Therefore, the scope of fiscal policy includes both obtaining fiscal resources available to public authorities and making public expenditure on account of such resources. [1]

Interventionist role of the state budget is, in fact, permanent and its development depends on various circumstances. It is constantly due to the nature of the budget, as act that authorizes the public revenues and expenditures each year and that inevitably has social and economic effects on both the payers of taxes and charges on beneficiaries of the budget. Contextual developments of the role of the state budget are more pronounced in phases of economic restructuring and in the time of modernization of public services. During these pressured times, the decision for revenues and annual expenditures is remarkable as a financially policy option of parliaments and governments of each country. The types and proportions of the authorized expenditure on the estimated revenue ground these options and the law approving the budget of each state finally expresses them. [2]

When the fiscal pressure exceeds certain limits, return on taxes may diminish, since taxpayers will manifest phenomena of resistance to taxation. In times of higher tax burden, taxpayers will get to perform operations that do not comply with tax, accounting or otherwise, entering the field of tax evasion. [3]

Fiscal policy is closely related to the allowance or budgetary policy, to be developed jointly by the competent public authorities. Fiscal connection with the social policy stems from the fact that some social objectives shall be fulfilled through fiscal measures, such as tax cuts, tax relieved, application of deductions from taxable material etc. [4]

In the present time, we may observe the governments' preoccupation to relief the tension on the social security and health budgets, the growth of the income not being a valid solution. [5] Therefore, the fiscal amnesty may be an option for supporting the private actors of the market, helping them to continue their activity and insuring, in long term, budgetary incomes. The law in force ensures, at least on declarative level, the concentration of financial capital on public services and supplier operation, with the respect of transparency. [6]

In the context of EU integration, we have to notice that the tax regulation prerogative is mainly reserved to Member State's competence, accordingly to the principle of subsidiarity. [7]

## THE RATIONAE OF ADOPTING THE LAW ON FISCAL AMNESTY

Tax amnesty is not a new method to rebalance the incomes of the public budget; it has been used before for different type of fiscal liabilities.

**Tabel 1 Examples of recent tax amnesty regulations**

| | | Year of tax amnesty law | Subject |
|---|---|---|---|
| 1 | Australia | 2007, 2009 | Repatriated funds |
| 2 | Belgium | 2004 | Income tax for individuals |
| 3 | Canada | 2002, 2007 | Tax related offence, unreported incomes |
| 4 | Germany | 2004 | Tax evasion |
| 5 | Greece | 2010 | All debs could be paid only up to 55% |
| 6 | Italy | 2001, 2003, 2009 | Mainly, repatriated assets |
| 7 | Portugal | 2005, 2010 | Tax evasion |
| 8 | Russia | 2007 | Tax crimes |
| 9 | South Africa | 2003 | Tax evasion |
| 10 | Spain | 2012 | Undeclared assets/in tax havens |
| 11 | United States | 2009, 2012 | Federal tax amnesty program |

Previous experiences in improving tax collection using tax amnesty determined Romanian fiscal authority to act in this way during 2015. Backed by four former delimitation criteria for independent and dependent activities, provided by Art.7 (2) tax code (criteria which, moreover, are irrelevant in terms of taxation), tax authorities proceeded to the reclassification as dependent activities for independent professions organized as individuals. It is the case of those particular situations when independent professions are paid in subsistence allowances or they collect *per diem* incomes.

Usually, dependent activities are entitled to collect salary and, almost in every fiscal system, the income taxes paid for salary are obviously higher than those paid as authorized individuals. Yet the risks of business are different. In Romania, for instance, an independent individual does not receive annual leave or sick leave allowance unless he/she has paid contributions to public/private health system. These individuals have to pay different taxes and are obliged to contribute to the public system pensions. [8]

We have to state that the motivation for adopting tax amnesty regulation aroused from the fiscal authorities necessity to justify their conduct. Their logic has entirely a different nature: according to their subjective interpretation of the former fiscal code, the income tax is reinstated, without giving pension contribution period, because taxes are higher. Additionally, their behaviour is justified by the advertisements and statistics of how effective, fair and cooperative are the fiscal authorities, in collecting money and helping the state budget to grow. [9]

The question that legitimately appeared is whether the reinstatement given by the new regulatory requirements is correct, as the regulation was highly interpretable. Clearly, taxpayers against whom the order is addressed to reinstate their activities went to the court of law, demanding justice and the fiscal authorities lose many of these cases. In these circumstances, we wonder if, somehow, the real beneficiaries of this amnesty law are precisely tax authorities who should justify abusive and discretionary manner in which they acted in all the litigant situations. It is not difficult to distinguish who is responsible for aberrant circumstances created: the tax authority and not the taxpayer, who only used the regulation in their own favour.

After long debates and pros and cons, Law no.209 was finally published in the Official Gazette on 20 July 2015. Although the law itself was named Law for cancellation of debts, public perception is that of the amnesty tax law.

## THE CONTENT OF THE LAW ON FISCAL AMNESTY

The first estimated effects of the amnesty law should be that hordes of criminals would benefit from its effects, discouraging the honest taxpayers. This unfortunate effect is present if we consider the "generosity" of the legislative authority, present in the following situations when the regulation states that the payments are not due:

- For the main tax liabilities, as well as for related accessories, established by tax decision issued and communicated to the taxpayer as a result of the reconsideration/reappointment of an activity as dependent;
- For principal tax liabilities and/or related accessories, established by tax decision issued and communicated to the taxpayer as a result of receiving amounts of money during the delegation and posting by employers who have worked on territory of another country; The pursuit of an occupation in another member state of the EU is the general right of any European citizen. [10] The amnesty law does not affect in any way the content of the EU regulation in this respect.
- For differences in tax added value added on the income for intellectual property rights and related accessories, established by tax decision issued and communicated to the taxpayer as a result of overruns and/or failure to register as a VAT taxpayer. If the taxpayer has exercised his right to deduct, under the law, when completing the first tax return application, after the decision for VAT taxpayer was issued, the tax authority does not cancel differences in value added tax and related accessories.

For all three categories mentioned above, the cumulative tax obligations are concerned, due to fiscal periods before 1 July 2015 and not paid until the entry into force of this regulation, on July 23, 2015 respectively.

- For health insurance contributions and the accessories concerned, established by the tax decision issued and communicated to the taxpayer, payable on a monthly basis by the individuals for whom the income is less than the minimum, for the fiscal periods between 1 January 2012 and end of the month before the coming into force of the law and which are not paid until the entry into force of the law. These provisions are applicable to persons who have no income and for whom the monthly basis for calculating the contribution of health insurance is the legal minimum wage.

The new regulation states that the competent tax authority automatically performs the cancellation of all tax obligations listed above by issuing a decision to cancel the tax liability, which shall be communicated to the taxpayer.

## PROCEDURES FOR APPLYING THE TAX AMNESTY

In the legal order of the EU, Romania included, the free movement of employers determined some particularities in tax collection. [11] Starting one month after the publication of the law, the Romanian government issued 4 procedures for application of the tax amnesty law. The documents refer to the cancellation of tax obligations for employees who received daily allowances abroad (considered by the fiscal authorities wages) and people who had earned below minimum wage and were required to pay contributions for health the minimum wage. [12]

We mention that in the same period was adopted the Law no.225/2015 [13], exempting certain categories of persons to pay individual contributions to health and identify some cases where the provisions of these two laws overlap. In this case, the fiscal authorities have adapted the application procedure for effective implementation of both laws. For law enforcement purposes, they were taken a total of four procedures that can take into account the framing of a taxpayer in one or more situations stipulated by Law no.209/2015. [14]

We present the 4 procedures, in the same order as they are included in the regulating document.

### *5.1 The main procedural issues*

The tax audit structures or structures which are issuing administrative acts containing tax liabilities subject to cancellation will perform a punctual identification of those who fall under the amnesty law. If there are other taxes that are not covered by amnesty in the reporting tax audit documents or tax decisions, the fiscal authority representatives will extract those obligations subject to cancellation. The persons responsible has to draw a list, which will be signed, duly approved and subsequently communicated to the precise department, which manages the particular taxpayer. There will be separate accounts for obligations to be cancelled that were previously communicated to the taxpayer, and accounts for those that have not been communicated yet.

### *5.2. The procedure to identify individuals for whom the health contribution is cancelled*

This procedure comprises two parts: taxpayers who have earned income lower than the minimum gross salary (for who the obligation to pay health contribution is cancelled) and taxpayers who were granted by Law no.225/2015 cancelling health contributions (mainly referring to children up to 18 years, pupils and students aged up to 26 years, pregnant women and young mothers).

Before cancelling the tax liability, the legal procedure requires verification if these people have achieved the following revenue categories: rental and leasing; investments; prizes and gambling incomes; fiduciary operation, according to Title III of the Tax Code; other sources as specified in art.78 of the Tax Code. [15]

After completing these procedures, the fiscal authority representatives will prepare a final list that will be communicated to the compartment with verifying and controlling responsibilities. People who have benefits from tax amnesty law will receive a decision for cancel tax liabilities previewed in the normative act.

### *5.3. Cancellation procedure of tax liabilities at the request of the taxpayer*

If there are cases of individuals who might benefit from amnesty laws (Law no. 209/2015 on the amnesty and/or Law no. 225/2015 on the exemption from payment of health contributions) and for whom ex officio procedure was not carried out, they are entitled to request application of the exemption from payment of health contributions. In this regard, the core element of the procedure is getting by individuals from health fiscal authority a document attesting the insured status without paying contributions. Subsequently, the individual will address fiscal authority to obtain exemption from payment of health contributions. The final decision will be communicated, in printed format, to the individual in case.

### *5.4. The procedure for issuing the decision to cancel*

The last part of the normative act we have analyzed includes the format for the decision to cancel of tax liabilities, respectively fiscal authority internal communication, archiving, use and storage of documents procedures, prepared for the actual implementation of the tax amnesty. We observe that in this fiscal amnesty law procedure that the main role is reserved to the fiscal authority, which is obliged to act *ex oficio*. Still, in order to prevent any abuses for deliberately non-acting, the law includes this 4$^{th}$ procedure, providing the possibility to initiate the procedure for the beneficiary of the law.

## CONCLUDING REMARKS

The Romanian tax amnesty regulation in 2015 was the solution for releasing the fiscal over-pressure on the small and medium businesses. The entrepreneurs that used their employees' work abroad, in the context of the EU free market, were mainly targeted. In the context of previous fiscal authority activity, there are some questions to be answered, related to the true beneficiary of the law. Considering the past misconduct, it seems that the fiscal authority itself is the main beneficiary of the amnesty and not the employers and the employees.

The amnesty laws generated the short-time effect of encouraging accurate taxation for the developing economic activity and the long-time effect of improving public budget income. The general idea that the tax amnesty is a minor present loss for insuring a major future tax collection was confirmed in the example of Romanian tax amnesty in 2015.

Some critics are to be mentioned. First, the regulation to implement the amnesty deserved some improvements (e.g. *ex oficio* procedure had no sanction for non-implementation). Second, there are some side effects observed in the activity of disciplined taxpayers, who considered they were disadvantaged.

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