1/2013

International Journal of Entrepreneurial Knowledge

An international scientific periodical peer-reviewed journal of entrepreneurship and business issues

www.ijek.org

International Journal of Entrepreneurial Knowledge (IJEK) ISSN 2336-2952 (Print)
Registration MK ČR E 21546 ISSN 2336-2960 (Online)

PUBLISHER:
Vysoká škola podnikání, a. s., Michálkovická 1810/181, 710 00 Ostrava-Slezská Ostrava, Czech Republic, IČ: 25861271

EDITORIAL OFFICE:
Editorial office of the International Journal of Entrepreneurial Knowledge
Vysoká škola podnikání, a. s.
Michálkovická 1810/181
710 00 Ostrava-Slezská Ostrava
Czech Republic
www.ijek.org
Email: **ijek@vsp.cz**

A scientific periodical peer-reviewed journal International Journal of Entrepreneurial Knowledge (IJEK) provides expert information on all aspects of entrepreneurship and business issues offers, including the results of basic and applied economic research of domestic and international authors in the English language. IJEK maintains a standard double-blind peer review process. IJEK is an Open Access Journal, and does not charge readers or their institutions for access. All publications in IJEK must be created in compliance with the publication ethics.

INTERNATIONAL JOURNAL OF ENTREPRENEURIAL KNOWLEDGE

Issue 1/2013, Volume 1

December 2013

CONTENTS

Research

Case studies

DOI: 10.15759/ijek/2013/v1i1/53753

THE THEORY OF PARTONIZED GOODS IN THE OPTICS OF COMPARATIVE METHODOLOGY

Aleksander RUBINSTEIN [1]
Institute of Economy of the Russian Academy of Science

ABSTRACT

The present study focuses on the methodological aspects of the Theory of patronized goods, modifications of two liberal principles of the Austrian school, incorporated into mainstream economic theory - "methodological subjectivism" and "methodological individualism", as well as the standard axiom of "homogeneity of economic agents". The paper discusses some modifications to these assumptions and their various combinations that form the basis of a number of theories that justify state activity. Analysis of the basic premises of the theory of public goods and merit goods, and the concept of libertarian paternalism allowed the author to suggest that from the point of view of methodology, these theoretical constructions are particular cases of the Theory of patronized goods based on "methodological subjectivism", "methodological relativism" and "the principle of heterogeneity". In the Theory of patronized goods they are integrated in the form of supposition that every person depending on the level of his understanding and his value judgments acts subjectively optimally in the given circumstances; in the principle of utility complementarity, according to which there may be a group interest alongside with the individual interests of the group members; and in the form of two irreducible to each other branches of formation of public interest – market and political.

KEY WORDS

patronized goods, public goods, meritoric, libertarian paternalism, methodological subjectivism, methodological relativism, heterogeneity, normative interests

JEL CLASSIFICATION

D01

INTRODUCTION

The present paper represents author's methodological reflections in the tideway of "Economic sociodynamics" and "Theory of Patronized Goods" (*Гринберг, Рубинштейн (2008, 2010), Grinberg, Rubinstein (2010), Рубинштейн (2008, 2010, 2012)).* This year Economic Sociodynamics marks its fifteenth anniversary. Throughout these years it has been developing, it's authors cooperatively and individually have published over ten books, multitude of articles and reports, delivered at Russian and international conferences; a sub-theory – "Theory of Patronized

[1] *Correspondence address*: prof. Aleksandr Rubinštejn, DrSc., CSc., Ph.D.; arubin@aha.ru: Institute of Economy, Russian Academy of Science, Moscow, Russia

Goods" has appeared, and a number of independent dissertation researches carried in various scientific canters of Russia are based on its fundamental principles and retain their relevancy forming foundation for problem discussion either face-to-face at conferences and seminars or at distance via debates in journals.

However, some of my recurrent collocutors and distinguished opponents with their doubtless talents and competences have some difficulties in adequate perceiving of some of the Theory of Patronized Goods' principles. And contrary, a number of scientists brought up within Soviet economic science who retained the leftism of their views, without looking deep into the true meaning of the elaborated theory, easily accept its main conclusions connected with normative social interest and need for state activity. While modern economic theory bases itself on the ideology of liberalism, the pro-Soviet nostalgia-stricken political economists advocate socialism-based views.

Personally, I am more inclined to support the liberal values, freedom of choice and market economy; however, the standard theory based on a number of fundamental implications (methodological individualism, principle of rational behavior, homogeny of economic agents, etc.) does not give answers to many important questions. At the same time, the attempts to interpret Theory of Patronized Goods within the boundaries of non-classic axiomatic create insoluble contradictions. This is best shown by my benevolent opponents who try to adapt Economic sociodynamics and Theory of Patronized Goods to the framework of general course of economic theory. Thus, the necessity to go back to discussion of the initial assumptions became apparent. The additional impulse was given by the articles of V.Polterovich on the crisis of economic theory and general social analysis ((Полтерович (1998, 2011)), a number of publications in the journal "Voprosy Economiki", which reveal the results of behavioral economics within the context of economy science development (Белянин (2003), Коландер (2009), Хэндс (2012)), reports at "round table" "New approaches to methodology of economic analysis" at the II Russian economic congress (Suzdal, 2013) and also several articles in "Social Sciences and modernity" journal, that organized discussions on topical issues in theoretical economics*(Либман (2013), Тихонова (2013), Урнов (2013))*[2].

There is yet another reason of my interest in methodological issues. The thing is that starting from the 30s of the XX century theoretical economics has been developing in the conditions of growing pressure of mathematic methods and models, which on the one hand made me understand really a lot[3], but on the other, required the introduction of very stringent assumptions that in most cases do not follow from the economic content of the simulated process. This gap was accumulating and became the subject of analysis of several theoretical studies as well as numerous empirical studies that demonstrated that economics was "pressed" in the neoclassical paradigm, which, according to de Soto, "is stagnating because of its completely unrealistic axioms, static nature, and its formal reductionism " *(де Сото (2008, с. 1)).*

Economic Sociodynamics and the Theory of patronized goods were born in an attempt to overcome this methodological "obstacle". They are based on a modification of a number of neoclassic premises. I mean two liberal principles of the Austrian school, incorporated into mainstream

[2] Let me take this opportunity to thank the editorial board of the journal "Social Sciences and Modernity" that gave me a chance to start the discussion on theoretical and methodological aspects of Economic Sociodynamics and the Theory of patronized goods *(Рубинштейн (2012, с. 13–34)).*

[3] Several years ago, in a conversation with Kenneth Arrow, I raised the issue of the mathematization of economics and a certain loss of real economic content in mathematical models. To which Arrow said: "the economy is so complex that without mathematics that simplifies the real world, it is impossible to understand" *(Гринберг, Рубинштейн (2010, с. 9–10)).*

economic theory - "methodological subjectivism " and " methodological individualism "[4], and the axiom of "homogeneity of economic agents". Adhering to methodological subjectivism and being a longtime critic of "trite methodological individualism "*(де Сото (2009, с. 3))*, I assume the practicability of its replacement with a more general ontological principle used in a number of scientific disciplines, including linguistics and sociology. We are talking about some sort of synthesis of individualism and holism - the "methodological relativism"*(Лещак (2002, с. 38–42))*. Within the Economic Sociodynamics it is concretized as the principle of complementarity of utility according to which there can be a group interest along with the individual interests of the group members. I see this as generic properties of the Theory of patronized goods, its object of study being private initiative and state activity aimed at realization of individual and public interests. Based on this viewpoint I consider premises for rational individual behavior and homogeneity of economic agents.

Let me also note that the premises of rational behavior, methodological individualism, and homogeneity have been revisioned in a number of different theoretical constructions. Without any attempt to provide an exhaustive analysis, in this work we will consider some modifications of the stated premises and their various combinations that constitute the methodological basis for a number of theories that substantiate state activity. We will talk about the corresponding comparison of welfare economics, theory of public goods and merit goods, and the concept of mild or libertarian paternalism with the Theory of patronized goods.

1 METHODOLOGICAL SUBJECTIVISM

Let us start with the fundamental assumption of the theory of welfare – the principle of rational behavior, which unites Austrian "methodological subjectivism" where individual preferences are taken for granted and non-classical assumption that every individual chooses the best option that optimizes his welfare. The "invisible hand" which provides public welfare defined as the aggregated welfares of the individuals does all the rest. If the losses in public welfare occur, they are explained by the "market failure" and account for government interventions aimed at their elimination[5]. Without elaborating on this well-known scenario, I would like to point out the essence – strongly rational behavior of individuals who maximize their welfare is one of the principle assumptions of the stated theory.

"Our ignorance is infinite and sobering" (Эволюционная… (2000, p. 299)). The words of Karl Popper have "sobering" effect on most of the models of human behavior in economy as well as their basic assumptions including the one of rationality. "The results of researches carried during the last quarter of the century show that people do behave consistently but in a way that substantially differs from the variants predicted by the standard model of rationality" (Стиглиц (2011, p. 3000)).Regular critics of this "simplifying abstraction", initiated probably by Thorstein Veblen, have accompanied this ontological principle throughout its history. The first significant revision of the principle of rationality is connected with the works of John Katona

[4] Among the six principles that "an economist trained in the tradition of the Austrian school should adopt," Fritz Machlup noted "methodological subjectivism" and "methodological individualism"*(Machlup (1982, P.42), Заостровцев (2007, с. 70)).* See also: *(Вольчик (2007, с. 103–104), де Сото (2009, с. 3–4)).*

[5] In opposition to the concept of "market failure" economists increasingly turn to "government failure" research, in which instead of individual behavior the analytical scope moves to the influence on governmental activity of the established legislative norms, social institutes and current political priorities that may lead to worse results than before interfering into market process. Apart from earlier works of Krueger *(Krueger (1974, 1990))*, a number of books within the last decade should be noted *(Tullock, Seldon, Brady (2002), Winston(2006))* as well as an ample article *(Радыгин, Энтов (2012)).*

(Katona (1951)) and Herbert Simon (Simon (1955)). Katona wrote challenging the assumption of rational behavior, "… we mustn't assume from the start that rational behavior indeed exists. While describing and classifying different reactions as well as circumstances which generate them, we should always wonder if these reaction have right to be called "rational", and if so than to which extend" (Katona (1951, s. 16). H.Simon has even more definite opinion challenging the very ability of people to adequately evaluate their choices (Simon (1955),Саймон (1993)). He also introduced to scientific discourse the established category of "restricted rationality" (Simon (1955, 1957))[6]. Simon's works gave rise to skeptical views of rationality postulate and dependence of individual behavior on aspiration to maximize their welfare. A certain weakening of this initial assumption found its way in theories of public goods and merit goods in which the taboo on irrational individual behavior was actually lifted. And while within the theory of public goods the possibility of "wrong" decisions was acknowledged indirectly – to the "free rider" behavior Paul Samuelson added "a false signal of individuals on the lack of demand for public welfare" *(Samuelson (1954), Самуэльсон (2004)),* in meritorics Richard Musgrave describes standard cases of irrational behavior*(Musgrave (1959, 1994), Масгрейв,* (2009)).

At that in compliance with specific qualities of "public goods", individuals consciously (according to Samuelson) conceal their preferences. In meritorious environment, a corrupted signal about demand appears due to non-conscious irrationality of behavior. This refers to "pathologic case", "Odysseys' infirmity", "irrationality of the poor" and "common needs" – systematically arising situations when individuals are not able to act in their best interests. Progressing skepticism as for people's optimizing behavior regardless the definition of their interests[7] created meritorics with its legitimate interference into consumer preferences and "paternalistic policy" (Musgrave (1959, p. 13), D'Amico (2009)), based on the methodological technique of "doublethink". The case is that in theory of public goods and in meritorics, which allow for irrational behavior of individuals, one has to discard both components of category of rationality – optimizing behavior and Austrian subjectivism. By admitting the very fact of irrational behavior of individuals, we are also forced to keep in mind those actions that could be called rational. This approach inevitably leads to supposition of at least two preference systems, two "standards of evaluation which under particular circumstances may exclude each other in a way that utterly different, even opposite actions are considered optimal*" (Tietzel, Muller (1998, s. 116)).* Moreover market-defined preferences often appear to be false *(Самуэльсон (2004, с. 375))*, and the true preferences conforming to some "legal standard" have only "reflective character" *(Brennan, Lomasky (1983, p. 183–206))*.

The model of Thaler and Shefrin that postulates "split personality" of individual by acting simultaneously as both tempter's victim (me-executor) and his rational antipode and "creator's pride" (me-programmator) adds nothing new to the problem. While "executor" tends to act egoistically and shortsightedly, "programmator" aspires to realization of long-term and enlightened interests *(Thaler, Shefrin (1981, p. 392–406)).*[8] Thomas Schelling characterizes this as a situation where "people act like two different selves and run the show in turns" *(Schelling (1984)).* Quite

---

[6] I cannot say that I support the following Giovanni Dosi opinion, "I do not fancy the expression *restricted rationality* as it has implications to some *Olympic rationality* from the height of which we can judge upon how *restricted* is the restricted. However in the changing and complicated environment it is often impossible to define such perfect rationality in principle" *(Дози (2012, с. 40), Dosi et al (2005)).*

[7] It's way back to Alfred Marshall who in his "Principles of political economy" underlined that egoism [was] not the only "operant motive of human activity" (Маршалл (1983,с. 77–79)). Howard Margolis who was one of the first to expand the notion of rationality by including altruism, came up with "fair-share model", or F-S model based on the principal of personality dualism, the presence of two "selves": egoist self and altruist self (Margolis (1982, p. 14)). For more details consult (Рубинштейн (2012, с. 21, 23)).

[8] This work first published in "work notebooks" *(Shefrin, Thaler (1978)),* goes back to earlier research in the field of experimental psychology, in which Richard Shefrin and Walter Schneider while studying the hypothesis of human being possessing two cognitive system discovered "battle between reason and intuition" – the prototype of the future models with the multiplicity of "Self" *(Schneider, Shiffrin (1977a, b)).*

understandingly, these circumstances give rise to the problem of self-government as in particular situation a person may act differently from what his more profound and multifold estimation of consequences could tell him *(Koboldt (1995, s. 13))*. The main fact about detabooing of irrational behavior is that it also means rejection of the principle of methodological subjectivism, a move to multiplicity of "Self", the use of governmental paternalistic policy aimed at supporting such a "Self" that insures compliance with normative standard. It is quite natural therefore, that the welfare economics, which grounds itself on the principle of methodological subjectivism and consumer sovereignty, is traditionally opposed to paternalism. However, as time zips along, during the last 30-40 years numerous researches in the field of behavioral and experimental economy appeared, that registered, though in laboratory conditions, systematical recurrent cases of irrational behavior of individuals. In this context the necessity of revision of rationality assumption increasingly gains recognition *(Коландер (2009), Хендс (2012), Ананьин (2013, с. 23), Ольсевич (2013, с. 11–17)).*

While the theories of public goods and merit goods following Simon viewed restricted rationality as theoretical abstraction, psychologists and behavioral economists having conducted a variety of experiments obtained empirical proof of individuals' irrational behavior. As a result by the beginning of the XXI century an impressive collection of "anomalies" was accumulated – "effect of initial endowment", "status-quo prejudices", "anchor effect", "ambiguity evasion" which show the real life examples of individuals' behavior that alter from the prognoses of standard theory (*Kahneman, Tversky (2000), Thaler (2000), Канеман, Тверски (2003), Павлов (2007, 2011)).* This challenge required an adequate answer.

With that just criticizing meritorics and its "methodological weaknesses" *(Schmidt (1988), Tictzel, Müller (1998), Müller, Tietzel (2002))* without any positive program is not enough anymore. Empirical facts that go beyond standard theory of welfare are in need of interpretation. It should be noted however that in this area behavioral economists just elaborated the meritorious argumentation based on the multiplicity of "Self" reinforcing it and turning into their main methodological technique[9] *(Thaler, Shefrin (1981), Sunstein, Thaler (2003)).* In other words they also followed the track of rejecting the principle of "methodological subjectivism" thus preserving and developing the meritorious trend in attempts to settle the argument between theoretical assumption of rationality and the realia of irrational behavior.

I do not wish however to overestimate the scale of changes in economics. Some economists are still quite reluctant towards revision of the assumption of rational behavior of individuals, "If it is possible to accept the irrationality of human's nature, it's possible to accept anything[10]". Regardless a doubtful flatness of the expression, it seems true that meritorics and behavioral economics's critique of rationality principle just highlights some exceptions within the models of rational choice that are in need of further theoretical generalization.

My perception coincides, though not completely with position of Vernon Smith, "In the latter case we can often explain the data by changing the original models. As a result we deepen the notion of rationality and simultaneously coordinate data with the models; improved normative models forecast the experimental result with more precision" *(Smith (1991, p. 878))*[11]. In other words, the

[9] This resembles John Rawls' "veil of ignorance" which at its time became the main methodological technique for constitutional economy of James Buchanan. In either case we encounter with the examples of "insurmountable dualism of economics" *(Автономов (2013, с. 6)),* or as quoted by Avtonomov, with dilemma of "strictness and realism" *(Mayer (1993)).*

[10] Special report "New paternalism. Amiable government" published in *Economist* journal in April, 2006 gives a very detailed review of different opinions on behavioral economics and "sacrificing" the principle of rationality (http://www.economist.com/node/6768159).

[11] Smith's position on this issue is very similar to Milton Friedman attitude towards prerequisites of theoretical models which significance is defined by their prognostic success (*Friedman (1953)).*

deepening of the notion of rationality that can be interpreted as weakening of presupposition allows not only to correct but also to improve the results of such models. I mean easing the standard regulations of individuals' preferences and in the first place consideration of the established institutional environment and external factors, which influence these preferences.

The question if it is necessary to discard both of these constituents of the category of rationality while explaining the irrational behavior of individuals still remains the main issue. I think that there is no such necessity. Remaining within the framework of "methodological subjectivism" with its demands to take the individual preferences for granted, it is still possible to look for the solution in other rendering of assumption on optimizing behavior of individuals. [12] The case is that from the perspective of "methodological subjectivism" each person within his understanding and based on his personal values and tastes, demonstrates subjectively optimal behavior. If this behavior is regarded as irrational or restrictedly rational, it means that this evaluation is obtained from exterior, as to individual, source and is based on definition of the so-called "normative standard". People may choose not the best variant in regard to the normative standard due to many circumstances including meritorious deficiency in knowledge, willpower or resources. Meritorics and behavioral economics as well as libertarian paternalism *(Sunstein, Thaler (2003, 2008), Camerer et al. (2003)* originated from them assume that the activity of state aimed at the change of the established circumstances are able to improve the quality of people's behavior and bring their preferences more in line with normative standard. Not entering the discussion so far about normative standard in itself, I would like to note that as a result of state interference that "pushes" individuals towards the right decisions, the "subjectively rational" behavior of individuals takes shape of rational choice and the defined preferences start corresponding to normative standard.

The main advantage of this construction however, according to the leading figures of this movement, lies in the fact that the push- policy resolves differences between paternalism and the freedom of choice *(Sunstein, Thaler (2003, p. 1188)).* Not fully supporting this categorical statement, I would like to note that the "push strategy" in itself - the tool that comes from meritorics – amounts to creating conditions under which the individual by choosing subjectively best variant for him realizes the normative standard or at least approaches to it. It actually very much resembles John Nash's methodology according to which individuals under suggested circumstances always act "subjectively rationally". However due to inadequate game rules (institutional environment or established circumstances) their actions may lead to individual welfare losses *(Майерсон (2010, с. 29)),* i.e. empirically observed irrationality (Nash equilibrium). Change in rules of the game in accordance with the same paternalistic understanding of "as it should be" can push individuals towards choosing such dominating strategy, which would put their preferences in compliance with normative standard.

In other words Nash's methodology makes it possible, with the same grounding of state activity, to preserve basic assumption of individuals' "subjective rationality" replacing "doublethink" and multiplicity of "Self" inherent to meritorics and behavioral economics with the provision about ineffective institutional environment. Using Nash's methodology allows easy incorporating of all types of paternalism into the instruments of modernization of institutional environment. At the same time the question of normative standard definition still remains unsolved – how to generate the "as it should be" knowledge, which actually defines the character and concrete directions of institutional modernization that "pushes" individuals towards choosing the "right" strategy.

[12] Here attention should be paid to the earlier quoted work of Dosi on evolutionary modeling of nonequilibrium processes in which he explores the possibility of discarding the principle of maximizing behavior of individuals *(Дози (2012)).*

Let me dwell now on the suppositions of the Theory of Patronized Goods, which follows meritoric line that has absorbed, according to Richard Sturn "traditions of German financial science and public finances after Pigou" *(Sturn (2010)).* In regard to this, let me repeat the main definition of meritorics: benefits are called meritorious if their demand on the part of individuals lags behind the desired by society and is stimulated by the state. Thus, the very notion of meritorics is directly connected with normative public interest. It is this very aspect of Musgrave's theory that is ultimately important for me, as here the affinity between Theory of Patronized Goods and meritorics most clearly reveals itself. At this point, however similarity comes to an end. Adhering to the Austrian principle of "methodological subjectivism" in the foundations of Theory of Patronized Goods and viewing individuals' behavior as a given, I assume that they act "subjectively rationally" including those situations described by Musgrave and later by behavioral economists. Note that in order to explain their behavior there is no need to resort to the idea of "doublethink", which is rather artificial for economic theory. It is quite enough, as above noted, to reconsider the second constituent of rationality theory – the optimizing behavior of individuals (Table 1).

Table 1 **Compartive analysis of modification of rational behavior of individuals**

	Theory of welfare	Theory of public goods	Theory of merit goods	Concept of mild paternalism	Theory of patronized goods
Individual preferences	Methodological subjectivism	False signals	Corrupted signals	Corrupted signals	Methodological subjectivism
		True preferences	True preferences	True preferences	
Optimizing behavior	Complete rationality	Restricted rationality	Restricted rationality	Restricted rationality	Subjective rationality

Let me accentuate that the fundamental difference between the Theory of Patronized Goods and Musgrave's meritorics lies not in the negation of preferences duality but in different understanding of its nature. In my view, such duality is determined by existence of two essentially different subjects with their own preferences, and is far from supposing the same subject double thinking. Therefore the situation described in meritorics and repeated in behavioral economics, when individuals are unaware of "their second thought" while some third party knows very well about it and for individuals' sake stimulate this very "thought", does not change anything meaningful. The ambivalence of individuals' preferences inevitably leads to the existence of external source of their evaluation: apart from the multiplicity of "Self" there appears a judge with his own normative standard, who decides which of the "Selves", is right. Reasoning from this fact, a different treatment of duality of individuals' preferences was introduced in the Theory of Patronized Goods. Let me quote in this regard one of the principles of Roman private law: a wish cannot be claimed unfair – *«volenti non fit iniuria»*. Within this context the basic dilemma between true and false preferences of individuals, that was formulated in the theories of public goods and merit goods and later repeated and intensified by behavioral economists, is false as such. Based on this understanding of "doublethink" model and adhering to the principle of methodological subjectivism, I would like to stress that the Theory of Patronized Goods has at its foundation another assumption explaining the nature of preferences duality. I am referring to the assumption of existence of a certain external source of evaluation, some autonomous bear bearer of preferences that can be treated as normative standard.

2 NORMATIVE STANDARD

It is a well-known fact that welfare economics proceeds from complete rationality of agents. I am referring to aspiration of individuals towards maximum realization of their structured and coordinated preferences and choosing from all available alternatives the best variants of behavior. The preferences defined with the help of market mechanisms act as a naturally positive normative standard regardless whether it is the evaluation of a single individual's welfare or the whole society. A.Radygin and R.Entov may have their point saying that "multiple difficulties arise both in defining and correspondent use of information on all participants' preferences and forming the basis for state activity" *(Радыгин, Энтов (2012, с. 8)).*

It may be supposed that those difficulties are immediately determined by the fact that the basis for state activity (normative standard) has entirely value nature and in fact does not depend on positive preferences of participants. To overcome these difficulties admitting the existence of only market branch in forming public interests that aggregates individual preferences seems to me as completely unreal. I would also like to stress that sometimes unsupported by empirical research hypothesis about rational behavior of individuals as well as inability of standard theory of welfare to account for the results of behavioral economists deteriorate the value of this most important theory of the XXth century.

It is somewhat different for the theory of public goods. The peculiarities of these goods and services that have a non-excludable and non-rival character making individuals give "false signals" about zero demand for a public good due to their egoistic interest, as well as the absence of market mechanism of defining individual preferences gave P.Samuelson the foundation for his theorem "On impossibility". According to it, there is no decentralized solution for production of a public good *(Самуэльсон (2004,с. 374)).* The production volume of such good is determined by the state that sets the "how it should be", i.e. normative standard generated by "ethics expert" (*Samuelson (1954, p. 388))*. This theory as it appears was the first to offer normative choice that actually settled the conflict between false and true preferences of individuals. As distinct from the Theory of Patronized Goods where the autonomous bearer of preferences defines the normative standard, and the Theory of public goods where this function is performed by samuelsonian "ethics expert", in meritorics and in the concept of mild and libertarian paternalism this supposition is not formulated explicitly. Thus, normative standard in these theories remains as undetermined as are the "true preferences" of individuals. Any attempt to specify the true preferences or at least to decrease the extent of their indefiniteness is based on some vague-sourced knowledge of what is good and bad and "how it should be". Even if we admit subsequent manipulations that preserve greater freedom of individual choice as an effective instrument of state policy, there remains a common for these theories "methodological gap" in respect of definition of normative standard.

It should be said that "state's opacity about the true preferences of individuals" (*Schmidt (1988, s. 384))* and the probability of arbitrariness in defining normatively correct preferences (normative standard) have always been the Achilles' heel of meritorics. An old comment of McLure on this drawback *(McLure (1968, s. 479))*, made as far as forty-five years ago has probably more point than Muller and Tietzel's statement that the state does not necessarily need to know the "true" preferences of individuals *(Tietzel, Müller (1998, s. 106)).* Such loyalty of meritorics critics can be explained by their adherence to individualistic paradigm. Remaining adherent to "methodological individualism" they assume that normative standard is either totally unnecessary, or is essentially an aggregation of individual preferences *(Tietzel, Müller (1998, s. 106)).* Within these lines, go multiple tries to reconcile meritorics with methodological individualism *(Brennan, Lomasky (1983, s. 183–206), Head (1988, s. 1–37), Priddat (1992, s. 239–259), Koboldt (1995, s. 153))* as well as the references to constitutional economy in which normative standard is defined with the help of consensus of individual preferences, and individuals are viewed as "ultimate source of evaluations" *(Buchanan (1986, p. 249)).* This approach however runs against evident conflict between "ultimate source of evaluations" and the multiplicity of "Self" inherent to meritorics. While in the theory of welfare, "methodological individualism" used in combination with "methodological subjectivism" is a quite natural assumption, in meritorics, which gave up on Austrian subjectivism and allows for two sources of evaluation, or two systems of individuals' preferences, there appears an unsolvable problem of their coordination with this ontological principle. The thing is that the ambivalence of individuals' preferences inherent to Musgrave's theory inevitably leads to appearance of external source of evaluation with its own normative standard. While remaining within methodological individualism, it is necessary to look for the normative standard directly in individuals' preferences. Moreover as different from theory of welfare, in meritorics market mechanism deals solely with "corrupted" preferences of individuals. However only their "true" preferences can claim the role of normative standard and their own definition involves normative standard. At this point, the circle closes with logical loop.

The bottom-line is obvious. Meritorics' renunciation of "methodological subjectivism" and the use of the model of human behavior based on "doublethink" or multiplicity of "Self" de-facto leads to the renunciation of "methodological individualism" as well. In this case, what is left, what methodological suppositions ground this theory? Apart from evidently formulated duplicity of preferences, the theory also has implicit duplicity of treatment of the very individualistic norm. On the one hand, the possibility of existence of corrupted and true preferences of individuals requires external source of evaluation, which poorly comports with methodological individualism; on the other, this theory supposes "on default" that normative standard can be formulated in terms of true preferences of individuals, i.e. within the framework of methodological individualism *(Head (1988, s. 27)).*

"Do not make a tangle of it, Philipp, for it is the happiness of humankind you are considering" – this is epigraph to Kurt Schmidt article *(Schmidt (1988, s. 384)),* in which he quotes Alfred de Musset from his "Lorenzaccio". This perfectly chosen epigraph, reflecting liberal tradition with amazing precision, registers the "tender point" of meritorics. However eligible to critique, Musgrave's attempts to justify state's intervention and reconcile it with liberal economic theory[13] gained momentum in the works of behavioral economists, the supporters of mild paternalism. Thinking of the "happiness of the humankind", they agreed that not everything could be given to "invisible hand" that something had to be done by the state by "pushing" people towards right decisions. Within their meaning, society has to give everybody an opportunity to be happy: both to those no real ideas about happiness, and those who do not possess enough means or willpower to make right decisions, and finally to the future generations.

It should be noted that with all the relevance of the concept of libertarian paternalism, it could be viewed only as "a second discovery" of meritorics made by behavioral economists. From the point of view of methodology, mild paternalism is nearly no different from meritorics that presupposes intrusion into customer preferences. Though in this concept describes slightly different factors influencing individual choice not connected with increasing the welfare, it is the "pushing" of individuals towards making normatively right decision which remains essential. In other words, libertarian *(Sunstein, Thaler (2003, p. 1188))* and asymmetrical *(Camerer et al (2003, p. 1212))* paternalism, which presuppose substitution of direct restriction of individuals' choice with "option on default", retain at their foundation meritorious intrusion into customer preferences.

Using the advances of behavioral economics Sunstein and Thaler in fact repeated paternalistic thesis of meritorics, which among others attracts attention of D'Amico *(D'Amico (2009))*. It is not hard to realize that paternalism in any shape including libertarian, asymmetrical, and "policy of gentle push" is based on normative standard, on the knowledge of "what should be". According to

[13] Public interest in particular is viewed by Musgrave as the result of "transfer into political trust" of the individual preferences. Voting at elections for particular candidate individuals with their vote assign to him the right to express their opinion on what public preferences should be *(Рубинштейн (2009c)).*

R. Sugden, for example, libertarian paternalism is "a concept that involves a planner responsible for correlating information about individual preferences and welfare and basing on these data promoting the growth of general welfare" *(Sugden (2008, p. 229))*.

Commenting on purely meritorious thesis of Sunstein and Thaler on paternalistic compensation for inadequate information, contracted mental capacities and insufficient willpower of individuals *(Sunstein, Thaler (2003, p. 1162))*, Sugden stresses that "without normative judgments we wouldn't be able to define full-rate information, non-contracted mental capacities, or absolute self-command" *(Sugden (2008, p. 232))*. In other words, here as well the normative nature of "true preferences" of individuals requires external source of estimation of their welfare that generates "normative judgments" or normative standard, which, however, does not correlate well with individualistic norm. Thus, we can state that in this issue meritorics and mild paternalism have but marginal differences and in fact suffer from the same affliction of incompatibility of the behavioral model of individuals with multiplicity of "Self" with the principle of methodological individualism.

Let me make general conclusion. Researches by behavioral economists led not only to the rediscovery of meritorics, to development of behavioral model of individuals with multiplicity of "Self" and strengthening of normative vector in economic analysis, but also created yet other doubts in absolutization of the methodological individualism principle, according to which any interests of society can be described via individuals' preferences that have sovereign status. To affirm these doubts let me quote the old philosophic law of David Hume – "it is impossible to derive *what should be* from *what there is*" as well as mathematical formulation of in fact the same idea in the shape of Arrow's impossibility theorem. Their direct conclusion appears in the statement that paternalistic directives of society and the correspondent normative standard cannot be derived from individuals' preferences that have positive nature.

Now let us speak about the normative standard in Theory of Patronized Goods, in which the paternalistic interference of the state is given ground from the united perspective *(Рубинштейн (2009a))*. In this respect let me quote Gunnar Myrdal ,"the only way to approach the objectivity in theoretical analysis is to bring our values from darkness to light, realize them, specify them, openly acknowledge them and let them define theoretical research" *(Myrdal (1970, p. 55–56))*. Such definitive peculiarity of patronized goods is their social utility – the way to meet public interests that form normative standard. This applies both to social merit goods, and to goods and services, which production and consumption are connected with "markets failures".

While applying to the theories of public and merit goods we can consider this regulation as proven, in respect to "market failures" some special comments should be made and some questions answered. For example, how should poverty be treated, which according to Musgrave leads to irrational behavior of individuals and subsequently to ineffective resources allocation? How should we evaluate what is better - either direct losses in welfare from ineffective use of resources without poverty, or no such losses at high level of poverty? Where should various other cases be placed that are treated by different authors either as market flaw, or as "state failure"? According to the definition of this phenomenon, it is always about the situations that are evaluated as unsatisfactory. Namely *evaluated* by economists based on "normative standard" drawn up by a correspondent theory[14]. An inevitable conventional element in these evaluations has nothing to do with the market mechanism in itself. Moreover, "market failure" is nothing more than a habitual metaphor that masks the neutrality of self-regulation mechanism[15]. The results of its activity cannot be either

[14] According to D.Davidson, for example, if there is no opportunity to interpret individual's behavior as "true in respect to our own standards, we have no reasons to consider it rational" *(Дэвидсон (2003, с. 197))*. Let me stress here that economists evaluate individuals' behavior using their *own standards.*

[15] I am inclined to consider "state failure" as another metaphor of the same kind. Thus, even democratic organization of society "does not always presupposes a more thorough study of true preferences of population and defining better

"fault", or "true". They become as such only within people's value judgments.[16] From the Theory of Patronized goods viewpoint markets inefficiency is no different from other situations that are recognized as unsatisfactory. For example, if the considered monopoly or adverse selection is not approved by society, they can be considered as the analogue to equilibrium evaluated as undesired due to growing inequality in wealth distribution. In both situations as well as in the case of individuals whose behavior is treated as irrational, the question is solely about value judgments that reflect normative directives of society in the form of correspondent preferences of the state – the autonomous market subject (table 2).

Table 2 **Comparative analysis of normative standard definitions**

	Theory of welfare	Theory of public goods	Theory of merit goods	Concept of mild paternalism	Theory of patronized goods
Normative standard	Revealed preferences	Preferences of samuelsonian "ethics expert"	Value perceptions	Value perceptions	Normative preferences of society

Thus, normative standard in the interpretation of Theory of Patronized Goods is the reflection of normative interest of society that cannot be reduced to preferences of individuals. The fact of existence of this interest is substantiated with the correspondent initial assumption based on relativistic philosophy. Methodologically speaking, there are two issues imbedded here. First, why is it necessary to renounce methodological individualism and consider the presence of autonomous interest of society as initial assumption? Second, what are "normative preferences of society", what is their nature, essence and mechanisms of formation? Let me elaborate on the first question.

3 METHODOLOGICAL RELATIVISM

I have been repeatedly reproached that the existence of public interest irreducible to individual preferences is postulated in Economic Sociodynamics. This is true, but only a part of the truth. What is meant is the replacement of one postulate of the standard theory – methodological individualism – with a more general original assumption. In this respect both methodological individualism, and its substitute "methodological relativism" have the same axiomatic nature. Though my colleague and partner in epistolary discussions A.Liberman draws attention to the inequality of these postulates, reasoning that "it is easier to admit that everything is confined to the actions of well-watched and familiar individuals than to build a more complicated theory", I cannot agree with him.

Surely, it is easier to make such an assumption, but it fails to explain a whole class of phenomena. According to this assumption, for one, it is impossible to define normative standard in theories of public and merit goods, in concept of mild paternalism where the behavioral model of individuals with multiplicity of "Self" is used. Moreover, it would be evidently erroneous to suppose that the existence of public interest irreducible to individual preferences in Economic Sociodynamics and the Theory of Patronized Goods can be combined with methodological individualism. It should be noted that public interests, as a whole as well as the problem of their interrelation with individual preferences are the "all time subjects" wandering through countries and epochs. By the end of the XIX century, two trends in interpretation of public interest were defined. Thus the German tradition

options to satisfy such requirements" *(Радыгин, Энтов (2012, с. 9)*. The question is again about "better options" – value judgements based on personal standards.

[16] Optimality criterion by Pareto is an example of value judgement.

postulating the interest of society as such (holism) recognized the category of "collective requirements" as a fundamental base for the famous "German finance science". The English tradition in its turn denied the very possibility of existence of interests different from the aggregated individuals' preferences (individualism). In the XX century, methodological individualism became an antithesis to holism, and steadily occupied its place in the main vein of economic theory. This state of affairs however makes me dissatisfied. As I see it, here lies the one of the main hindrances for the development of economic theory and one of the reasons for unreasonable narrowing of general social analysis. The latter conclusion can be formulated inversion ally – renunciation of radicalization of individualism and move towards relativist philosophy give opportunity to form economic methodology with more general assumptions.

In this respect, allow me to give some comments on interpretation of individualism and holism. But first the arguments pro et contra. Albert Schaffle, for example, wrote about the existence of public requirements "that cannot be met by individual members of society" *(Schaffle (1873, s. 113))*. Karl Menger expresses himself even more definitely, "…not only human individuals that form these unions but the unions themselves have their own nature and thus the necessity of preserving its essence and development – the general requirements that should not be mixed with the requirements of individual members or even with requirements of all members put together *(Menger (1923, s. 8))*. Alternative perceptions typical for the XX century are found in the works of Paul Samuelson – "I do not suppose the existence of some mystical collective mind that enables enjoyment of using collective consumer benefits…" *(Samuelson (1954, p. 387))*, Richard Musgrave – "as a group of people as such cannot talk, the question arises who is able to express the feelings of this group" (*Musgrave (1959, p. 87))*, and Karl Popper – "behavior and actions of such bodies as groups should be reduced to the behavior and actions of individual people" *(Поппер (1992, с. 109))*. [17] Such simple arguments and counterarguments are abundant on both sides. It seems to me however that the time for *simple* arguments is gone. From the perspective of modern social science with its principal assumption about "background range space"[18] and institutional understanding of socium they do not seem that convincing. In addition, the idea that the bearer of any interest is some animate creature is clearly superficial. Amid the complicating of interconnections between people, the very institutes generate specific interests of particular communities of individuals and society in general. If we involve the games theory tour discussion, another conclusion will become obvious: because of autonomous and self-interested individual decisions, their aggregate can transgress into the state that contradicts to the interests of each individual. In other words, the obtained result cannot always be reduced to the individual utility functions, which also shows that social entity possesses of system properties that individuals do not have. Quite representative in this respect was the discussion on dilemma "individualism-holism" that took place in the second half of XX century *(Блауг (2004, с. 100–101), Krimerman (1969), O'Neil (1973))*. One of its peculiarities was that the critics of holism were developing methodological individualism from "ontological individualism" not quite on a reasonable basis – from the fact that society consists of people and from the ideas that individuals create all social institutes, while social values are just hypothetical abstractions *(Kincaid (1998, p. 295))*. This approach however did not gain universal support. "People do not create society", writes Roy Bhaskar, "as it has always existed before them and is an indispensable condition for their activity" (*Bhaskar (1989, p. 36))*. Blaug also says, "Though at the trivial level ontological individualism appears fair, it does not necessarily define the way we should or should not study collective phenomena, i.e. with methodological individualism" *(Блауг (2004, с. 101))*. At the same time, a general opinion about insufficient reasonableness of transition from "ontological

[17] According to Mark Blaug "Popper's own works do not give an insight into how decidedly he advocates methodolovigical individualism" *(Блауг (2004, с. 100))*, moreover Popper did not take part in the famous methodological dispute in the 1950s.

[18] What is meant here is the "background range space" that exists outside of individuals' heads in which their thoughts and words acquire general sense" *(Витгенштейн (1994))*. I will later come back to this important philosophic statement that gives base for the scientific explanation to the formation processes of social directives.

individualism" to methodological individualism has been formed *(Ходжсон (2008, c. 45, сн. 3))*. In the end of the XX century this discussion moved chiefly to the works of sociologists, the historical "opposition of the extremes" was preserved – methodological collectivism of Emil Durkheim *(Дюркгейм (1899), Гофман (2001))* with its demand to view social phenomena as a phenomenon of social entity not reducible to individual actions and methodological individualism of MaxWeber *(Вебер (1980, 1994))* with its directive to view everything through the actions of individuals. However, the main vector of this discussion moved to the sphere of less radical perception of individualism.
Benno Verlen, for example, stresses, "Methodological individualism does not mean denying the existence of collectivities and institutions. Nor does it require accepting that society is nothing more than an aggregate of individuals belonging to it, or that society can be reduced to individual psychology and explaining it in such notions" *(Верлен (2002, c. 16))*. Joseph Agassi takes quite the same attitude by interpreting methodological individualism in neutral and even appeasing tones *(Agassi (1960, 1973))*. This all indicates the formation of certain compromise between holism and individualism and moving towards relativist methodology.

Thus Anthony Giddens views methodological individualism on the one hand as a possible alternative to structural sociology, while on the other comes to the conclusion that structural sociology and methodological individualism are not alternative to each other in a sense that by accepting one we have to dismiss the other *(Giddens (1984, 2001))*. Another English sociologist R. Bhaskar, who thinks that social relations are compatible to both individualist, and collectivist theories, continues this line of reasoning within the framework of relativist methodology *(Бхаскар (1991))*. French sociologist R.Boudon upholds rather the same position, stressing that methodological individualism is a necessary but not indispensable condition for social research that requires obligatory analysis of macro sociological phenomena *(Boudon (p1988), Будон (1999)*. He also places himself closer to the "centre" and expresses a significant reservation, "assimilation of a group to an individual is legitimate only if the group is organized and evidently possesses institutional forms enabling collective decision making" *(Boudon (1979))*. In this context, the works of Alain Touraine and Michel Crozier should be discussed with their characteristic trait of accepting the doubleness of public life where social structures and individual behavior act as equal and complimentary elements of surrounding reality *(Touraine (2005), Крозье (1993, c. 35–43))*.[19] Methodologically research directives of Tourain and Crozier are quite correspondent to the approach of Giddens and Bhaskar and actually are based on the synthesis of micro- and macro-sociological approaches, on holism and individualism without any obligation to choose any as a fundamental principle. It may be supposed that this essentially relativist methodology creates additional opportunities for modern society research and expands the boundaries of economic analysis.

Now it is necessary to discuss a more complicated and more subtle aspect of "holism-individualism" dilemma characteristic for modern philosophy that divides and inseparably complementing analysis of individuals' behavior and functioning of institutions as elements of society as such. In this respect, we should pay attention at the research of Canadian philosopher and culture scholar Charles Tailor. Having displayed one of the possible ways of economic analysis methodology development, he distinguishes the so-called "indecomposably social benefits" that are by nature inappropriate for individual consumption *(Тейлор 2001))*. They are in essence identical to "social benefits" in Economic sociodynamics and Theory of Patronized Goods, which having no individual utility are capable of meeting irreducible (*indecomposable*) social requirements *(Гринберг, Рубинштейн (2000, c. 47–54), Рубинштейн (2008, c. 93–114))*. The main point of Tailor's work however lies not even in the result that has sovereign significance, but in the

[19] See the detailed review of modern French philosophy by Paul Ansar publiched in several issues of "Sociological Review" *(Ансар (1995, 1996, 1997))*.

argumentation, that substantiates this result. It is a completely different direction of analysis based on methodology of Austrian philosopher Ludwig Wittgenstein, who enriched modern philosophy with categories of thought and language *(Витгенштейн (1994, 2009), Болдырев (2008))* and on works of Ferdinand de Saussure, one of the founders of semiotics, who displayed fundamental differences and cyclic connection between language and speech *(Соссюр (2000, 2009)).* Using the already mentioned "background range space that exists outside individuals' heads"[20] and extrapolating it to the relations of people within socium, Tailor not only strengthens the conclusions in favor of intercompatibility of institutions and individual actions, but also, most importantly, introduces into scientific use phenomenon of "general understanding" as a set of "background base of practices, institutions, and judgments"*(Тейлор (2001, с. 12))* immanent to society as a social entity. This approach ensured exceeding the "tight scope" of methodological individualism and founded the philosophic base for viewing socium as a bearer of particular properties and even requirements that can be met by "indecomposably social benefits". [21] Tailor displays Saussure's endless circle and notes, "Speech activities suppose the existence of language, and language is reproduced in speech activities" *(Тейлор (2001, с. 11)).* At some stretch, Saussure's circle can by associative be applied to the pair individuals-institutions: individual interactions should be viewed within the framework of culturally determined institutions, which are reproduced through the actions of individuals. Let me note that here Tailor goes further than the above mentioned sociologists preserving however their characteristic principle of intercompatibility of holism and individualism that corresponds with methodology of relativism used in Economic Sociodynamics and Theory of Patronized Goods. Adhering to this principle enables "breaking free" from atomization of society as it allows for explaining individual behavior with "macro sociological variables" inter alia. Blaug has also pointed this out in application to economic methodology, "it is in principle highly desirable that all holistic concepts, macroscopic factors, aggregated variables were defined in terms of individual behavior were possible. However when it is not possible, let us not fall into silence just because we cannot violate the principle of methodological individualism" *(Блауг (2004, с. 103)).* John Maynard Keynes probably also discovered such *impossibility*. It will be recalled that he outputs the key notions of his theory that display macroeconomic characteristic of the system in general from macro phenomena of the same order and not from individual behavior. Unemployment he explains, for example, with insufficiency of cumulative demand, etc. Though the critics of Keynesianism insisted that macro phenomena should be interpreted through microeconomic actions, it looks like their point has not become dominant. The thesis that explanation of social phenomena cannot be reduced to the actions of individuals has also gained a foothold in new institutional economics *(Aoki (2001)).* The following words of George Hodgson are also appropriate in this context, "Regardless of their centenary rivalry, methodological individualists and collectivists have more common traits than it is customary supposed. Methodological individualism demands that society should be explained from an individual's viewpoint, which makes it lose sight of the key mechanisms of social influence thus accepting goals and preferences of individuals as given. Methodological collectivism explains individual through society and subsequently lacks adequate explanation of how individual goals and preferences can change. The variants of explanation in both methodological strategies are different; however, the results are much the same in essential points" *(Ходжсон (2008, с. 51)).* I do not recollect exactly where I read the following thought, possibly in A.B. Hofman's works, but I clearly remember the essence of it. There are multiple levels of research of society and human realities. The specific character of each level is always there: any researcher under certain circumstances explains individual behavior with social conditions of individuals 'existence, while under the other circumstances he analyses collectives through individual behavior. In other words, the discussion

[20] Illustrating Wittgenstein's ideas, Tailor says the following, "Thoughts presuppose and demand the background range space to be the very thoughts they are" *(Тейлор (2001, с. 10)).*

[21] By naming the phenomena of "general understanding" as culture and using Saussure's approach to a wide class of social phenomena Tailor defined its only bearer – society as such.

about “the only true” individualism or holism cannot provide any ontological results. This conclusion reveals the very essence of relativist methodology that allies a number of Russian economists *(Автономов (1998), Полтерович (2011), Лившиц (2013), Ореховский (2013))*. I needed this little insight to justify the move from the strictly individualistic norm to “methodological relativism”. As Blaug said, if possible, social preferences should be viewed as an aggregate of individuals’ preferences; when it is impossible, other laws of formation of socium interest should be considered, including historically formed institutions and mechanisms of political system, the peculiarities of interconnection and competition of political elites supported by interests of corresponding social groups and possessing of their own preferences. This directly relates to the normative standard as well, which defines the direction of state’s activity in the theories of public and merit goods, concept of mild paternalism and theory of patronized goods.

In the theory of public welfare methodological individualism, in combination with methodological subjectivism, is a natural provision for the formation of normative standard in the shape of market aggregate of individuals preferences; yet in the theories of public and merit goods, as well as in the concept of mild paternalism that all use the behavioral model of individual with multiple “Self”, situation looks quite different. The postulated in those theories “true preferences” (read *normative standard*) are formed, as shown above, by an external source of evaluation. In other words, such “normatively correct” preferences evidently “clash” with methodological individualism. And only denial (according to Blaug) of strict form of individualism in this theories lets defining normative standard based on value judgments of “how it should be”. Though it is unclear as for how this knowledge arises, we can conclude that by declaring their adherence to methodological individualism and simultaneously violating this canon, the representatives of these theories display latent relativism (table 3).

Table 3 **Comparative methodology of some economic theories**

	Theory of welfare	Theory of public goods	Theory of merit goods	Concept of mild paternalism	Theory of patronized goods
Individual preferences	Methodological subjectivism	False signals	Corrupted signals	Corrupted signals	Methodological subjectivism
		True preferences	True preferences	True preferences	
Methodological individualism / methodological relativism	Methodological individualism	Latent relativism	Latent relativism	Latent relativism	Methodological relativism
Normative standard	Revealed preferences	Preferences of samuelsonian “ethics expert”	Value perceptions	Value perceptions	Normative preferences of society

In the theory of patronized goods with its axiomatic using combination of methodological subjectivism and methodological relativism, normative standard is defined based on normative interest of society in the shape of its preferences as an autonomous market subject. While individual preferences merging into market stream are averaged on the whole set of individuals, preferences of society as such that exist alongside with them do not undergo such reduction being defined by means of political system mechanisms. These interests are formed within two different institutional environments, thus they are not reducible to each other and are complimentary to each other.

Thus, we speak here about two parallel processes, about market and political branches. One of them is solely connected with individual preferences and their harmonization with the help of market mechanism, while the other reflects the origin, expansion and actualization of normative interests of society by means of institutes of political system. Wherein, normative interests of socium, depending on the level of development of society and its political system, absorb the entire spectrum of public preferences based on socially approved values and ethic norms, ideas of justice and expediency, and other social directives. In other words, the field of public normative interests generated by political branch gets those value judgments that Samuelson in "Pure theory of public expenditures" attributed to his "ethics expert" and representatives of meritorics and mild paternalism called "true preferences." Note that the political branch is not a theoretical abstraction, it is real and observable process serviced by institutions of society. There participate certain individuals – “passionarities” – who define the “hot spots” of socium before others; mass media, public movements and parties that serve as “institutional lift” for the interests that have not obtained wide circulation; the representative organs of all levels that ultimately formulate the objectives variously correspondent with public expectations. It is this process that I consider the main formation mechanism of interests of society as such that finds a correspondent display in normative standard. By including into analysis’ scope two branches of formation of public interest, we will have to reconsider one more assumption of economic theory.

4 HETEROGENEITY PRINCIPLE

Discussing the above stated question on the nature and mechanisms of formation of social entity interests in the Theory of patronized goods, I would like to support V.Polterovich’s idea that it is not only about accepting their existence but also about concrete description of the political system that forms and actualizes these irreducible interests[22]. It is quite plausible that innuendos in this issue created a certain lack of understanding among some of my colleagues.

When I am considering the political branch of formation of public interest and ground their autonomy and irreducibility to the interests of individuals who take part in generating public interest elicited by market mechanism, I do not mean that normative interests are defines by some “mystic organ” or another abstraction. Of course not. As in the case of market branch of public interest, concrete people that interact with each other and with the existing institutions realize the formation of public normative interest. The problem however arises in defining whether these are the same people or different groups of individuals, the same institutions or different institutional environments immanent to each of the two branches of formation of public interest.

Here the content analysis begins that requires going back to initial assumptions. The standard axiom of homogeneity of economic agents and their preferences being one of them seems doubtful to many researchers. Let me quote G.Dosi, “It would be easier if we could justifiably represent the real “general equilibrium” (with multiple agents that are inhomogeneous at least in their initial resources and preferences) in compressed form as a representative agent. However, it is *actually impossible*. If we still do it against all the odds, we than suppose the coordination problem to be solved by construction” *(Дози (2012, с. 35)).* Though the statement about inhomogeneity of agents has an almost semi centennial history[23], research papers in the main economic literature have been only recent addition.

[22] For more detailed presentation of V.Polterovich’s viewpoint expressed in our personal conversations see *(Рубинштейн (2010, с. 111–116)).*

[23] Apart from the studies devoted to the critics of general equilibrium models with “representative agent”, let me point out some works in the are of economic and social psychology. For example, *(Kelley,*

After the works of Nobel laureate James Heckman who demonstrated real opportunities for improvement of state policy by suggesting it acted in society with heterogenial agents and social groups with contrary interests, the assumption of heterogeneity began to be considered as a more adequate methodological principle *(Heckman (2001a, b))*. The results of experiments including the sphere of public goods significantly corroborate to this conclusion *(Fehr, Gachter (2000), Webley et al. (2001), Fischbacher et al. (2001), Andreoni, Miller (2002), Goeree et al. (2002))*. Noteworthy is also a recent research by P.Orekhovsky devoted to the analysis of homogeneity axiom applied to economic agents, consumer preferences, production functions and public choice, in which he demonstrates an evident remoteness of "of this prerequisite from a modern economic reality"*(Ореховский (2013, c. 31))*. Essentially, we have here a similar situation to that observed above when analyzing the principle of rational behavior, where empirical studies of behavioral economists became the impetus for a critical assessment. In this case, the above-mentioned experiments as well as the case studies of sociologists and political scientists, repeatedly demonstrated the existence of social groups whose interests and the behavior of their members differ significantly from each other. P.Orekhovsky actually points out this almost commonplace fact, “Political (and sociological) analysis assumes that the interests of the various groups may be the opposite: some are interested in progressive taxation, others - in the "flat rate", some require free sales and the possibility to carry weapons, and others are strongly opposed. This is not simply “different preferences”, these are different goals and values” *(Ореховский (2013, c. 19–20))*. The overall conclusion is also fair: the most important for the mainstream theory assumption of homogeneity of preferences in combination with methodological individualism, as well as the principle of rational behavior, discussed above, suffer from one affliction - "detachment from reality". Given this conclusion, it makes sense to consider how this issue is solved in the analyzed theories of public welfare, public and merit goods, and concept of libertarian or mild paternalism. It is clear that certain integrity and self-sufficiency of the public welfare theory that considers irrational individual behavior only in the line of market flaws and state failures; do not require either “doublethink”, or normative standard, or two branches of public interest formation. The condition of homogeneity of economic agents and their preferences in combination with methodological individualism and the principle of rationality enables the construction of equilibrium models with optimum allocation of resources and the highest possible realization of social welfare. However, as before, it is necessary to state that this theory does not explain the many empirical facts displayed in the experiments of behavioral economists. Analysis of the theory of public goods, in which "normative standard" is defined by samuelsonian "ethics expert", located at will of Samuelson outside economy[24], suggests that a not quite standard condition of heterogeneity is implicitly used here. It directly follows from the fact that "ethics expert" and individuals who consume public goods are different economic agents in this theory and have dissimilar preferences. And although Samuelson said nothing about heterogeneity assumption and, conversely, uses the "default" condition of homogeneity of aggregated consumers of public goods and their preferences, the mere existence of an "ethics expert” makes you think about the heterogeneity of economic agents. As for meritorics and the concept of mild paternalism, here, apparently, we face the same “default” use of heterogeneity condition as in the theory of public goods. The thing is that both meritorious, and libertarian paternalism presuppose state intervention in individuals’ preferences. In other words, regardless the definition of normative standard, in all forms of "true preferences" identification it is admissible, or rather necessary in both concepts to push individuals by the external entity towards "right solutions".

Staheliski (1970a), Johnson, Nohrem-Hebeisem (1979), Andreoni (1995), Offerman et al. (1996), Burlando, Hey (1997), Burlando, Webley (1999)).

[24] Let me emphasize that Paul Samuelson took out the solutions of "expert on ethics" beyond economics and believed that they were not economic task (*Самуэльсон (2004, c. 375))*.

Therefore in this case, de facto the assumption of heterogeneity is used that allows to divide the whole set of economic agents into two homogeneous groups with different preferences. In this sense, the theory of public goods, meritorics, and the concept of libertarian or soft paternalism are special cases of the Theory of patronized goods, where the explicitly formulated principle of heterogeneity belongs to the main methodological provisions. We can also state that, in accordance with the Theory of patronized goods, the interests generated by the political branch are principally inadequate to the interests formed by the market environment, and they cannot be defined in terms of market preferences. The vast majority of people do not possess such interests. Only a statistically irrelevant part of society – those whom Plato called "philosophers" *(Платон (1971, т. 3, с. 275))*, Musgrave attributed to the "informed group of people" *(Musgrave (1969, s. 16))*, and Schmidt classified as "politicians" *(Schmidt (1988, s. 384))* are able to acknowledge these interests. The presence of this special group of people providing their articulation requires the mitigation of excessively rigid prerequisite of homogeneity of economic agents and their preferences.

Assuming the heterogeneity of economic entities, we can suppose the existence of at least two major groups - "individuals" who generate public interest through the market mechanism, and "politicians" whom the rest of the population entrusted to take care of the general welfare.[25] To this, I would like to add a very important point of C. Taylor, "Living in society and, especially, studying its work, one should acknowledge such phenomena that are neither human nor their combinations: roles, responsibilities, status, rights, laws, customs "*(Тейлор (2001, с. 7–8))*. Therefore, if we can talk about participation of other citizens in the formation of public interest generated in the political environment, it can only be indirect, meaning political institutions and mechanisms of entrusting politicians with voters' opinions.

Considering in the Theory of patronized goods the political branch of formation of public interest and the "politicians" who generate normative attitudes of society and the corresponding normative standard, we should keep in mind a principally "different behavior" of this group of economic agents in relation to completely "different events"[26]. Let me explain what I mean by "politicians", "different events" and "different behavior". First, we are talking about a democratic society and its institutions, including the parliament, whose members based on an established procedure "define" normative interests of society and their current priorities[27]. Clearly, the concurrence of the two sets of individuals operating in the market and political environments is only possible when replacing parliamentary procedure with referendum. Taking into account the fact that the referendum itself is a rare exception to the standard of civil practice, we can assume that in the current discourse the only meaningful behavior is one of "politicians".

[25] In a well-known experiment with public goods the existence of " three types of players" is assumed , in particular, "free riders, cooperators and manipulators" (Burlando, Guala (2005 , p . 35)) . Here is another example. Recalling the work of Daron Acemoglu (Acemoglu (2007)), in which questions of "survivability of inefficient economic and political institutions" are researched, A. Radygin and R. Entov indicate that in the used models other three group of players are considered " 1) representatives of some abstract " elite" (apparently , a group of representatives of the ruling political elite), 2) the middle class , trying to resist the "elite" ; 3) employees" *(Радыгин, Энтов (2012, с. 17))*.

[26] In my earlier works, I used the concept of "other people" with "different behavior" in relation to "different events" *(Рубинштейн (2011, 2012))*. Following the principle of heterogeneity, the concept of "other people" can be replaced by a more appropriate category - "politicians", whose preferences differ from the preferences of individuals.

[27] In the preface to the English-language translation of Knut Wicksell's edition of the book "Study on the theory of finance" James Buchanan urged "fellow economists first to build any model of government or political system, and only then begin to analyze the results of government activities"» *(Бьюкенен (1997, с. 18))*. Following this methodologicaldirective and in order to analyze formation of public interest, I consider a fairly simple model of parliamentary democracy.

Secondly, if an individual in market environment assesses available alternatives from the standpoint of their own benefit[28], political branch generates alternatives related to normative understanding of public welfare. In this respect, it really is about "different events." For example, if in market environment individual decides on whether to go to the theater or buy apples, in the political environment "politicians" face another alternative: whether to support the exposure of the population to the theatrical art, or whether fruit consumption more important for society. It is clear that the identity of these alternatives is also possible only in the case of a referendum on the consumption of each good. That is why we can conclude that in the political process of public interests formation usually the “different events” are viewed.

Third, the Theory of patronized goods considers "different behavior" as the preferences of "politicians" acting on behalf of society, are mainly determined not by personal but public media. In addition, no matter how much we talk about the possible self-identification of the selected people with society, on behalf of which they form a normative standard and take appropriate decisions, it is still not the same as when individual has to pay for the consumed benefits by refusal to personally consume other benefits. Many studies indicate the possibility of lower evaluation of the usefulness of public resources for elected people in relation to their own resources[29]. In this sense, even a referendum cannot fix the "genetic defect" of public resources, which, in fact, determines the phenomenon of "*different behavior*".

I needed such lengthy explanations to clarify once more the mechanisms of formation of public normative interest - one of the most important provisions of the Theory of patronized goods. Using the heterogeneity principle as inter alia the basis for explaining "different behavior" and "politicians," I wanted to show that in the general case of the proposed model with two branches of public interests formation there is no place for dualism of preferences of the same individuals. We are talking about two sets of people, about fundamentally different public interests defined in the market and political environments, about their irreducibility to each other (table 4).

Table 4 **The principle of homogeneity in methodology of some economic theories**

	Theory of welfare	Theory of public goods	Theory of merit goods	Concept of mild paternalism	Theory of patronized goods
Heterogeneity/ homogeneity	Homogeneity	Heterogeneity “by default”	Heterogeneity “by default”	Heterogeneity “by default”	Heterogeneity
Market branch of formation of public interest	Market aggregate of individual preferences	Market aggregate of individual preferences	Market aggregate of individual preferences	Market aggregate of individual preferences	Market aggregate of individual preferences
Political branch of formation of public interest	Not available	Preferences of “ethics expert”	Value judgments on “true preferences”	Value judgments on “true preferences”	Normative preferences of society

Whiler researching such a category as the interest of social entity, one cannot but pay attention to the differences in the nature of individual and group interests. It should be said that this problem has

[28] Following Margolis I'm also willing to expand the boundaries of the Smithonian selfishness, and so far that altruism turns into component of rational behavior *(Margolis (1982, p.17))*. Note that in this formulation, the market branch of the formation of public preferences"captures" the altruistic interests of individuals.

[29] I will note that the end of the century was crowded with references to "rent-searching class", "political income", "bureaucratic rent", "logrolling", etc.

never been very popular among economists. If it is present in the economic analysis, it is only in a small number of works and more on a “tangential" scale[30].

The main subject after the fundamental work of Arrow on the public choice theory (Arrow (1951)), was the construction of general solutions (formation of social preferences), which have, by definition, the same properties as the preferences of individuals. Moreover, the theory itself with its reliance on methodological individualism and homogeneity of economic agents failed to expand the boundaries of economic analysis. Based on the fact that the public interest is merely an aggregate of (a combination) the interests of individuals, it actually postulates their equally *positive* nature, leaving out the interests of social entity which have *normative content*. It should be noted also that the ever existent desire to free the economic theory from value concepts, bring it closer to mathematics and make a positive science[31] led to the fact that the category of normative interests was practically driven from economic analysis - there is no place for normative categories where only "rigor and consistency" are recognized *(Кэй (2012, с. 7))*. Meanwhile without normative interests it is simply impossible to account for many processes. Therefore, expanding the boundaries of the traditional interpretation of group interest seems to me a very important step towards building an adequate economic methodology. To the group aggregate of individual preferences that along with individual interests are of *positive* nature, we should add the preferences of the group as such with the invariably *standard* nature. Let me also note that the normative character of social group interest as a whole is neither a hypothesis, nor a postulate. Regardless of the mechanisms of formation of such interest - whether it is a personal decision of a group leader or a choice of the coalition of like-minded (a party), or voting of all members of the group, it is always defined in the form of value judgments. Discussing methodological issues of Theory of patronized goods that include the normative interest of society and "likening" the state to the market subject that realizes this interest, we cannot but forget the verdict of R.Boudon, who emphasized that such assumptions were correct only in the case when the subject "... is endowed with institutional forms that allow it taking collective decisions "*(Boudon (1979))*. Thus, a clear and quite feasible requirement to the state -market subject is the presence of some institutional system that would allow making decisions on behalf of society. Basically, we are talking about another aspect of the considered methodology - the political structure of the state and civil society institutions, enabling collective decisions. This raises another important issue connected with the premise of the heterogeneity of economic agents. The fact is that in general case it makes sense to consider a variety of social groups and their authentic representatives, a certain part of which is in accordance with the institutions of the political system defines a set of "politicians" who express the corresponding group interests. Considering this, one should take into account the fact that "politicians" themselves are not a homogeneous group. Therefore, normative public interest generated by political branch, should be considered only as a democratic compromise formed during discourse determined by the current political system and the existing institutional environment capable both to approach and to distance public choice from social needs. One can only agree that "the political process has its own logic, which in many cases does not coincide with the habitual logic of optimizing economic mechanisms" *(Радыгин, Энтов (2012, с. 26))*. In other words, the political branch actualizes only the interests that are ready to be recognized by the political system itself, i.e. the complex of existing institutions and individuals in authority. It is these interests, regardless of their proximity to the real public needs, become by definition the normative public interests. Although the mechanisms of "social immunity" eventually make their adjustments by "correcting" public choice *(Гринберг,*

[30] I mean publications on value directives of society and their reflection in the institutional theory. See also (*Харсаньи (2004))*.

[31] This is the famous debate at the "Union social policy" council meeting in Vienna in 1909 and the "free from value judgments of social science” doctrine of the Weber-Zombmart (Wertfreiheit) that retains its supporters until today.

Рубинштейн (2000, с. 210)), it remains impossible to overcome the uncertainty factor. We are always dealing with some approximations of interests of society as such. It should be also noted that while in the recent past there dominated the concept of "benevolent state" whose activity was aimed at implementing the actual public interests, by the end of the twentieth century the thesis of the displacement of public choice and related policy decisions in favor of the ruling elites started playing an increasingly important part *(Stigler (1971))*. Jean- Jacques Laffont draws attention at this trend, by considering the "authentic adviser" of the ruling party , who offers the action programme, that increases party's benefits in the current economic and political situation" *(Лаффон (2007, с. 22–23))*. While agreeing with this trend, it should be emphasized that it would be wrong to assume the existence of the only possible or objectively better choice. It always lies in the field of normative decisions, with the main role played by social attitudes and targets of the ruling party or coalition that has a majority in the parliament. It is their decisions that transform public interest into a normative interest formulated by the group of people with appropriate authority. One way or another, subjectivity is always present in determination of normative interest, which a number of authors explain with the phenomenon of "principal-agent": the real policy makers (agents) can have their preferences that do not coincide with the preferences of voters (the principal) on whose behalf they act *(Афонцев (2010))*[32]. In addition, it is not just about parliament's representability or organization of its work. Due to the heterogeneity of society, normative interest formulated by the ruling party will always differ from the real needs of society. It refers to any "collective decisions". Therefore, while discussing the methodological aspects of the Theory of patronized goods we should bear in mind the possibility of the development of civil society institutions that under conditions of uncertainty of public interests are able to reduce the deviation from the public interests articulated by politicians. Laffont offered a partial solution to the problem coming up with what he called as "a complete constitution approach"*(Лаффон (2007, с. 29))*. These, of course, are not the regulatory mechanisms of the public normative interests' formation, yet only certain frameworks that restrict political decisions. Sharing a common skepticism as for the adequacy of policy decisions, I assume that is very difficult, if not unreal to overcome this state of affairs in the absence of appropriate channels of expression opinions and demands of different social groups as well as legitimate opportunities to assert their rights. Therefore it is impossible not to think of adequate democratic institutions that reflect the interests of different social groups at the same level as the civil society is developed with its mechanisms of self-organization, which form these groups and generate relevant interest groups *(Posnett (1987), Rose-Ackermann (1996), Salamon, Hems, Chinnock (2000), Аузан, Тамбовцев (2005), Гражданское… (2011))*.

* * *

Comparative analysis of methodology of the discussed theoretical constructions allows drawing the general conclusions of the research. First, it is possible to state that the Theory of the patronized goods is based on three basic assumptions: "methodological subjectivism", "methodological relativism" and "heterogeneity principle". They are integrated in this theory, first, in the form of supposition that every person depending on the level of his understanding and his value judgments acts subjectively optimally in the given circumstances; second, in the principle of utility complementarity, according to which there may be a group interest alongside with the individual interests of the group members; and third, in the form of two irreducible to each other branches of formation of public interest – market and political.

Second, analysis of basic premises of the Theory of public and merit goods, as well as the concept of libertarian paternalism gives ground for supposing that methodologically these theories are the particular cases of the Theory of patronized goods. Direct comparison of the initial premises speaks in favor of this hypothesis (table 5).

[32] A more general explanation is present in the works for a new political economy. See *(Persson, Tabellini (2005), Либман (2007, 2008))*.

A close look at the data in the table shows that apart from the principle of "methodological subjectivism" all other initial premises and their consequences with the accuracy of general formulations are the same in all compared theoretical constructions. Moreover, as shown in the proceeding analysis, it is the use of the principle of multiplicity of "Self" that actually leads to some lack of explicitness of other initial premises and their consequences in the theory of public and merit goods and in the concept of libertarian or mild paternalism. It only remains to say that the principle of multiplicity of "Self" itself can be viewed as a particular case of the "methodological subjectivism". The thing is that the model with "multiple "Self" also supposes that each of these "Selves" act subjectively optimally.

Table 5 **Basic premises and their consequences in some economy theories**

	Theory of welfare	Theory of public goods	Theory of merit goods	Concept of mild paternalism	Theory of patronized goods
Methodological subjectivism/ principle of multiplicity of "Self"	Rationality principle	Principle of multiplicity of "Self"	Principle of multiplicity of "Self"	Principle of multiplicity of "Self"	Methodological subjectivism
Methodological relativism/ methodological individualism	Methodological individualism	Latent relativism	Latent relativism	Latent relativism	Methodological relativism
Heterogeneity/ homogeneity	Homogeneity	Heterogeneity "by default"	Heterogeneity "by default"	Heterogeneity "by default"	Heterogeneity
Market branch of formation of public interest	Market aggregate of individual preferences	Market aggregate of individual preferences	Market aggregate of individual preferences	Market aggregate of individual preferences	Market aggregate of individual preferences
Political branch of formation of public interest	Not available	Preferences of "ethics expert"	Value judgments on "true preferences"	Value judgments on "true preferences"	Normative preferences of society
Motivation of state intervention	Correction of "market failures"	Definition of volume of public goods	Pushing towards realization of "true preferences"	Pushing towards realization of "true preferences"	Realization of public normative interest

Third, it is not hard to see that at least in three of its premises the Theory of patronized goods is close to evolutionary paradigm, which regards economic phenomena as "results of unequal interactions of limitedly rational, heterogenial agents with endogenial preferences...with their own understanding of the world and available behavioral models" *(Дози (2012, с. 31, 40)).*[33]

Fourth, the expansion of the boundaries of economic analysis in the result of easing of too strict premises of neoclassic theory and change of the rationality axioms, methodological individualism and homogeneity with a more general ontology centered on "methodological subjectivism",

[33] For more about the research statement of evolutionist see also (*Dosi, Orsenigo* (1988), Dosi, Nelson (1994), Нельсон, Уинтер (2002), *Dosi et al (2005)).*

"methodological relativism" and "heterogeneity principle"[34] with regard of the generalized Wiksell-Lindahl equilibrium model for patronized goods built upon the stated principles *(Рубинштейн (2009b, 2011, 2012)),*allows viewing the Theory of patronized goods as the next evolutionary stage of Economy welfare theory. We speak here about formation of Normative theory of public welfare.

[34] In this context let me draw attention to the research of O.Ananyin "Ontological premises of economic theories" *(Ананьин (2013))*. In his report delivered at the seminar "Theoretical economy", Ananyin notes that ".. within the body of economic knowledge there developed the research programs with their own "hard cores", in fact, ontologies, the irrefutable within the framework of research program sets of basic premises" (*Ананьин (2013, с. 18))*. In the annotation to this report author calls such ontologies particular.

REFERENCES

Автономов В.С. Модель человека в экономической теории и других социальных науках. М.: Изд. дом. ГУ-ВШЭ, 1998.
Автономов В.С. Абстракция – мать порядка? // Вопросы экономики. 2013. №4
Ананьин О.И. Онтологические предпосылки экономических теорий. М.: ИЭ РАН, 2013.
Ансар П. Современная социология // Социологические исследования. 1995. №12; 1996. №1–2, 7–10; 1997. №7.
Аузан А.А., Тамбовцев В.И. Экономическое значение гражданского общества // Вопросы экономики. 2005, №5.
Афонцев С.А. Политические рынки и экономическая политика. М.: КОМКНИГА, 2010.
Белянин А. Дэниел Канеман и Вернон Смит: экономический анализ человеческого поведения (Нобелевская премия за чувство реальности) // Вопросы экономики. 2003. №1. С. 4–23.
Блауг М. Методология экономической науки, или как экономисты объясняют / Пер. с англ.; Науч. ред. и вступ. ст. В.С. Автономова. М.: «НП "Журнал Вопросы экономики"», 2004.
Болдырев И. Языковые игры и экономическая теория мейнстрима. М., 2008.
Будон Р. Теория социальных изменений (пер. с англ.) / Под ред. М. Черныша. М.: Аспект-Пресс, 1999.
Бхаскар Р. Общества / Пер. с англ. // Социо-логос. Вып. 1. М.: Прогресс, 1991.
Бьюкенен Дж. Конституция экономической политики // Нобелевские лауреаты по экономике. Джеймс Бьюкенен. М.: Таурус Альфа, 1997.
Вебер М. Исследования по методологии наук. М.: ИНИОН, 1980.
Вебер М. Избранное. Образ общества / Пер. с нем. М., 1994.
Верлен Б. Объективизм Поппера и метод критического рационализма» / Пер. с англ. // Социологическое обозрение. 2002. Т. 2. № 4.
Витгенштейн Л. Логико-философский трактат / Пер. с нем. М., 1958 (2009).
Витгенштейн Л. Философские работы / Пер. с нем. Ч. I. М., 1994.
Вольчик В.В. «Затерянный мир» австрийской экономической теории // Экономический вестник Ростовского государственного университета. 2007. Т. 5. №3.
Гофман А.Б. Эмиль Дюркгейм в России: рецепция дюркгеймовской социологии в российской социальной мысли. М.: ГУ ВШЭ, 2001.
Гражданское общество: зарубежный опыт и российская практика. [Сб. науч. ст.] / РАН, Институт экономики; ред. А. Лебедев. А. Ру бин штейн. СПб.: Алетейя, 2011.
Гринберг Р.С., Рубинштейн А.Я. Экономическая социодинамика. М.: ИСЭПРЕСС, 2000.
Гринберг Р.С., Рубинштейн А.Я. Основания смешанной экономики. Экономическая социодинамика. М.: ИЭ РАН, 2008.
Гринберг Р.С., Рубинштейн А.Я. Теория, инновации и контуры будущей экономики в диалоге с Кеннетом Эрроу // Вопросы экономики. 2010. №10.
Де Сото. У.Х. Сущность австрийской школы (Лекция). Государственный университет – Высшая школа экономики. Москва 30 октября 2008 г.
Де Сото У.Х. Австрийская экономическая школа: рынок и предпринимательское творчество (пер. с англ. Б.С. Пинскера под ред. А.В. Куря ева). Челябинск: Социум, 2009.
Дози Дж. Экономическая координация и динамика: некоторые особенности альтернативной эволюционной парадигмы // Вопросы экономики. 2012. №12.
Дэвидсон Д. Исследование истины и интерпретации. М.: Праксис, 2003.
Дюркгейм Э. Метод социологии. Киев–Харьков, 1899.
Заостровцев А.П. Австрийская школа экономической мысли // Вестник Удмуртского университета. 2007. №2.
Канеман Д., Тверски А. Рациональный выбор, ценности и фреймы // Психологический журнал. 2003. Т. 24. №4.

Коландер Д. Революционное значение сложности и будущее экономической науки // Вопросы экономики. 2009. №1.

Крозье М. Современное государство – скромное государство. Другая стратегия изменения // Свободная мысль. 1993. №11.

Кэй Дж. Карта – не территория: о состоянии экономической науки // Вопросы экономики. 2012. №5.

Лаффон Ж.-Ж. Стимулы и политэкономия / Пер. с англ. М.: Изд. дом ГУ-ВШЭ, 2007.

Лещак О.В. Очерки по функциональному прагматизму: Методология –онтология – эпистемология. Тернополь-Кельце: Підручники & посібники, 2002.

Либман А.М. Экономическая теория и социальные науки об экономике: некоторые направления развития. М.: ИЭ РАН, 2007.

Либман А.М. Политико-экономические исследования и современная экономическая теория. М.: ИЭ РАН, 2008.

Либман А.М. Социальный либерализм, общественный интерес и поведенческая экономика // Общественные науки и современность. 2013. № 1. С. 27–38.

Лившиц В.Н. Основы системного мышления и системного анализа. М.: ИЭ РАН, 2013.

Майерсон Р. Равновесие по Нэшу и история экономической науки // Вопросы экономики. 2010. №6.

Маршалл А. Принципы политической экономии. Т. I. М.: Прогресс, 1983.

Масгрейв Р., Масгрейв П. Государственные финансы: теория и практика / Пер. англ. М.: Бизнес Атлас, 2009.

Нельсон Р., Уинтер С. Эволюционная теория экономических изменений. М.: Дело, 2002.

Ольсевич Ю.Я. Современный кризис «мейнстрима» в оценках его представителей (предварительный анализ). М.: ИЭ РАН, 2013.

Ореховский П.А. Посылка однородности экономических агентов: парадоксы теории и практики. М.: ИЭ РАН, 2013.

Павлов И.А. Поведенческая экономическая теория – позитивный подход к исследованиям человеческого поведения. М.: ИЭ РАН, 2007.

Павлов И.А. Феномен «уклонения от двусмысленности» в теории рационального выбора. М.: ИЭ РАН, 2011.

Платон. Государство / Платон. Собр. соч. в 3 тт. М., 1971.

Полтерович В.М. Кризис экономической теории // Экономическая наука современной России. 1998. №1.

Полтерович В.М. Становление общего социального анализа // Общественные науки и современность. 2011. №2.

Поппер К. Время лжепророков: Гегель, Маркс и другие оракулы: В 2 т. Т. 2. Открытое общество и его враги. М., 1992.

Радыгин А., Энтов Р. Провалы государства»: теория и политика // Вопросы экономики. 2012. №12.

Рубинштейн А.Я. К теории рынков «опекаемых благ» // Доклад на Секции экономики Отделения общественных наук РАН, 25 марта 2008 г.

Рубинштейн А.Я. К теории рынков опекаемых благ. Статья 1. Опекаемые блага и их место в экономической теории // Общественные науки и современность. 2009а. №1.

Рубинштейн А.Я. К теории рынков «опекаемых благ». Статья 2. Социодинамическое описание рынков опекаемых благ // Общественные науки и современность. 2009б. №2.

Рубинштейн А.Я. Мериторика и экономическая социодинамика: дискуссия с Р. Масгрейвом // Вопросы экономики. 2009с. №11.

Рубинштейн А.Я. Рождение теории. Разговоры с известными экономистами. М.: Экономика, 2010.

Рубинштейн А.Я. Опекаемые блага: институциональные трансформации // Вопросы экономики. 2011. №3.

Рубинштейн А.Я. Социальный либерализм: к вопросу экономической методологии // Общественные науки и современность. 2012. №6.
Саймон Г. Рациональность как процесс и продукт мышления // THESIS. 1993. Вып. 3.
Самуэльсон П. Чистая теория общественных расходов. // Вехи экономической мысли. Т. 4. Экономика благосостояния и общественный выбор / Пер. с анг. под общ. ред. А.П. Заостровцева. СПб: Экономическая школа, 2004.
Сапов Г. Значение австрийской школы экономики, ее эволюция и перспективы (стенограмма лекции). М.: ВШК, 1998 (www.sapov.ru/ staroe/si03.html).
Сокал А., Брикмон Ж. Интеллектуальные уловки. Критика современной философии постмодерна / Пер. с анг. А. Костиковой и Д. Кралечкина. М.: Дом интеллектуальной книги, 2002.
Соссюр Ф. де. Заметки по общей лингвистике. / Пер. с фр. М.: Прогресс, 2000.
Соссюр Ф. де. Курс общей лингвистики. М., 2009 (переиздание 1933 г.).
Стиглиц Дж. Крутое пике. Америка и новый экономический порядок после глобального кризиса. М.: Эксмо, 2011.
Тейлор Ч. Неразложимо социальные блага // Неприкосновенный запас. 2001. №4 (18).
Тихонова Н.Е. Социальный либерализм: есть ли альтернатива? // Общественные науки и современность. 2013. № 2. С. 32–44.
Урнов М.Ю. Социальный либерализм в России (взгляд политолога) // Общественные науки и современность. 2013. № 3. С. 30–43.
Фридман М. Методология позитивной экономической науки // THESIS. 1994. Вып. 4. С. 20–52.
Харсаньи Дж. Ценностные суждения // Экономическая теория. М.: ИНФРА-М, 2004.
Ходжсон Дж. Институты и индивиды: взаимодействие и эволюция // Вопросы экономики. 2008. №8.
Хэндс У. Нормативная теория рационального выбора: прошлое, настоящее и будущее // Вопросы экономики. 2012. №10.
Эволюционная эпистемология и логика социальных наук: Карл Поппер и его критики / Составление Д. Г. Лахути, В. Н. Садовского и В. К. Финна М.: Эдиториал УРСС, 2000.
Acemoglu D. Modeling Inefficient Institutions // Advances in Economic Theory. Proceedings of the World Congress 2005. Cambridge, MA: Cambridge University Press, 2007.
Agassi J. Methodological individualism // The British Journal of Sociology, 1960. Vol. 11. No. 3. P. 244–270.
Agassi J. Methodological Individualism // Modes of Individualism and Collectivism. Ed. by J. O’Neill. L., 1973.
Andel N. Zum Konzept der meritorischen Guter // Finanzarchiv. 1984.Vol. 42.
Andreoni J. (1995). Cooperation in public-goods experiments: Kindness or confusion? // American Economic Review. 1995. Vol. 85. No. 4.Pp. 891–904.
Andreoni J., Miller J. Giving according to GARP: An experimental test of the consistency of preferences for altruism// Econometrica. 2002. Vol. 70(2). Pp. 70, 737–753.
Aoki M. Toward a comparative institutional analysis. Cambridge, MA, 2001.
Arrow K. Social Choice and Individual Values. Chicago: Univ. of Chicago, 1951.
Benabou R. Tax and education policy in a heterogeneous-agent economy: What levels of redistribution maximize growth and efficiency? // Econometrica. 2002. Vol. 70(2). Pp. 481–517.
Bhaskar R. The possibility of naturalism: A philosophical critique of the contemporary human sciences. 2nd ed. Brighton: Harvester, 1989.
Boudon R. La logique du sociale: introduction a l’analyse sociologique. Paris: Hachette, 1979.
Boudon R. Individualisme ou holisme: un debat metodologique fondamental. In: Mendras H., Verret M. (eds.) Les Champs de la sociologie francaise. Paris: Armand Colin, 1988.
Brennan G., Lomasky L. Institutional Aspects of «Merit Goods» Analysis // Finanzarchiv. 1983. No. 41. S. 183–206.

Buchanan J.M. Liberty, Market and State, Brighton. England: Wheatsheaf Books, 1986.
Burlando R., Hey J. Do Anglo-Saxons free-ride more? // Journal of Public Economics. 1997. Vol. 64. No. 1. Pp. 41–60.
Burlando R., Webley P. Individual differences in value orientation in the private provision of public goods. Inquiries into the Nature and Causes of Behaviour: Proceedings of the XXIV Colloquium of the International Association for Research in Economic Psychology. 1, Belgirate, Italy, 1999, 518–526.
Burlando R.M., Guala F. Heterogeneous Agents in Public Goods Experiments // Journal of Experimental Economics. April 2005. Vol. 8. Issue 1. Pp. 35–54.
Camerer C., Issacharoff S., Loewenstein G., O'Donaghue T., Rabin M. Regulation for Conservatives: Behavioral Economics and the Case for 'Asymmetric Paternalism' // University of Pennsylvania Law Review. 2003. Vol. 151. Pp. 1211–1254.
D'Amico D. Merit Goods, Paternalism and Responsibility, mimeo Universita di Pavia, 2009.
Dosi G., Orsenigo L. Coordination and Transformation: An Overview of Structures, Behaviours and Change in Evolutionary Environments Technical Change and Economic Theory / G. Dosi et al. (eds.). L.: Pinter; N. Y.: Columbia University Press, 1988.
Dosi G., Nelson R.R. An Introduction to Evolutionary Theories in Economics // Journal of Evolutionary Economics. 1994. Vol. 4. No. 3. Pp. 153–172.
Dosi G., Marengo L., Fagiolo G. Learning in Evolutionary Environments // The Evolutionary Foundations of Economics. Cambridge: Cambridge University Press, 2005.
Fehr E., Gдchter S. Cooperation and Punishment in Public Goods Experiments Source // The American Economic Review. 2000. Vol. 90. No. 4 (Sep., 2000). Pp. 980–994.
Fischbacher U., Gдchter S., Fehr E. Are People Conditionally Cooperative? Evidence from a Public Goods Experiment. Economics Letters. 2001, 71, 397–404.
Friedman M. The Methodology of Positive Economics. In: Friedman M. Essays in Positive Economics. Chicago: University of Chicago Press, 1953.
Giddens A. The Constitution of Society. Outline of the Theory of Structuration. Cambridge: Polity Press, 1984.
Giddens A. Sociology. Cambridge: Polity Press, 2001.
Goeree J., Holt C., Laury S. Private costs and public benefits: Unreavealing the effects of altruism and noisy behavior // Journal of Public Economics. 2002. Vol. 83, 255–276.
Grinberg R., Rubinstein A. Economic Sociodynamics. Berlin, New York: Springer, 2005 (reprinted 2010).
Head J.G. On Merit Goods // Finanzarchiv. 1966, 25.
Head J.G. On Merit Wants // Finanzarchiv. 1988, 46.
Heckman J. Micro-data, heterogeneity, and the evaluation of public policy: Nobel lecture // Journal of Political Economy. 2010a. Vol. 109, 673–748.
Heckman J. Accounting for heterogeneity, diversity, and general equilibrium in evaluating social programmes // The Economic Journal. 2010b. Vol. 111, 654–699.
Johnson D., Norem-Hebeisem A. A measure of cooperative, competitive, and individualistic attitudes // Journal of Social Psychology. 1979. Vol. 109, 253–261.
Kahneman D., Tversky A. (eds.). Choices, values and frames. New York: Cambridge University Press, 2000.
Kahneman D. Maps of Bounded Rationality: Psychology for Behavioral Economics // American Economic Review. 2003. Vol. 93. No. 5. P. 1449–1475.
Katona G. Psychological Analysis of Economic Behavior. NY: McGrow- Hill, 1951.
Kelley H., Staheliski A. Social interaction basis of cooperators' and competitors' beliefs about others // Journal of Personality and Social Psychology. 1970a, 16, 66–91.
Kelley H., Staheliski A. The inference of intention from moves in the Prisoner's Dilemma Game // Journal of experimental social psychology. 1970b, 6, 401–419.
Kincaid H. Methodological Individualism/Atomism // The Handbook of Economic Methodology. UK, London: Edwar Elgar Publishing Limited, 1998.

Koboldt C. Okonomic der Versuchung; Drogenverbot und Sozialvertragstheorie, Tьbingen, 1995.

Kreuger A.O. The Political Economy of the Rent-Seeking Society // American Economic Review. 1974. Vol. 64.

Kreuger A. Government Failures in Development // Journal of Economic Perspectives. 1990. Vol. 4. P. 9–23.

Krimerman L. (ed.). The Nature and Scope of Social Science. A Critical Anthology. New York: Appleton-Century-Crofts, 1969.

Machlup F. Austrian Economics//Encyclopedia of Economics. New York: McGraw-Hill, 1982.

Margolis H. Selfishness, Altruism and Rationality: A Theory of Social Choice. Chicago and London, 1982.

Mayer T. Truth versus Precision in Economics. Aldershot, Brookfield, VT: Edward Elgar, 1993.

McLure C.E. Merit Wants: a Normatively Empty Box // Finanzarchiv. 1968, 27.

Menger C. Grundsatze der Volkswirtschaftslehre. 2. Aufl., Wien-Leipzig, 1923.

Mukoyama T. Macroeconomic Models of Heterogeneous Agents. University of Virginia / February 2008, Bank of Japan lectures.

Mьller Ch., Tietzel M. Merit goods from a constitutional perspective. In: Brennan G. et al. (eds.). Method and morals in constitutional economics. Essays in honor of James M. Buchanan, Springer, Berlin & New York, 2002, 375–400.

Musgrave R.A. The Theory of Public Finance. N.Y.; London: McGraw-Hill, 1959.

Musgrave R.A. Provision for Social Goods. In: Margolis J., Guitton H. (eds.). Public Economics. London-Besingstoke: MacMillan, 1969.

Musgrave R.A, Musgrave P.B, Kullmer L. Die цffentlichen Finanzen in Theorie und Praxis, Band 1, 6. Auflage, Tьbingen, 1994.

Myrdal G. Objectivity in Social Research. London: Duckworth, 1970.

Offerman T., J. Sonnemans and A. Schram. Value orientations, expectations, and voluntary contributions in public goods // Economic Journal. 1996, 106, 817–845.

O'Neil J. (ed.). Modes of Individualism and Collectivism. London, 1973.

Persson T., Tabellini G. The Economic Effects of Constitutions. Cambridge: MIT Press, 2005.

Posnett J. Trends in the Income of Charities, 1980 to 1985. In: J. McQuillan (ed.). Charity Trends 1986/87. Tonbridge, Chanties Aid Foundation, 1987.

Priddat B.P. Zur Цkonomie der Gemeinschaftbedurfnisse: Neuere Versuche einer ethischen Begrьndung der Theorie meritorischen Guten // Zeitschrift fur Wirtschafts-und Sozialwissenschaften. 1992, 112.

Rнos-Rull J-V. Models with heterogeneous agents. Chapter 4. In:T. Cooley (ed.). Frontiers of Business Cycle Theory. Princeton University Press, 1995.

Rose-Ackermann S. Altruism, Nonprofits, and Economic Theory // Journal of Economic Literature. 1996. Vol. 34. No. 2. Pp. 701–728.

Salamon L., Hems L., Chinnock K. The Nonprofit Sector: For What and for Whom? Working Papers of the Johns Hopkins Comparative Nonprofit Sector Project. No. 37. Baltimore, The Johns Hopkins Center for Civil Society Studies, 2000.

Samuelson P.A. The pure theory of public expenditure // Review of Economics and Statistics. 1954. Vol. 36. No. 4.

Schaffle A.E.F. Das gesellschaftliche System der menschlichen Wirtschaft, 3. Aufl., 1. Band, Tubingen, 1873.

Schelling T. The intimate contest for self-command. In: Choice and Consequence: Perspectives of an errant economist. Cambridge: Harvard University Press, 1984.

Schmidt K. Mehr zur Meritorik. Kritisches und Alternatives zu der Lehre von den offentlichen Gutern // Zeitschrift fur Wirtschafts- und Sozialwissenschaften. 108. Jahrgang 1988.

Schneider W., Shiffrin R.M. Controlled and Automatic Human Information Processing: I. Detection, Search, and Attention // Psychological Review. 1977a. Vol. 84. No. 1. P. 1–66.

Schneider W., Shiffrin R.M. Controlled and Automatic Human Information Processing: II. Perceptual Learning, Automatic Attending and a General Theory // Psychological Review. 1977b. Vol. 84. No. 2. P. 127–190.

Shefrin H.M., Thaler R. An Economic Theory of Self. Center for Economic Analysis of Human Behavior and Social Institutions. Working Paper. 1978. No. 208.

Shefrin H.M., Thaler R.H. An Economic Theory of Self-Control // Journal of Political Economy. 1981, 89.

Simon H.A. A Behavioral Model of Rational Choice // Quarterly Journal of Economics. 1955. Vol. 69. No. 1. P. 99–118.

Simon H.A. A Behavioral Model of Rational Choice. In: Models of Man, Social and Rational: Mathematical Essays on Rational Human Behavior in a Social Setting. New York: Wiley, 1957.

Smith V.L. Rational Choice: The Contrast between Economics and Psychology // Journal of Political Economy, University of Chicago Press. 1991. Vol. 99(4). Pp. 877–897.

Stigler G. The Theory of Economic Regulation // Bell Journal of Economics. 1971. Vol. 2(1).

Sturn R. «Public goods» before Samuelson: interwar Finanzwissenschaft and Musgrave's synthesis. Year: 2010.

Sugden R. Why incoherent preferences do not justify paternalism // Constitutional Political Economy. 2008. Vol. 19. Pp. 226–248.

Sunstein C., Thaler R. Libertarian paternalism is not an oxymoron. University of Chicago Law Review, 2003. Vol. 70. Pp. 1159–1202.

Sunstein C., Thaler R. Nudge: Improving Decisions about Health, Wealth, and Happiness. Yale University Press, 2008.

Thaler R.H. From Homo Economicus to Homo Sapiens // Journal of Economic Perspectives. 2000. Vol. 14. No. 1. Pp. 133–141.

Tietzel M., Muller C. Noch mehr zur Meritorik // Zeitschrift fur Wirtschafts – und Sozialwissenschaften. 1998. 118. Jahrgang. Heft 1.

Touraine A. Un nouveau paradigme. Pour comprendre le monde d'aujourd'hui. Paris, 2005.

Tullock G., Seldon A., Brady G. Government Failure: A Primer in Public Choice. Washington, DC: Cato Institute, 2002.

Verlen B. The objective perspective // Society, Action and Space. L.: Routledge, 1993.

Webley P., Burgoyne C.B., Lea S.E.G., Young B.M. The Economic Psychology of Everyday Life. Hove: Psychology Press, 2001.

Winston C. Government Failure versus Market Failure. Microeconomics Policy Research and Government Performance. Washington, DC: AEI-Brookings Joint Center for Regulatory Studies.

http://socioline.ru/pages/lektsiya-h-uerta-de-soto-suschnostavstrijskoj-shkoly.

http://www.economist.com/node/6768159.

DOI: 10.15759/ijek/2013/v1i1/53754

CORPORATE SOCIAL RESPONSIBILITY: OPPORTUNITIES, DRIVERS AND BARRIERS

Sasan GHASEMI [1]
ALA Excellence Consulting Group

Mehran NEJATI [2]
Graduate School of Business, University of Science Malaysia (USM)

ABSTRACT

The following study employed a qualitative research methodology in order to explore the views of Iranian business professionals about the opportunities, drivers and barriers of corporate social responsibility (CSR). Thirteen Iranian business professionals with 9.2 years of overall working experience participated in in-depth interviews. The study revealed that majority of interviewees consider CSR as a threat for Iranian businesses in the short-term, yet as an opportunity in long-run in case businesses are ready to transform and commit to their responsibilities. The findings also included the emerging themes for the key drivers and barriers of CSR from the interviewees' perspectives.

KEYWORDS

Corporate social responsibility, CSR drivers, CSR barriers, Developing countries, Iran

JEL CLASSIFICATION

M14

INTRODUCTION

Corporate social responsibility (CSR) has become the centre-point of interest by many researchers and organizations, resulting in an increased momentum for CSR movement over the past number of years (Crawford and Scaletta, 2005). CSR can provide both opportunities and challenges for a firm, and influence its performance depending on how well the organization addresses the social demands from its stakeholders. Successful stakeholder engagement and strategic undertaking of firm's social responsibilities can enhance the customer loyalty (Bhattachary and Sen, 2001; 2004), improve the firm's reputation (Fombrun, 2005) and ultimately result in improved financial performance (Barnett and Salomon, 2012). While there is a growing trend in empirical studies on CSR from developing countries, still majority of studies on CSR are embedded in the economic and organizational contexts of Europe and the US (Raman, 2006). Moreover, as the concept of CSR has

[1]Correspondence address: Sasan GHASEMI; CEO, ALA Excellence Consulting Group, Isfahan, Iran
[2]Correspondence address: Assoc. Prof. Mehran Nejati, Ph.D.; Mehran@usm.my; Post-Doctoral Fellow, Graduate School of Business, University of Science Malaysia (USM)

been claimed to be ambiguous (Fischer, 2004) and unclear (McWilliams, 2001), it might be interpreted and addressed differently in various contexts and communities. Thus, understanding the dynamics of social responsibility from the perspective of managers in a developing country can enrich the CSR literature and provide fresh insights from contexts where CSR is still at its infancy level. The current study aims to investigate the opportunities arising from CSR from the perspective of several Iranian managers and identifies their views on the drivers and barriers of CSR.

Literature Review

Previous studies on corporate social responsibility in Asian developing countries have been conducted in Bangladesh (e.g., Belal and Owen, 2007), China (e.g., Lam, 2011), India (e.g., Arevalo and Aravind, 2011), Iran (e.g., Nejati and Ghasemi, 2012, 2013; Valmohammadi, 2011), and Lebanon (e.g., Menassa, 2010). These studies have addressed various issues on social responsibility such as CSR challenges, drivers, barriers, outcomes, disclosure, managers' views, and employees' perspectives.

Arevalo and Aravind (2011) investigated the interpretation of CSR by Indian corporations and found that they are mostly in favour of stakeholder approach and caring or the moral motive. Moreover, the most significant impediments to CSR implementation were reported to be the lack of resources and CSR complexity. Belal and Owen (2007) examined the perspective of senior managers from 23 Bangladeshi companies on social reporting in Bangladesh and found that the major motivation for current social reporting is a mixture of desire for managing powerful stakeholder groups and external pressures. Nejati and Ghasemi (2012) investigated CSR practices in Iran from the perspective of employees and revealed that despite a low score in all four investigated areas of CSR, Iranian employees perceived their organizations to be fairly committed to CSR. In a more recent effort, Nejati and Ghasemi (2013) empirically examined and confirmed the positive influence of corporate social responsibility on the organizational commitment of business professionals in Iran. Moreover, Menassa (2010) explored the quality and type of social disclosed by 24 Lebanese commercial banks and examined its link with size, financial performance and age. The findings of this study revealed a low availability and extent of environmental disclosure, as the banks attributed the greatest importance to human resource, product and customers in their reporting. Moreover, a strong association was observed between corporate social disclosure and size, as well as between corporate social disclosure and financial performance However, the link between social disclosure and bank age was not confirmed.

Research Method

This study applied a qualitative approach to examine the perception of business professionals about the opportunities, drivers and barriers of corporate social responsibility. Qualitative inquiry seems to be appropriate for this study as qualitative methods are considered most helpful to examine situations where real-life context is important (Sinkovics et al., 2005; Sykes, 1990).

According to McCracken (1988), eight long interviews are a sufficient basis for qualitative research projects and for in-depth exploration a small but diverse sample is recommended (Öberseder et al., 2011). In this study, semi-structured in-depth interviews were conducted with 13 business professionals working in various industrial and manufacturing businesses, located in Isfahan, Iran. The interviewees aged between 26 and 41, averaging 31.9 years of age. Moreover, they had an average of 9.2 years of overall working experience and 6.33 years of experience in their current company. Majority of interviewees had a bachelor degree in engineering, while 4 of the interviewees had obtained a master degree.

According to Mohr et al. (2001), studies of ethics-related topics are vulnerable to social desirability bias. Thus, to reduce the issue of social desirability in responses and minimize the pressure on the interviewees, prior to the interview session, participants were briefed about the objectives of the study and advised that there were no right and wrong answers to the interview questions.

Findings and Discussion

Analysis of the interviews revealed that majority of interviewees considered social responsibility as either a direct threat for businesses or a threat in the beginning, whereas 5 interviewees argued that CSR could be an opportunity for the firms in society. Those who considered CSR as a threat to businesses often claimed that the society and businesses in Iran are not yet ready for and receptive of CSR. However, they believed that CSR can become an opportunity in the long-run. One of the interviewees (41 years old, 23 years of working experience) mentioned that:

> "CSR might be initially a threat in our society for businesses. However, ultimately it can become an opportunity. It helps companies to leave a good name for themselves in society."

Another interviewee (28 years old, 7 years of working experience) believed that:

> "CSR can be an opportunity for responsible business and a threat to those which do not accept their responsibilities."

Moreover, two of the interviewees considered CSR as the "forgotten element of businesses in Iran". With regards to the drivers for CSR, the most frequently mentioned CSR drivers included branding and image (5 times), profitability (4 times), community welfare and organizational conscious (4 times). Moreover, quality improvement, customer retention, and environmental preservation were among the other key drivers for CSR perceived by the interviewees. Figure 1 depicts the key drivers of CSR from the perspective of the interviewees. These findings are almost consistent earlier studies which argue that social responsibility is driven by a concern to improve corporate image (Belal and Owen, 2007). However, no indication of addressing the expectations of stakeholders was provided in the interviews, which could be due to the lack of stakeholder salience with regards to CSR in Iran.

Figure 1 **CSR Drivers**

Furthermore, interviewees believed that the most significant obstacles for CSR implementation in Iran include insufficient financial resources for Iranian businesses and the managerial views of

Iranian managers towards CSR. Additionally, lack of will by managers for CSR implementation, lack to time, lack of the technical expertise, foreign sanctions, and marginal profit of most businesses were also mentioned as other barriers of CSR implementation.

CONCLUSION

The current study explored the perception of several Iranian business professionals about corporate social responsibility and its drivers and barriers. Using a qualitative approach through semi-structured interviews, this study found that majority of interviewees consider CSR as a threat for Iranian businesses in the short-term, yet argue that it can lead to a good opportunity if companies transform themselves. Moreover, the key drivers for social responsibility implementation were found to be strategic reasons including branding and profitability for the company. According to Graafland and van de Ven (2006) there are two major dimensions which motivate organizations to pursue CSR, namely strategic motives and moral motives. Thus, it appears that the strategic motives of CSR are more prevalent from the perspective of the interviewed business professionals. Besides, the major obstacles for CSR implementations were perceived to include lack of financial resources and narrow views of Iranian managers towards CSR.

This study also found that interviewees considered the lack profit margin and striving for business survival as another key obstacle for CSR implementation. This is an interesting finding which confirms the earlier result pertaining to the managerial views towards CSR and confirms that Iranian managers lack a thorough understanding about CSR and its benefits. As CSR has been seen as a vital factor in the long-term survival of companies (Khan et al., 2009), efforts must be made to educate Iranian managers about the importance, nature and significance of social responsibility and sustainability initiatives, and how they can ultimately enhance the firm’s efficiency and profitability in long term. Nonetheless, this finding is not limited to Iran and Hargett and Williams (2009) have also shown that CSR and sustainability are not typically understood as the execution strategy among majority of companies’ leaders and employees.

Being a qualitative study in nature, this paper is limited in terms of generalizability. Yet, findings of this study contribute to literature of CSR from developing countries and can help future researchers in designing relevant scales for measuring CSR, its antecedents and outcomes in similar contexts.

Acknowledgement
Dr. Mehran Nejati Ajibisheh is a recipient of Post-Doctoral Fellowship from University of Science Malaysia (USM).

REFERENCES

Arevalo, J. A. and Aravind, D. (2011), “Corporate social responsibility practices in India: approach, drivers, and barriers”, *Corporate Governance*, Vol. 11 No. 4, pp. 399-414.

Barnett, M. L. and Salomon, R. M. (2012), “Does it pay to be really good? Addressing the shape of the relationship between social and financial performance”, *Strategic Management Journal*, Vol. 33 No. 11, pp. 1304-1320.

Belal, A. R. and Owen, D. L. (2007), “The views of corporate managers on the current state of, and future prospects for, social reporting in Bangladesh: An engagement-based study”, *Accounting, Auditing & Accountability Journal*, Vol. 20 No. 3, pp. 472-494.

Bhattacharya, C. B. and Sen, S. (2001), “Does doing good always lead to doing better? Consumer reactions to corporate social responsibility”, *Journal of Marketing Research*, Vol. 38 No. 2, pp. 225-243.

Crawford, D. and Scaletta, T. (2005), “The balanced scorecard and corporate social responsibility: aligning values and profits”, *CMA Management*, Vol. 79 No. 6, pp. 20-7.

Fischer, J. (2004), “Social responsibility and ethics: clarifying the concepts”, *Journal of Business Ethics*, Vol. 52 No. 4, pp. 391-400.

Fombrun, C. J. (2005), “The leadership Challenge: Building Resilient Corporate Reputations”, In J. P. Doh & S. A. Stumpf (Eds.), *Handbook on responsible leadership and governance in global business*: 54-68. Cheltenham, UK: Edward Elgar.

Hargett, T. R., & Williams, M. F. (2009). Wilh. Wilhelmsen Shipping Company: moving from CSR tradition to CSR leadership. *Corporate Governance*, 9(1), 73-82.

Graafland, J., & van de Ven, B. (2006). Strategic and moral motivation for corporate social responsibility. *Journal of Corporate Citizenship*, 2006(22), 111-123.

Khan, M. H. U. Z., Halabi, A. K., & Samy, M. (2009). Corporate social responsibility (CSR) reporting: a study of selected banking companies in Bangladesh. *Social Responsibility Journal*, 5(3), 344-357.

Lam, M. L. L. (2011), “Challenges of sustainable environmental programs of foreign multinational enterprises in China”, *Management Research Review*, Vol. 34 No. 11, pp. 1153-1168.

McCracken, G. (1988). *The long interview*. Newbury Park, CA: Sage.

McWilliams, A. (2001), “Corporate social responsibility: a theory of the firm perspective”, *Academy of Management Review*, Vol. 26 No. 1, pp. 117-28.

Menassa, E. (2010), “Corporate social responsibility: an exploratory study of the quality and extent of social disclosures by Lebanese commercial banks”, *Journal of Applied Accounting Research*, Vol. 11 No. 1, pp. 4-23.

Mohr, L. A., Webb, D. J., & Harris, K. E. (2001). Do consumers expect companies to be socially responsible? The impact of corporate social responsibility on buying behavior. *Journal of Consumer Affairs*, 35(1), 45-72.

Nejati, M. and Ghasemi, S. (2012), “Corporate social responsibility in Iran from the perspective of employees”, *Social Responsibility Journal*, Vol. 8 No. 4, pp. 578-588.

Nejati, M. and Ghasemi, S. (2013), “Corporate social responsibility and organizational commitment: Empirical findings from a developing country”, *Journal of Global Responsibility*, Vol. 4 No. 2, pp. 263-275.

Öberseder, M., Schlegelmilch, B. B., & Gruber, V. (2011). “Why Don’t Consumers Care About CSR?”: A Qualitative Study Exploring the Role of CSR in Consumption Decisions. *Journal of Business Ethics*, 104(4), 449-460.

Raman, S.R. (2006), “Corporate social reporting in India: a view from the top”, *Global Business Review*, Vol. 7 No. 2, pp. 313-24.

Sinkovics, R. R., Penz, E., & Ghauri, P. N. (2005). Analysing textual data in international marketing research. *Qualitative Market Research*, 8(1), 9-38.

Sykes, W. (1990). Validity and reliability in qualitative market research: A review of the literature. *Journal of the Market Research Society*, 32(3), 289-328.

Valmohammadi, C. (2011). Investigating corporate social responsibility practices in Iranian organizations: an ISO 26000 perspective. *Business Strategy Series*, Vol. 12 No. 5, pp. 257-263.

International Journal of Entrepreneurial Knowledge *Issue 1/2013, Volume 1*
DOI: 10.15759/ijek/2013/v1i1/53755

COSTING METHODS UTILIZATION IN CZECH ENTERPRISES

Boris POPESKO [1]
Tomas Bata university in Zlin, Czech Republic
Ostrava Business School plc

ABSTRACT

This paper presents the results of the research of the different types of product costing methods utilization in Czech enterprises performed in the years of 2004, 2007 and 2009. Results of individual surveys are compared, in order to prove the expected tendencies of higher usage of modern costing methods such as Activity-Based Costing, in recent years. First part of the paper refers to previous studies of the enterprise cost structure presented by other authors and illustrates the most important reasons of the individual costing system utilization. Following part of the paper defines the basic research methodology and expected limitation of the study. In final part of the paper, results of the survey are introduced and properly discussed.

KEY WORDS

cost management, costing system, overhead cost, Activity-based costing

JEL CLASSIFICATION

M20, M41

INTRODUCTION

Field of the product costing techniques is one of the important features of cost management and management accounting. While the method used for product costing purposes are usually not an object of the any regulations, companies could use any method of product costing and any tape of cost allocation technique. This fact causes a high variety of used costing methods. According to traditional management accounting (Drury 2003, Garrison et al. 2010, Weygandt et al. 2010, Shim and Siegel 2009) product costing methods could be divided in two major categories: job order costing and process costing. These systems differ in the object of the cost assignment. While in job order cost system, the company assigns costs to each job or to batch of goods, in process cost system companies apply costs to similar products that are mass-produced in similar fashion (Weygandt et al. 2010). It is therefore unnecessary to assign costs to individual units of output (Drury 2001). Based on this definition we can expect, that choice to use either job order costing system or process costing system will be more determined by the characteristics of the company production process than by desired way of cost assignment.

[1] *Correspondence address*: doc. Ing. Boris Popesko, Ph.D., boris.popesko@vsp.cz; Tomas Bata University in Zlín, Czech Republic; Vysoká škola podnikání, a. s., Michálkovická 1810/181, 710 00 Ostrava - Slezská Ostrava, Czech Republic, www.vsp.cz

Objective of the study was to identify the product costing method according to used method of cost allocation. Traditionally, two different product costing systems are defined, the traditional absorption costing and alternative variable costing (Drury 2001). These two major costing approaches differ from one another, by the degree of costs assigned to the cost driver. Many other methods of product costing are defined in traditional management accounting. Special category of product costing method is the Activity-Based Costing, which was designed in 1980´s and became more natural part of enterprise's costing system in recent years. One of the objectives of the study was to identify the level of Activity-Based Costing utilization in Czech Republic.

1 PRODUCT COSTING METHODS

Various types of the product costing systems are defined by the academics and practitioners. As mentioned above, product costing methods are not object of any regulation which lead in situation, where users of these systems are free in design, construction and use of the product costing system. Shields (1998) has speculated that there will be an increasing divergence in management accounting practices across industries. Classification of the product costing methods is not general. Product costing methods could be classified in different ways. As mentioned above the costing methods could be classified into job order costing and process costing based on the type of production process. More important classification of the product costing systems is based on cost allocation principles. In this field we can distinguish the traditional absorption costing, variable costing and Activity-Based Costing.

Product costing methods used in organizations went through the relatively important changes in last decades. Al Omiri and Drury (2007) suggests that a need to improve the sophistication of product costing systems has been driven by changes in manufacturing technology, global competition, information costs and customers' demands for greater product diversity. These changes prompted criticisms of the ability of traditional management accounting systems to report sufficiently accurate product costs and ABC systems were promoted as the solution to overcome the distortions in the product costs reported by traditional costing systems (Cooper, 1988; Kaplan, 1994).

Many studies had been performed in order to analyse the level of utilization of individual costing methods. Most of these studies are focused on the individual segments of the business (Brierley et al, 2007). Many surveys into product costing practice identify the industries making up their sample (e.g. Bright et al., 1992; Drury et al., 1993; Lamminmaki and Drury, 2001) and others have identified industries making up their samples in Activity-Based Costing (ABC) research (e.g. Cobb et al., 1993; Gosselin, 1997).

Performed studies had the focus on different industry segments and used different structure of questions, which make even more difficult to declare any common results. Brierley´s (2007) study performed in England shows that 20.7% of companies do not include overhead costs in product costs, while 33.6% of companies uses or is open to use ABC. Similar study made by Al Omiri and Drury (2007) in 1000 UK companies showed very similar result: 35% of companies use traditional absorption costing system, 23% of companies use variable (direct) costing system and 29% of the companies use ABC system.

Many studies have been reported in field of ABC extent. Cokins (2003) suggest that significant variations in usage of ABC both within the same country and across different countries have been reported. These differences may arise from the difficulty to define precisely the difference between traditional costing systems and ABC systems and the specific time period when the surveys were actually undertaken. The same limitations could play role in distinguishing other types of costing systems such as absorption and direct costing.

Drury (2003) suggests that performed survey evidence points at an increasing interest in ABC over the last two decades. In the UK, surveys in the early 1990s reported adoption rates around 10% (Innes and Mitchell, 1991), similar adoption rates of 10% were found in Ireland (Clarke, 1992) and 14% in Canada (Armitage and Nicholson, 1993). In the USA Green and Amenkhienan (1992) claimed that 45% of firms used ABC to some extent. More recent studies suggest higher ABC adoption rates. In the UK reported usage was 29% (Al Omiri and Drury, 2007). In the USA Shim and Stagliano (1997) was reported usage rate 27%.

Large surveys related to the ABC adoption had been performed in mid 1990s. Report usage rates from mainland Europe are 19% in Belgium (Brugemann *et al*, 1996), and 6% in Finland in 1992, 11% in 1993 and 24% in 1995 (Viertanen *et al*, 1996). Low usage rates have been reported in Denmark (Israelsen *et al*, 1996) in Sweden (Ask et al, 1996) and Germany (Scherrer, 1996). Activity-based techniques do not appear to be adopted in Greece (Ballas and Venieris, 1996), Italy (Barbato et al., 1996) or Spain (Saez-Torrecilla, 1996).

Along with the relatively strong differences between used product costing methods in different surveys, many authors points at the dependence of the used method of product costing on the type of the organization and organization cost structure. Study performed by Lawson et al. (2009) showed very strong relation between indirect cost portion and cost management methods used. Study proves the fact, that best-practice organizations have a much higher level of indirect costs, requiring them to have a costing system that can more accurately allocate these costs in a relevant, reliable, and reasonable manner. The greater use and appreciation of Activity-Based Costing by the best practice companies can be attributed to their greater need for better costing system. Strumactickas and Valanciene (2009) proved that the applicable instruments of management accounting depend on an organization type. Their study indicates that Market Creators use the least tools and Value Creators have most of them on an average. Market creators are strategically oriented young companies, which reach their “blossom” phase and start to stabilize, while value creator is mainly related to the getting out of stabilization phase.

Another reason which drives the selection of the product costing system is the structure of the products, customers and performed activities. Many authors (Cokins, 2001; Stanek 2003) refer that application of more sophisticated product costing method, such as Activity-based costing, is most effective in enterprises with complex structure of the products, customers and activities. Abernethy *et al.*(2009) shows how product diversity and cost structure influence the design of costing systems.

1.1. Specifics of the product costing in Czech perspective

Use of the management accounting techniques in Czech Republic in the second half of 20th century had several specifics caused by political environment. Orientation on central planned economy led to the establishment of integral system for company management. Methodology of the product costing was regulated by the statutory rules in order to fulfil the needs of central planned economy. This costing technique was based on traditional absorptions costing principles and used three different types of overheads (production, administrative and sales). In 1966, the regulations of the unified costing rules were accepted and in 1971 act of unified social-economic information system finished the complex regulation of the management accounting techniques in state owned enterprises (Lanča and Sedláček, 2005).

Change of the politic system in 1989 caused the transformation from central planned economy into free market economy. In this situation no regulations related to the system of the management accounting were furthermore demanded. The change of the political system doesn’t mean radical change in the management accounting practices. Companies started very slow process of adoption of diverse costing techniques. Anyway, many companies keep in use the traditional techniques known from 1970s.

2 RESEARCH OBJECTIVES AND USED METHODOLOGY

Research focused on the product costing method application in Czech enterprises had been performed in years 2004-2009. Three individual surveys had been performed: first in 2004, second in 2007 and last in 2009. The performed researches has been focused on the more aspects of the management accounting practices such as cost structure, used methods of product costing, budgeting practices etc. This paper reports the results of the research focusing on used product costing techniques. Performance of the similar researches in different periods of time allows the analysis of the product costing method utilization trends. The expectations, based on the foreign studies, were in increasing usage of the sophisticated costing methods such as Activity-based costing and decreasing use of traditional absorption costing methods. Foreign experience shows, that relative use of modern costing systems is gradually increasing in long term period. Expectation about absolute portion of use of different costing methods was different than in foreign studies. Because of the above mentioned specifics of the costing process before 1989 and slower adoption of progressive managerial techniques, considerably lower usage of ABC was expected in the study.

The hypothesis about the low usage of ABC techniques and about their increasing use in Czech enterprises was tested by the questionnaire survey and by the statistical comparison of the data gathered from different time periods.

Data from three questionnaire surveys has been analyzed in the research in order to get better and more accurate results and also because of a need to compare the evolution of the researched indicators. First questionnaire survey was made in 2004, when 116 questionnaires had been evaluated (Popesko 2005). Similar research was made in 2007. The structure of the questionnaire was focused on the same objectives as in 2004. 96 questionnaires have been gathered and analyzed (Popesko & Novak 2008). Final questionnaire survey was performed in 2009 as a part of extended research focused on costing methods use in Czech enterprises (Novak 2009). Finally 77 questionnaires have been processed. Enterprises of different sizes have been researched within the individual surveys. Table 1 shows the structure of statistic file.

Table 1. **Structure of the researched enterprises**

YEAR/ENTERPRISE CATEGORY		TOTAL	RELATIVE
2004			
	Small	9	7,76%
	Medium	55	47,41%
	Large	52	44,83%
2007			
	Small	38	39,58%
	Medium	32	33,33%
	Large	26	27,08%
2009			
	Small	8	10,39%
	Medium	42	54,55%
	Large	27	35,06%

3 RESULTS

As mentioned above, first research survey has been made in 2004 where 116 manufacturing enterprises have been investigated. The objective of the survey was an identification of the used product costing methods in Czech enterprises. Results of the survey are depicted in table 2. Total sum of answers doesn't give the number of surveyed enterprises, because some of the respondents use more than one method.

Table 2. **Product costing methods used in 2004**

USED PRODUCT COSTING METHOD	TOTAL	RELATIVE
Do not use any product costing method	7	5.98%
Division costing	5	4.27%
Traditional absorption costing	36	30.77%
Joint and by-product costing	2	1.71%
Standard costing	50	42.74%
Variable costing	35	29.91%
ABC/M	6	5.13%
Other	11	9.40%

(*Source*: Popesko, 2005)

The survey proved relatively high use of traditional absorption costing (over 30%) and high use of variable (direct) costing method (30%). Relatively surprising was the use of the standard costing method. Because this method in not pure allocation method, but rather cost control method, it was mostly marked along with the other costing methods. Use of the Activity-based costing and management techniques were identified by 5.1% enterprises.

Very similar research had been performed in 2007. The performed research, which was primarily oriented on the complex management accounting techniques used by Czech enterprises, contained the same questions related to the used product costing methods as research performed in 2004, in order to allow the comparison with 2004 research. Results of the survey are depicted in table 3.

Table 3. **Product costing methods used in 2007**

USED PRODUCT COSTING METHOD	TOTAL	RELATIVE
Do not use any product costing method	5	5.21%
Division costing	9	9.38%
Traditional absorption costing	30	31.25%
Joint and by-product costing	4	4.17%
Standard costing	39	40.63%
Variable costing	23	23.96%
ABC/M	5	5.2%
Other	2	2.1%

(*Source*: Popesko and Novak, 2008)

Despite relatively different structure of the researched enterprises (table 1), survey performed in 2007 showed very similar results as the study performed in 2004. This similarity could support the relevance of the performed studies based on the relatively low number of respondents. Two major product cost techniques showed similar utilization as in 2004, the traditional absorption costing (31.5%) and variable costing little lower volume (24%). The study showed again relatively high usage of the standard costing method very often used along with other costing methods. Utilization of ABC is almost the same (5.2%).

Similar data were gathered in questionnaire survey performed in 2009. Results of the survey are depicted in table 4.

Table 4. **Product costing methods used in 2009**

USED PRODUCT COSTING METHOD	TOTAL	RELATIVE
Do not use any product costing method	3	3,90%
Division costing	2	2,60%
Traditional absorption costing	31	40,26%
Joint and by-product costing	0	0,00%
Standard costing	8	10,39%
Variable costing	4	5,19%
ABC/M	6	7,79%
Other	30	38,96%

(*Source*: Novak, 2009)

Result of the survey is relatively different form previous studies. Most common product costing method is again the traditional absorption costing. Survey showed relatively low use of variable costing. Some of the users of variable (direct costing) could be in the category “other” because of various description of this type of product costing method in practice. The use of ABC/M was very similar to the expectations. Result showed that use of this method is slightly increasing.

4 DISCUSSION AND CONCLUSIONS

Above described results qualify the authors to several statements. Most used type of product costing method in Czech manufacturing enterprises is traditional absorption costing. Surprising result was the relatively increasing use of this type of product costing, together with the relative lower use of variable (direct) costing. Explanation of this could be tendencies of manufacturing companies to adopt the full costing method in order to better support of pricing decisions. The variable costing method seems to be relatively popular in Czech enterprises in 1990´s. Temporary adoption of the absorption costing method could be accepted as the interpretation of the survey results.

Expected results have been indicated in the Activity-based methods utilization. Survey showed relatively low use of these methods with comparison to other European countries. The study also proved increasing use of ABC/M in Czech manufacturing enterprises. The study also showed that the utilization of Activity-based techniques is relatively more frequent in large enterprises, than in small and medium enterprises. The large companies were ABC users in 5 out of the 6 cases in 2004, in 4 out of the 5 cases and in 2 out of the 6 cases in 2009.

The study could have limitations in number of researched enterprises, in understanding of question by the respondents or in ability of respondents to provide undistorted answers in the survey. Despite that fact it provides the actual overview of the used product costing methods in Czech manufacturing enterprises during 2000´s. The comparison of the individual survey results could also depict the tendencies in product costing method utilization.

REFERENCES

Abernethy, M. A., Lillis, A.M., Brownell P., Carter, P. (2001) *Product diversity and costing system design choice: field study evidence,* Management Accounting Research, 2001, 12, 261–279

Al Omiri, M., Drury, C. (2007) *A survey of factors influencing the choice of product costing systems in UK organizations*, Management Accounting Research 18, p. 399–424

Armitage, H.M., Nicholson, R. (1993) *Activity-based costing: a survey of Canadian practice*, Issue paper No. 3, Society of Management Accountants of Canada

Ask, U., Ax, C., Jonsson, S., (1996), *Cost management in Sweden: from modern to post-modern*, in Bhimani, A. (ed), Management Accounting: European Perspectives, Oxford, Oxford University Press, pp. 199-217

Ballas, A., Venieris, G. (1996) *A survey of management accounting practices in Greek firms*, in Bhimani, A. (ed), Management Accounting: European Perspectives, Oxford, Oxford University Press, pp. 123-139

Barbato, M.B., Collini, P, Quagli (1996) Management accounting in Italy, in Bhimani, A. (ed), Management Accounting: European Perspectives, Oxford, Oxford University Press, pp. 140-163

Brierley, J.A., Cowton, C.J., Drury, C. (2007) „Product Costing Practices in Different Manufacturing Industries: A British Survey", *International Journal of Management*, Dec 2007. vol. 24, Iss. 4; pg. 667, 10 pgs

Bright, J., Davies, R.E., Downes, CA. and Sweeting, R.C. (1992) *The Deployment of Costing Techniques and Practices: A UK Study*, Management Accounting Research, pp. 201-211

Brugemann, W., Slagmulder, R., Waeytens, D. (1996) *Management accounting changes; the Belgian experience*, in Bhimani, A. (ed), Management Accounting: European Perspectives, Oxford, Oxford University Press, pp. 1-30

Clarke, P.J. (1992) *Management Accounting Practices and Techniques in Irish Manufacturing Firms*, The 15th Annual Congress of the European Accounting Association, Madrid, Spain

Cobb, I., Innes, J., Mitchell, F. (1993) *Activity-based Costing Problems: The British Experience*, Advances in Management Accounting, pp. 63-83

Cooper, R. (1988) „The rise of activity-based costing-part three: how many cost drivers do you need, and how do you select them?" *Journal of Cost Management in Manufacturing Industry*, 34–46.

Drury, C, Braund, S., Osborne, P. and Tayles, M. (1993) *A Survey of Management Accounting Practices in UK Manufacturing Companies*, London, Chartered Association of Certified Accountants

Drury, C., *Management and Cost Accounting*, Fifth Edition, Thomson Learning 2001, ISBN 1-86152-536-2

Garrisin, R.H., Noreen, E.W., Brewer, P.C., *Managerial Accounting*, McGraw/Irwin New York 2010, ISBN 978-0-07-337961-6

Gosselin, M. (1997) „The Effect of Strategy and Organizational Structure on the Adoption and Implementation of Activity-based Costing, Accounting*"*, *Organizations and Society*, pp. 105-122

Green, F.B., Amenkhienan, F.E. (1992) „Accounting innovations: A cross sectional survey of manufacturing firms", *Journal of Cost Management of the manufacturing industries*, Spring 58-64.

Innes, J., Mitchell, F. (1991) „ABC: A survey of CIMA members", *Management Accounting*, October, 28-30

Israelsen, P., Anderson, M., Rohde, C., Ssorensen, P.E. (1996) „Management Accounting in Denmark: theory and practice", in Bhimani, A. (ed), *Management Accounting: European Perspectives*, Oxford, Oxford University Press, pp. 31-53

Kaplan, R.S. (1994) „Management accounting (1984–1994): development of new practice and theory.”, *Management Accounting Research 5*, 247–260.

Lamminmaki, D., Drury, C. (2001) „A Comparison of New Zealand and British Product Costing Practices”, *The International Journal of Accounting*, pp. 329-347

Lanca, J., Sedlacek, J. (2005) *Manažerské účetnictví.* 1.vyd. Brno: Masaryk University. 172 p., ISBN 80-210-3643-5

Lawson, R., Stratton, W., Desroches, D., Hatch, T., „Best practices in cost and profitability systems”, *Cost Management*, Sep/Oct 2009; vol. 23, 5; pg. 13

NOVÁK, P., *Problematika řízení a alokace režijních nákladů v podmínkách výrobních podniků*, disertation thesis, Univerzita Tomáše Bati ve Zlíně 2009

POPESKO, B., *Aplikace procesního řízení nákladů v podmínkách českých organizací*, dissertation thesis, Univerzita Tomáše Bati ve Zlíně 2005, ISBN 80-80-7318-280-7

POPESKO, B., NOVÁK, P., *Activity-Based Costing applications in the Czech Republic*, Lex et Scientia International Journal Nr. XV Vol.1/2008, Nicolaue Tulescu University from Bucharest, ISSN 1583-039X

Saez-Torrecilla, A., Fernandez-Fernandez, A., Texeira-Quiros, J., Vaquera-Mosquero, M., (1996), „Management accounting in Spain: trends in thought and practice”, in Bhimani, A. (ed), *Management Accounting: European Perspectives*, Oxford, Oxford University Press, pp. 180-190

Scherrer, G., (1996), „Management Accounting: a German perspective”, in Bhimani, A. (ed), *Management Accounting: European Perspectives*, Oxford, Oxford University Press, pp. 100-122

Shields, M.D., (1998), „Management Accounting Practices in Europe: A Perspective from the States”, *Management Accounting Research*, pp. 501-513

Shim, E., Stagliano, A., (1997), „A survey of US manufacturers on implementation of ABC”, *Journal of Cost Management*, March/April, 39-41

Shim, J.K., Siegel, J.G., *Modern Cost Management & Analysis*, Barron´s Business Library 2009, ISBN 978-0-7641-4103-4

Viertanen, K., Malmi, T., Vaivio, J., Kasanen, E., (1996), „Drivers of management Accounting in Finland”, in Bhimani, A. (ed), *Management Accounting: European Perspectives*, Oxford, Oxford University Press, pp. 218-241

Weigandt, J.J., Kimmel, P.D., Donald, E.K., (2010), *Managerial Accounting*, John Wiley & Sons, ISBN-13 978-0-470-47714-4

International Journal of Entrepreneurial Knowledge *Issue 1/2013, Volume 1*
DOI: 10.15759/ijek/2013/v1i1/53756

SELECTED FACTORS OF DEVELOPMENT IN THE FIELD OF METALLURGIC COMPANIES' MANAGEMENT

Šárka VILAMOVÁ [1]
Vysoká škola podnikání

Kamila JANOVSKÁ [2]
Vysoká škola podnikání

Roman KOZEL [3]
Vysoká škola báňská-Technická univerzita Ostrava

Milan STOCH [4]
Vysoká škola podnikání

ABSTRACT

The business success in the competitive environment depends very much on efficiency and flexibility of firms. The tense economic situation forces companies to change the perspective of the strategic management and use new opportunities for marketing, management, business integration, networking and offshoring.

This paper presents the results of resources evaluation of the modern management trends application in the field of metallurgy, including the identification of specific areas of metallurgical companies in the context of a differentiated approach to the role of the customer as a potential positive competitiveness factor.

KEY WORDS

Management, Development Trends, Metallurgy Sector, International Market

JEL CLASSIFICATION
O10, F63, L11, M10

[1] *Correspondence address:* Doc. Ing. Šárka Vilamová, Ph.D., sarka.vilamova@vsp.cz, Vysoká škola podnikání, a. s., Michálkovická 1810/181, 710 00 Ostrava - Slezská Ostrava, www.vsp.cz
[2] *Correspondence address*: Doc. Ing. Kamila Janovská, Ph.D., kamila.janovska@centrum.cz, Vysoká škola podnikání, a. s., Michálkovická 1810/181, 710 00 Ostrava - Slezská Ostrava, www.vsp.cz
[3] *Correspondence address*: Ing. Roman KOZEL, Ph.D., roman.kozel@vsb.cz , Vysoká škola báňská-Technická univerzita Ostrava, 17. listopadu 15/2172, 708 33 Ostrava-Poruba, www.vsb.cz
[4] *Correspondence address*: Ing. Milan STOCH, Ph.D., milan.stoch@vsp.cz, Vysoká škola podnikání, a. s., Michálkovická 1810/181, 710 00 Ostrava - Slezská Ostrava, www.vsp.cz

INTRODUCTION

Participation of industrial companies in the international market is potentially very profitable activity, although companies cannot expect to be successful immediately after they start international trading. They have to adapt to needs and options of the international market so they can become long-term participants. Due to advancing globalization, the companies have less time to adapt to new market situation and besides, many industrial companies are exposed to international competition, and that is why it is in essence necessary to take part in the international trade.

Europe is a global leader in the fields of metallurgical and in particular steel industry. This sector with a turnover of about 200 billion euro directly employs approximately 400 000 highly qualified individuals, produces 200 million tons of steel per annum in more than 500 manufacturing locations in 23 EU Member States, which handles both direct and indirect employment and source of income for millions of European citizens.

However, this sector is currently facing unprecedented challenges not only in Europe, but also at global markets. Several world´s economic indicators and market prognosis indicate the need to make a number of changes in the field of metallurgical industry in the near future. The business success in this competitive environment is mostly given by the measure of efficiency and flexibility. Tight economic situation (low profitability, reluctance of banks to lend to industry, growth of energy prices), which occurred as a result of the global crisis, forced the metallurgical enterprises to change their perspective of strategic management and use new opportunities in marketing, management and business integration.

1 ANALYSIS OF SELECTED INDICATORS OF METALLURGY SECTOR

Latest economic forecasts indicate that the Eurozone debt crisis is increasingly eroding the real economy. Risk aversion in the financial sector led to further decline in credit offer. This factor consequently acts to reduce economic growth and employment. Investment and private consumption will be suppressed until the return of financial market confidence. But the outlook for most steel producers is relatively favourable.

There are a number of negative factors identified in the world economy within field of metallurgy sector such as:

- increasing cost of capital and the presence of potential risk of credit constraints;
- worldwide reduction in leverage for states, banks, industry and families;
- instability of the euro, its weakening against the U.S. dollar;
- slowing economies of the BRIC countries;
- risk of stagflation;
- sudden slowdown of real demand;
- and fierce competition caused by the overlapping roles of steel plants, service centres and wholesalers.

What are the prognoses for metallurgical industry in individual territories of the world? The economic growth of Brazil is not progressing as expected, but may seize the new opportunities. Russia's accession to the WTO may improve the situation.

India will continue to try to go forward in its role as an emerging power. China's demand will continue to grow, although at a lower rate than it has until now. The investments of large international manufacturers of steel equipment in the construction of technical equipment, sales and service centres in China and India show, that those countries are trustworthy and indicates where the new business is going to take place. In the long term view the need to release the latent potential of many African countries will arise (WORLDSTEEL, 2013).

China and India will continue to be the key drivers only with a different rate than in the last decade. Middle East and Africa should not be underrated. The crises in Greece or "The Arab spring" could not be predicted. Orders for steel producers decreased due to the fear factor: the concern that banks will be forced to limit loans and the demand in China may therefore fall as well. The future therefore depends on governments, central bankers and state administrations.

Steel suppliers must offer their services globally and organise themselves according to segments; e.g. car parts, building industry, power industry, etc. Manufacture of intermediate products was placed in countries like Brazil, China and Russia. As an example may serve the new joint venture - ThyssenKrupp steel mill in Santa Cruz, Brazil, which produces slabs exclusively for export, 3 million tonnes a year to the steel mill TKS in Mobile, Alabama and 2 million tonnes a year to Duisburg, Germany via Rotterdam (METAL BULLETIN, 2013).

New production capacity will continue to be built especially in low-costs countries and high market demand countries. World steel production will continue its inexorable rise in 2014 despite the downbeat economic prospects. Stabilizing element of global economic development will remain to be Asian markets, primarily China and also some parts of South America.

The year 2014 will be in particular characterized by the efforts to stabilize public finances in the USA and also the economies in developed European countries. It is expected that emerging economies will continue to grow significantly faster than those of the developed countries (METAL BULLETIN, 2013).

The global population should reach 9 billion people in the year 2050. In the context of international relations will demographic development have significant impact not only in terms of availability of global resources such as water, energy or metals, but also in terms of change within supply of goods and on capital markets. Today's emerging markets are going through similar path as the established economies have come in the past 150 years. However, the development is much faster due to technological progress (EUROFER, 2013).

2 NEW RISK FACTORS ON THE INTERNATIONAL MARKET

There are new threats in the form of new risk factors emerging on the global markets in relation to dynamic development of metallurgy industry, problematic economic situation, long-term financial instability and other negative factors that were identified in the introduction of this article. These factors are mostly caused by the inappropriate interferences of governments into the market economy.

The most improper actions are in particular protectionism, subsidies and the effort to provide environmentally friendly production. In the last decades the markets became more open, the business barriers were removed, but the distortions of competition caused by non-transparent subsidy and protectionism in various fields unfortunately persist. There are a few on-going issues such as different environmental standards, direct financial support, tax exemptions, loan support, free infrastructure and land, subsidized energy and least but not last allocated tenders in advance (EUROFER, 2013).

Among the most important examples of subsidies belongs the support of Chinese government in metallurgical sector as well as its tendency to keep the artificial exchange rate of the currency. These factors reduce the competitiveness of other producers, and ultimately cause the loss of thousands of jobs and billions of dollars of investment in production and technology. Another factor that may significantly affect the economic characteristics of metallurgical companies is the European legislation highly regarding the environmentally friendly production.

Cooperation or partnership with the consumers may be a possible tool to minimize these impacts by means of implementation of technological innovations, which should be leading to positive economic and environmental effects. Boundary conditions valid for European steel producers are worsening due to two most important factors: carbon tax related to the reduction of CO_2 since the year 2013 and the new Renewable energy law. Those factors make the situation even more dramatic.

The resulting additional costs lead to distortions of competition in comparison with direct competitors in other countries. European commitment to environmental protection is well meant, but it has to be based on a uniform set of global rules that do not diminish competition at the expense of the environment (METAL BULLETIN, 2013).

3 DIFFERENCES OF BUSINESS MARKET

To define the application of modern management trends in a very specific sector as the metallurgical industry certainly is the focus must be aimed at the analysis of current development changes of market environment as well as the recent trends in the dynamic environment of business markets.

The greatest difference is the fact that the receivers of this service are not the end consumers but another business subjects. The market consists of not large, but integrated customers with high volume demand; there is a geographical concentration of customers with very close supplier-customer relationships, demand is inelastic and dependent on consumer demand, purchases are professional, rational and bulk (KOZEL *et al.*, 2011).

Purchase process happening on business markets is very complicated since there is a great influence of several groups of associates such as the purchase initiators, product users, final decision-making influencing factors, purchasers themselves and above all the decision-makers who are actually the most important in this whole process (without them the transactions cannot be made).

Therefore it is very essential for any company participating in business market to be perfectly aware of their customer needs and then be able to create and develop a long-term mutually beneficial relationship with them (VILAMOVÁ *et al.*, 2011).

4 SELECTED DEVELOPMENT TRENDS IN THE FIELD OF METALLURGIC COMPANIES' MANAGEMENT

In the previous chapter the key differences of business markets were established. There are new trends in the metallurgical industry that are directly related to those differences. The business success in this competitive environment depends very much on efficiency and flexibility. The tense economic situation forces metallurgical companies to change the perspective of the strategic management and use new opportunities for marketing, management, business integration, networking and offshoring.

a) Marketing trends

The key aspect on all markets is nowadays the customer satisfaction, which is more and more demanding. This fact brings the need to use the application of those marketing tools which will change and adapt according to the target customer, group and market.
The fundamental characteristic of the contemporary era of the world´s economic development is dynamic globalization. There are other new factors affecting the success of firms operating in business markets, such as:

- Monitoring and consequential use of comparative advantages,
- Use of interactivity of economical subjects supported by modern technologies,
- Absolute necessity to focus on customer value,
- Monitoring and use of new integration trends in networking, strategic alliances etc.

The only company that can succeed within the competition in the global market is the one that can understand the needs of its customer in the whole process of development, production, sales, implementation and use of products. This basic assumption of success of the industrial enterprise is based on specifications of business markets and places, strong demand for differentiated approach to individual firms/customers through market segmentation and rigorous principles of relational marketing (MUDAMBI *et al.,* 2009).

b) Selected trends in management

Specific nature of leadership tasks and responsibilities emphasise the need of structured tool for leadership competence management. Specifically tailored leaders will represent advantage for organizations (VUKOVIĆ *et al.*, 2011).

Within the new trends in company management we have recently come across a new term: compliance. Growth of legal regulation, its high complexity and specialization, as well as requirements for expertise and narrow professional knowledge, along with the efforts to prevent breaches of generally binding legal regulations to ensure consumer protection, market transparency and equal competition, led to the creation of compliance function as an integral element of control system of various companies from many different fields.

This is an effort to find ways to transparent compliance with the law in practice and extension of ethics in society and especially in the corporate sector.

The fundamental function of compliance is securing and control of activities, and compliance especially of the corporate subject with generally obligatory legal regulations. Within this established legal framework the compliance officer search for optimal solution for each business plan and minimize the following risks: regulatory (sanctions), reputation (reputation damage) or other nature. Compliance is a new function and its importance and economic benefits not only for the business, grow in proportion to the increasing legislative requirements and complexity of legal regulations in various fields. This function represents extensive economic contribution to business in the field of prevention, searching for new approaches and everyday decision-making.

The compliance officer position is therefore highly vocational and very much appreciated. Preventive management of compliance is the assurance in the case of liability risk of the employees. In the long-term view it leads to the business value optimization. Apart from that the compliance management prevents the damage of strategic advantages in the economic competition (METAL BULLETIN, 2013).

c) Consolidation and networking opportunities

The corporate sector is making all the efforts to maximize the productivity and minimize the costs. It seems that the consolidation is inevitable. The Japanese Nippon Metal Industry recently announced that its division will fuse with the same division of Nisshin Steel. There is also a rumour about conspicuous alliances of the European producers or joint ventures of European and Asian enterprises. One of the other ways to achieve greater competitiveness in the global business market is the networking or setting up alliances and acquisitions. These modern forms of integration are the most important issue of today.

So far it appeared that the basic function of these types of cooperation is strategic joint ventures of small and middle companies in the context of threats elimination impending form larger enterprises. Results of EQS modelling suggested that shared vision and resource sharing among network members significantly benefited members' businesses, and that these benefits were associated with generalized perception of the advantages of network membership and also positively affected members' future participation plans, thus furthering the likelihood of network continuance (MILLER *et al.*, 2007).

The networking is becoming quite strong in the metallurgy industry in order to use the synergic effects, competitive advantages in the partner network, your partner´s market knowledge, etc. Industrial firm boundaries are dynamic, changing with every new alliance or acquisition. As boundaries evolve, managers must develop organizational structures that effectively leverage knowledge (MUDAMBI *et al.*, 2009).

At present the industry that use networking in the most profitable way is the automotive industry, however, the metallurgy is another field where these efforts can be effectively used. The largest independent wholesalers/service groups such as the German Kloeckner & Co. are growing into huge acquisition and create large international multi-metal distribution and service networks. Large steel traders, such as Stemcor have also made strategic acquisitions of wholesalers and service centres this year (METAL BULLETIN, 2013).

d) Offshoring

The use of offshoring is another tool of modern business. It has been very much used to lower the operating costs of the industrial enterprises resulting from placing part of the business on a different continent. The reason for transferring some activities abroad is mostly the cheaper labour, but it can be also foreseen as the effort to get closer to the customers. In the field of industrial production it is possible to offshore almost every activity abroad.

CONCLUSION

Within the world´s economy the metallurgy industry plays an important role: as the major industry it is placed at the beginning of the industrial value chain in many key sectors and thus creates a decisive contribution to international competitiveness. Steel companies with more than 3,5 million employees generate an annual turnover of 900 billion euros. The future starts with steel. Whether in the automotive sector, engineering, energy industry or the electronics the new steel and manufacturing technologies are the basic presumptions of innovative capacity and success.

A key aspect of the present in all markets has become the need of the best possible satisfaction of the needs of customers whose requirements keep growing. That fact incites the necessity to apply such corporate marketing tools which will develop and vary according to who is their target customer and, therefore, in which market they are applied.

This paper presents the results of resources evaluation of the modern management trends application in the field of metallurgy, including the identification of specific areas of metallurgical companies in the context of a differentiated approach to the role of the customer as a potential positive competitiveness factor.

REFERENCES

EUROFER (2013). The European Steel Association. Brussels: Eurofer. Language version: EN. Available from www: <http://www.eurofer.org/>. Consulted 18. 10. 2013.

KOZEL, R., MYNÁŘOVÁ, L., SVOBODOVÁ, H. (2011) Moderní metody a techniky marketingového výzkumu. Praha: Grada Publishing.

ISBN 978-80-247-3527-6.

METAL BULLETIN (2013). Metal Bulletin. London: Metal Bulletin. Language version: EN.

ISSN 0026-0533.

Available from www: <http://www. metalbulletin.com/>. Consulted 12. 8. 2013.

MILLER, N., J., BESSER, T., MALSHE, A. (2007) Strategic networking among small businesses in small US communities. *International Small Business Journal*, v**ol.** 25**,** no.: 6, pp. 631-665. ISSN 0266-2426.

MUDAMBI, S., M., OLIVA, T. A., THOMAS, E., F. (2009) Industrial marketing firms and knowledge transfer. *Industrial Marketing Management*, vol. 38, no.: 2, pp. 181-190.

ISSN 0019-8501.

VILAMOVÁ, Š., JANOVSKÁ, K., VOZŇÁKOVÁ, I., KOZEL, R. (2011) Selected specific of marketing analysis and management in terms of industrial enterprises. *Metal 2011*, Ostrava: Tanger.

ISBN 978-80-87294-22-2.

VUKOVIĆ, A., IKONIĆ, M., DOBOVIČEK, S. (2011) Model for leadership competence management in metallurgical enterprise. *METALURGIJA*, vol. 50, no.: 3, pp. 167-171.

ISSN 0543-5846

WORLDSTEEL (2013). The Worldsteel Association. Brussels: Worldsteel. Language version: EN. Available from www: <http://www. worldsteel.org/>. Consulted 14. 11. 2013.

International Journal of Entrepreneurial Knowledge *Issue 1/2013, Volume 1*

DOI: 10.15759/ijek/2013/v1i1/53757

DOES CASH FLOW AFFECT INVESTMENT? EVIDENCE FROM THE ROMANIAN CAPITAL MARKET

Andriana PUTUNTICA [1]
Babes-Bolyai University, Cluj-Napoca

Carmen Giorgiana BONACI [2]
Babes-Bolyai University, Cluj-Napoca

ABSTRACT

Our paper addresses the relation between corporate investments and cash flow. While literature agrees upon the existence of a correlation between the two, its interpretation continues to generate intense debates. We use data from a sample of 125 Romanian listed companies for the 2005-2011 period. Using a fixed effects least squares model we document a positive significant association between investments and cash flow. The results show that a 1% cash flow fluctuation leads to a 0.27% alteration of the planned investments. We therefore add to the literature on a widely debated topic by bringing evidence in the case of Romanian listed companies.

KEY WORDS

Investments, cash flow, financial reporting, panel data, fixed effects

JEL CLASSIFICATION

M 10, M 40, G11

INTRODUCTION

It is a well known fact that information provided through companies' cash flows is especially important for capital markets and investors. While cash flow related information is often used in order to make short term decisions, our paper mainly focuses on long term consequences. More precisely, we investigate whether cash flow influences long term investments and look at the details of such a potential influence in the particular case of Romanian listed companies.

Therefore, the objectives of our analysis are as follows: to investigate the existence of an association between a company's cash flow and its investments, to develop a linear econometric model which would explain the effect of the considered independent variable (cash flow) on the

[1]*Correspondence address*: Andriana Putuntica, Master student, +40.264.41.86. 52, andriana.putuntica@gmail.com, Babes-Bolyai University, Cluj-Napoca, Faculty of Economics and Business Administration, econ@econ.ubbcluj.ro, www.econ.ubbcluj.ro.
[2]*Correspondence address*: Carmen Giorgiana Bonaci, Associate professor, +40.264.41.86. 52, carmen.bonaci@econ.ubbcluj.ro, Babes-Bolyai University, Cluj-Napoca, Faculty of Economics and Business Administration, econ@econ.ubbcluj.ro, www.econ.ubbcluj.ro.

assumed dependent variable (investments) and to validate the results of the regression analysis through the necessary tests in order to see to what extent they respond to the general research question. We expect the investments being made by a company in a certain period to display direct correlation with the company's cash flow for the same time frame.

The remainder of the paper is organized as follows. Section 1 presents a brief theoretical motivation of our paper and positions it within literature. Section 2 explains the employed research methodology. Section 3 develops the analysis and presents the obtained results. Section 4 concludes and discusses limitations of the study together with perspectives for future research.

1 THEORETICAL GROUNDING

Shimko (1997) emphasizes how risk managers spend significant part of their time in order to analyze the factors that can cause big cash flow fluctuations. This is especially relevant as a week cash flow can generate total chaos in companies' budgets, keeping managers away from productive work, postponing capital spends or slowing down debt reimbursement (Shimko, 1997). Stancu (2002) considers the decision to invest as being the most important one in companies' financial flow, being made together with the financing one as the market is not perfect (Stancu, 2002: 549).

The decision to invest is influenced by several factors such as tax, cost of insurance, cost of capital, etc. The factor that our analysis focuses on is companies' cash flow, our paper looking at investments' sensibility in relation to cash flow generated by the company. Theoretically speaking, chances are higher that a company will decide to invest when it records high cash flow. This can be explained as follows: internal capital could be less expensive than external ones (Fazzari *et al.*, 1988); free cash flow related hypotheses show that managers tend to spend more than the internal available capital (Richardson, 2006); and it is possible that cash flow is correlated with investment opportunities (Ciccolo & Fromm, 1979).

A number of previous empirical studies document a significant association between investments and cash flow. Fazzari *et al.*'s (1988) study uses a sample of 422 industrial companies for the 1970-1984 period and uses Tobin's Q as the variable reflecting the company's investment opportunities. A high level of Q tells us that companies should invest more as the value of their capital is higher than the actual price paid for it. Their assumption is that cash flow influences investments as the market is imperfect and internal capital is "less expensive" than the external one. It therefore makes sense that cash flow would play an important role in financially constrained companies' investment related decisions. Fazzari *et al.* (1988) also consider companies' dividend payments, documenting a stronger association between investments and cash flow for companies paying lower dividends. Kaplan & Zingales (1997) focus on a sample of low dividends companies and analyze the particularities of companies' financing constrains by making use of information from financial statements and liquidity statements - known as a statement of maturity of assets and liabilities. Their results document that for companies having less financing constrains investments are more sensible to cash flow fluctuations, therefore concluding that high investments sensibility in relation to cash flow can not be interpreted as an indicator of companies facing financing constrains. Cleary (1999) and Baker *et al.* (2003) also investigate the influence of cash flow on investments, finding values such as 0.05 – 0.15. More recently, Hennessy *et al.* (2007) document investments' sensibility to cash flow to record values such as 0.01-0.09. Summing up, we may conclude that previous studies in literature investigating the association between companies' investments and their cash flow document mixed results.

2 RESEARCH METHODOLOGY

The proposed research question is approached by developing a fixed effects model for panel data. The data being used in our analysis is mainly based on accounting information taken from companies' financial statements. The companies being included in our sample are those listed on the Romanian capital market. We have eliminated from our sample financial companies as well as companies for which we were unable to find data (corresponding to the considered variables) for more than two years. The analysis being developed includes 125 companies for the 2005-2011 period, generating a number of 875 observations. The considered variables were investments, cash flow and Q (Tobin's Q) computed as follows:

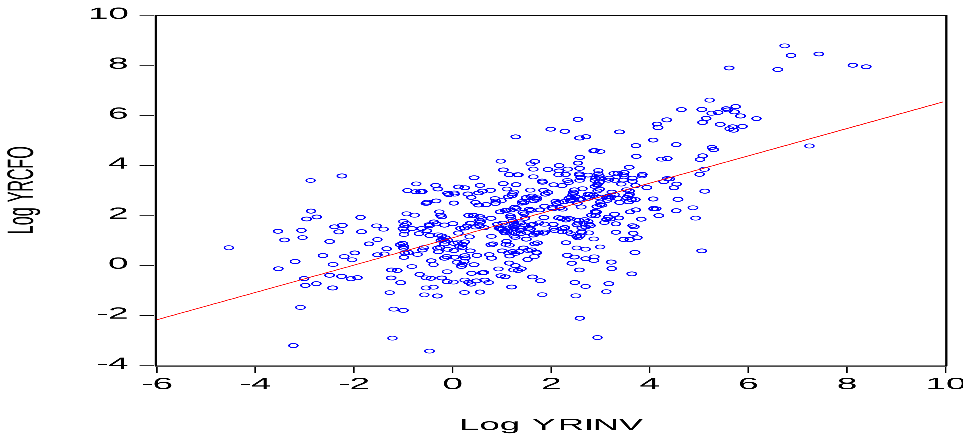
- *Investments (Inv)*: representing funds being used by a company in order to purchase or modernize tangible assets (property, plants and equipments); dependent variable;
- *Operating cash flow (CFO)*: is computed through the indirect method; a comparative analysis of profit and cash flow showed that cash flow follows a more linear, less volatile tendency; independent variable;
- *Tobin's Q (Q)*: the use of this variable is based on previous studies documenting its relevance in relation to investments and cash flow, starting with Keynes who concluded that the decision to invest becomes more attractive once the value of the capital raises in relation to its cost (Abel & Eberly, 2010); although the close correlation between cash flow and investments is a well documented one, the causality is hard to establish as both variables (investments and cash flow) are influenced by the company's profitability; this variable (Q) helps control the effect of profitability on investments; independent variable;
- *Social capital (K)*: is included as a control variable; an increase in the company's social capital is a sign of "financial health" and the company can use additional profits in order to invest in its projects; independent variable;
- *Sales (S)*: control variable used by Fazzari *et al.* (1988) as a determinant of capital spends; measured as turnover at the end of the year; independent variable.

The data being collected for the 125 companies for the 7 years included in our analysis is further transformed in log values (for most of the variables) for the purpose of our analysis.

3 DEVELOPING THE ANALYSIS AND INTERPRETING THE OBTAINED RESULTS

A first step in choosing the proper econometric model aiming to capture the association between investments and cash flow imposes the observation of its graphical representation as we can see in Graph 1 presented below:

Graph 1 **Distribution of the observed variables**



The above presented representation supports the consideration of a linear model ($y = a + bx + \mathcal{E}$). Furthermore, assuming a positive coefficient (b) for the independent variable (x) is supported by previous empirical evidence showing that an increase in cash flow will determine an increase in investments. We therefore propose the following model in order to investigate our paper's research question related to the relation between investments and cash flow:

$$\boldsymbol{logInv_{it} = a_0 + a_1 logCFO + a_2 logS + a_3 Q + u_{it}} \quad (1)$$

where all variables are log of the corresponding variables or the variables discussed in the research methodology section of the paper.

Using the data from our sample we obtain the following results:

Table 1 **Regression analysis**

Dependent variable: **LOG_INV**
Panel Least Squares
Sample: 1 875
Included periods: 7
Included cross-sections: 120
Total number of panel observation: 520

Variables	Coefficients	Std. Error	t-Statistic	Prob.
LOG_CFO	0.58 ***	0.060	9.76	0.000
LOG_S	0.19 **	0.069	2.76	0.005
Q	0.09 **	0.037	2.44	0.014
C	-0.50	0.243	-2.07	0.038

R-squared	0.40	Mean dependent var	1.607
Adjusted R-squared	0.40	S.D. dependent var	2.043
S.E. of regression	1.57	Akaike info criterion	3.755
Sum squared resid	1281.27	Schwarz criterion	3.787
Log likelihood	-972.31	Hannan-Quinn criter.	3.767
F-statistic	118.81	Durbin-Watson stat	0.629
Prob(F-statistic)	0.00		

The results show that 40% of the investments variance is explained by cash flow variance and other variables taken together. The cash flow variable's coefficient is 0.58 suggesting that a 1% increase in operating cash flow will generate a 0.58% increase in investments. In depth analysis shows that results might be impacted due to the existence of unobserved factors that might influence investments. The Durbin-Watson test points out that the model is affected by factors which we did not consider. This might be the consequence of the fact that companies belong to different industries, have different size and might or might not be facing financial constraints. We therefore further develop the analysis by adding estimators that account for the fixed effects.

Table 2 **Regression analysis – fixed effects**

Dependent variable: **LOG_INV**
Panel Least Squares
Sample: 1 875
Included periods: 7
Included cross-sections: 120
Total number of panel observation: 520

Variables	Coefficients	Std. Error	t-Statistic	Prob.
LOG_CFO	0.27 ***	0.053	5.16	0.000
LOG_S	0.32 **	0.147	2.20	0.027
Q	0.01	0.026	0.39	0.689
C	-0.37	0.628	-0.59	0.550

Cross-section fixed (dummy variables)
Period fixed (dummy variables)

R-squared	0.83	Mean dependent var	1.607
Adjusted R-squared	0.78	S.D. dependent var	2.043
S.E. of regression	0.95	Akaike info criterio	2.950
Sum squared resid	354.37	Schwarz criterion	4.005
Log likelihood	-638.14	Hannan-Quinn criter.	3.363
F-statistic	15.61	Durbin-Watson stat	1.829
Prob(F-statistic)	0.00		

The period under analysis (2005-2011) brought a series of changes for the Romanian economy. By only mentioning the economic crisis and the country becoming a member of the European Union, we might easily expect one period to be different from the other. Being a EU member might also have brought more foreign capital and access to more refundable and non-refundable funds which may further influence company's investments. When considering fixed effects, our results improve, as we can see from the Durbin-Watson test, initially pointing problems with the first results. The coefficients maintain their relevance, further documenting the relevance of the model. The independent variable which is the focus of our analysis (LogCFO) is still representative at a significance level of 0.0001, though its coefficients dropped more than 50% (from 0.58 to 0.27).

Comparing the model can also be done by using the Akaike Information Criterion, also pointing towards the second model as being more suitable. The Schwarz criterion follows the same principle as Akaike, but puts more emphasis on the free parameters. Again, the second model is preferred. Comparing the R-squared in the two models we see a significant increase (from 40% to 83%). As R-squared may increase artificially due to including more (dummy) variables into the model, we must also analyze the Adjusted R-squared in order to avoid „*overfitting*". As Adjusted R-squared (0.78) is close to R-squared (0.83) we may anticipate a minimum contraction of this indicator. Further testing imposes in depth analysis of the independent variables.

Table 3 **Matrix of independent variables correlation**

	LOG_CFO	LOG_S	Q
LOG_CFO	1.00	-	-
LOG_S	**0.76**	1.00	-
Q	0.01	-0.02	1.00

The above presented table shows a high level of correlation between log_CFO (log of operating cash flow) and log_S (log of sales) documenting that our model displyas multicollinearity. This is a problem often met in accounting research making it difficult to establish precise estimates of the coefficients in regression analysis. A series of strategies were used in order to respond to this problem, but were further debated by other studies arguing that it does not improve results. What we did is try to eliminate one of the problematic variables, and as cash flow is the focus of our analysis, we looked at the model without considering sales. The results therefore obtained still show an R-squared of 0.83 documenting that the explanatory power of the model did not diminish, coupled with an F statistic of 15.55, slightly below the previous one, documenting that the model is significant. The cash flow related variable does not record any relevant changes. In such a case literature recommends to keep the excluded variable in the model as excluding it might cause new problems (Gujarati, 2004).

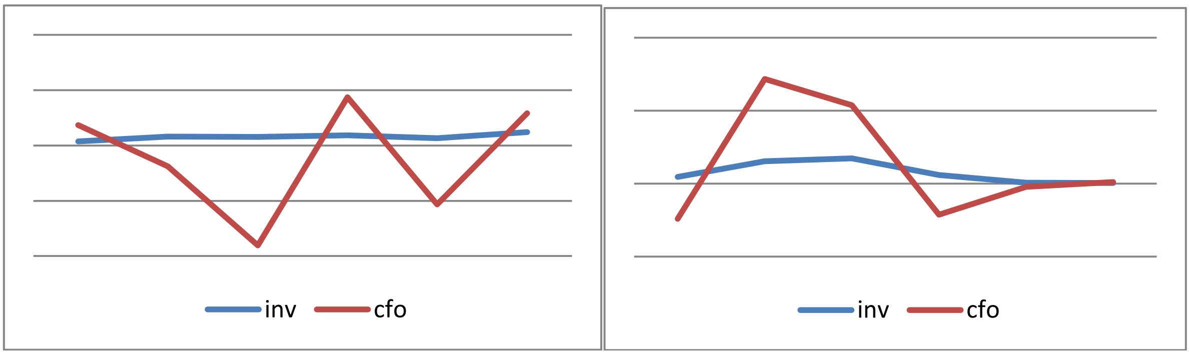
4 CONCLUSIONS AND DISCUSSIONS

Previous empirical studies focusing on the relation between corporate cash flow and investments cluster the sample based on size, industry and many use financial constrains as a classification criteria as well. They mainly reach the conclusion that the influence of cash flow on investment is stronger for companies with financial constrains as for them internal capital is not perfectly replaceable with external capital. This is due to the fact that companies going through periods of economic instability (including low and volatile cash flow) bear higher risks as perceived by creditors and this generates an increase in interest. For companies this spells into an increase in the cost of external capital. When needing money, companies with financial constrains can not reach external capital as easy as companies without financial constrains do. In this context companies that face financial constrains become much more dependent on the health of cash flow.

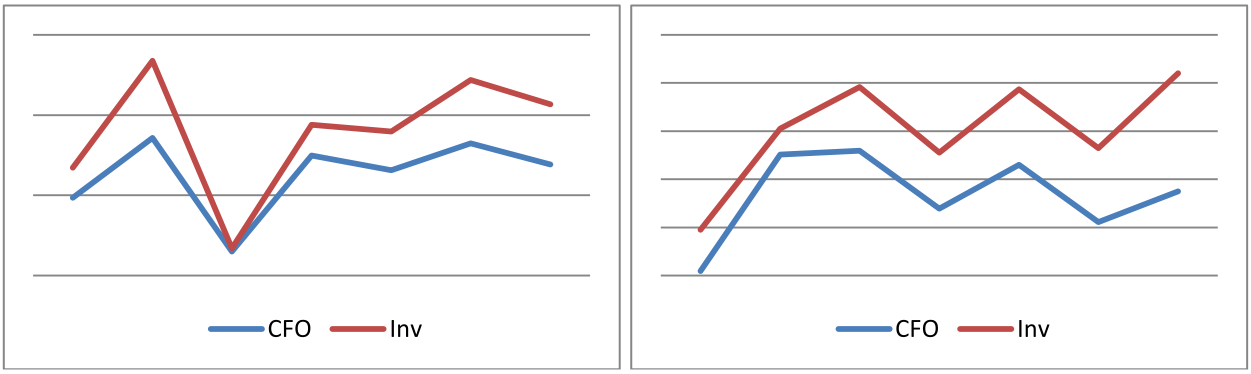
Literature uses different proxies for financial constrains. One would be the ratio between the profit remaining in the company and the net result. The lower the ratio, the better the economic condition of the company should be as this would mean the company is paying dividends to shareholders, decision that would be approved in cases when remaining resources are enough to cover all necessities. Fazzari *et al.* (1988) and Gilchrist and Himelberg (1995) use the level of paid dividends, assessing a company that pays low dividends as facing financial constrains. We will further use this criterion to complete the analysis developed on our sample. Dividends and investments represent competing elements, therefore companies facing financial constrains having to maintain profits within the entity in order to be able to finance their activity.

The below presented graph 2 illustrates companies which can be characterized as having a favorable financial situation (not facing financial constrains). It is easy to observe how the evolution of cash flow differs from that of investments. In such cases operating cash flow and investments are not connected due to the fact that the companies can easily replace internal capital with external capital. On the other hand, graph 3 illustrating companies which can be characterized as having an unfavorable financial situation (facing financial constrains) documents the opposite, cash flow and investments having similar evolutions.

Graph 2 **Evolution of CFO and INV for companies not facing financial constrains**



Graph 3 **Evolution of CFO and INV for companies facing financial constrains**



The evolutions of cash flow and investments differ significantly when comparing the two categories of companies. There is no doubt that the results of our study are impacted by the sample including a high number of companies which, based on proxies used by previous studies, can be characterized as facing financial constrains. Out of the 125 companies in our sample, only 18 paid dividends, and even those did not do it constantly over the analyzed period.

Overall we can conclude that there is a significant positive association between investments and cash flow in the context of Romanian listed companies. A 1% cash flow fluctuation generates a 0.27% change in the planed investments. Among the limitations of our study we must mention the following. We did not separate the companies by several classification criteria as done by previous studies. This is due to the relatively low number of companies in the sample which, for criteria such as industry, would have led to a number of companies per industry that would not have allowed us to test the proposed model. Our paper focuses on the relation between investments and cash flow which is empirically tested, without considering the cost of capital which is also informative. The model is only tested based on annual data due to limitations in terms of information being available. This excludes the consideration of cash flow volatility during the financial reporting period. The information available on Romanian companies (or better said lack of) also limits the number of control variables being used. Limitations help identify perspectives for future developments over the proposed research question. Further developments of the study should consider adding control variables that would allow testing of the model's robustness, finding new proxies in order to identify those companies facing financial constrains, adding the cost of capital as a determinant of investments into the analysis and of course considering cash flow volatility during the year.

REFERENCES

Abel, A.B. & Eberly, J.C. (2011). How Q and Cash Flow Affect Investment without Frictions: An Analytic Explanation, *Review of Economic Studies*, vol. 78, pp. 1179-1200.

Baker, M., Stein, J. C. & Wurgler, J. (2003) When Does the Market Matter? Stock Prices and the Investment of Equity-Dependent Firms, *The Quarterly Journal of Economics*, vol. 118, pp. 969-1005.

Ciccolo, J. & Fromm, G. (1979) "Q" and the Theory of Investment, *The Journal of Finance*, Vol. XXXIV, No.: 2, pp. 535-547.

Cleary, S. (1999) The Relationship between Firm Investment and Financial Status, *Journal of Finance*, vol. 54, no.: 2, pp. 673-692.

Fazzari, S.M., Hubbard, R.G., Petersen, B.C., Blinder, Alan S. & Poterba, J.M. (1988) Financing Constraints and Corporate Investment, *Brookings Papers on Economic Activity*, vol. 1988, no.: 1, pp. 141-206.

Gilchrist, S. & Himmelberg, C.P. (1995) Evidence on the role of cash flow for investment, *Journal of Monetary Economics*, vol. 36, no.: 3, pp. 541-572.

Gujarati, D.N. (2004) Basic Econometrics, McGraw-Hill International Editions, 4th edition.

Kaplan, S.N. & Zingales, L. (1997) Do investment-cash flow sensitivities provide useful measures of financing constraints? *Quarterly Journal of Economics*, vol. 112, pp. 169-215.

Richardson, S. (2006) Over-investment of free cash flow, *Review of Accounting Studies*, vol. 11, pp. 159-189.

Shimko, D. (1997) Yearnings per share, *Risk*, vol. 10, pp. 37.

Stancu, I. (2002) Finanţe, Editura Economică, Bucureşti.

International Journal of Entrepreneurial Knowledge *Issue 1/2013, Volume 1*
DOI: 10.15759/ijek/2013/v1i1/53758

RISK MANAGEMENT DEBATE FOCUSED ON BANKING INDUSTRY

Eugenia Ana MATIS [1]
Dimitrie Cantemir Christian University Cluj Napoca, Romania

Cosmin Dumitru MATIS [2]
Babes-Bolyai University Cluj Napoca, Romania

Jiří STROUHAL [3]
Škoda Auto University Mladá Boleslav, Czech Republic

ABSTRACT

Corporate governance is a subject of constant timeliness and broad interest, mainly aimed at ensuring adequate protection for investors and financial institutions. This interest in corporate governance is due to its influence on the healthy growth of companies and society as a whole. Paper provides evidence on implementation of Basel II and Basel III within Romanian banking sector from the historical perspective trying to show an overview on Basel developments and encourages further investigations into the particularities of the Basel III which is soon to be put into practice.

KEY WORDS

Basel II, Basel III, corporate governance, banking sector, Romania

JEL CLASSIFICATION

G20

INTRODUCTION

The concept of corporate governance has many definitions, because of the complex elements it covers. Basically, corporate governance is the system which companies are directed and controlled by. Corporate governance structures specify the distribution of rights and responsibilities to the different direct and indirect participants in the work of the company or institution (executives, managers, employees, shareholders, customers, funders) as well as the rules and procedures

[1] *Correspondence address*: Eugenia Ana Matis; Ph.D.; Dimitrie Cantemir University Cluj Napoca, T. Mihali 56, 400 591 Cluj Napoca, Romania.
[2] *Correspondence address*: Cosmin Dumitru Matis; Ph.D. student; Babes-Bolyai University Cluj Napoca, T. Mihali 58-60, 400 591 Cluj Napoca, Romania.
[3] *Correspondence address*: Jiří Strouhal; associate professor; ystrouhal@is.savs.cz; Škoda Auto University Mladá Boleslav, Na Karmeli, 1457, 293 01 Mladá Boleslav, Czech Republic.

underlying the decision-making process, the establishing of objectives and the methods of achieving and monitoring performance.

The monitoring and management function should be fulfilled within each credit institution. The supervisory authority (National Bank of Romania, hereinafter NBR) will check if the credit institutions have established their decision-making process in terms of hierarchy and responsibilities, according to regulations.

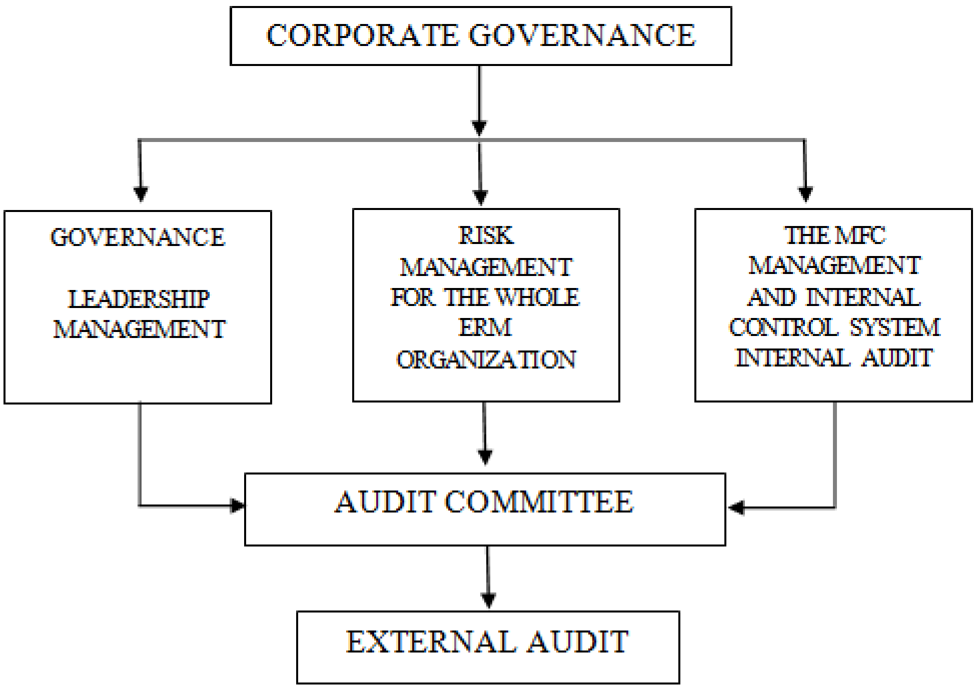
In order to implement an effective corporate governance to manage banking risks, the governing structures of a credit institution have as main tasks the following:

- providing the implementation plan for the IRB approach (internal-rating based) on the most important exposure categories;
- developing the methodology for internal risk rating process;
- identifying and evaluating the events that generate risks;
- monitoring and managing potential sources of conflict of interest;
- establishing responsibilities for the risk control unit and professionally evaluating the staff.

Corporate governance system takes into consideration the following:

- the permanent monitoring of the credit institution activities, the institution's management and the risk control personnel should having to regularly meet to discuss their performance, the areas that need improvement and, not least, the state of the previously identified weaknesses;
- the existence of a risk control unit within each credit institution to carry significant risk control function;
- providing an overall assessment on the adequacy of the internal control system and on the banking risk control function by the internal audit;
- the existence of an internal reporting system, which varies depending on the nature, size and degree of complexity of the credit institution and which is based on the analysis of the institution's risk profile.

Figure 1 **Corporate Governance Components**



(Source: NBR*)*

After the year 2000, corporate governance failures in the financial and banking system stood out, having a strong impact on the society's level of confidence in the credit institutions. Three significant problems stand out according to this point of view:

- imbalances in reward structures;
- neglect of fundamental values by investors and executive management;
- manager's lack of accountability for their actions.

Reward structures. The trend is to include reward structures as part of banking risk management, by providing incentives for the implementation of the deferred compensation plans. According to them, the employee is immediately rewarded with part of the bonus only, the difference being paid after a certain period of time (e.g. one year), when the performance of his work can be confirmed. Another option circulating proposes connecting bonuses and annual awards to certain profit indicators adjusted with the risk.

Core values have changed significantly in recent years, due to the increasingly sophisticated demands, the credit institutions diversifying their activities. Thus, a global risk was generated and because of the claims for even higher profits, the client portfolio has increased. However, human relationships began to lose their original values, because each client was perceived as a quick source of profit rather than a long-term partner. The 2008 financial crisis highlighted even more these problematic issues, often resulting in not understanding their customers, their needs and perspectives.

The responsibility of employees and managers is a new increasingly recognized trend and is based on educating people with regard to the financial and banking system, the products and services it offers, by government and credit institutions.

The basic concept of effective management is based on the idea that risk management is the responsibility of every employee of the credit institution, on every level and functional line. Banking risk management must become a fundamental part of the institution's culture, in addition to respect for the value system and for information.

1 BASEL I

The 1988 Basel Agreement established the criteria to be considered for determining the optimal size of a bank's capital and the minimum level of capital that a bank needs to have. The formula set by the Basel Agreement in 1988, simply called Basel I provides precise criteria for capital adequacy. It is important for a bank to have a solid financial basis, to protect it from insolvency. If a bank has a loan portfolio with a high degree of risk, it needs to make sure that it has sufficient financial resources to protect itself in the event of bad loans. Also, a large capital basis protects depositors and maintains their confidence in the bank, being sure that they will not lose money if the bank losses from other activities.

Following the Basel I Agreement, banks in most countries comply with regulations on capital adequacy. This eliminates a certain type of competition, as respecting this requirement restricts banks' ability to attract new customers by simply increasing the volume of granted loans.

According to the Basel I Agreement regulations, banks must have their 1st rank capital proportionate to their assets weighted with the risk at a minimum of 4%, and their 2nd rank capital of minimum 8%. Currently, most banks in developed countries have a capital adequacy index of at least 10%, the most well capitalized reaching 12%. NBR regulations in the field of capital adequacy foresee a minimum index (solvency ratio) of 8%, which is calculated by dividing the equity of banks to the assets (balance-sheet and off balance-sheet) weighted according to risks.

A banking institution's own funds consist of the following categories of capital:

- equity, consists of the paid-in capital, bonus shares, provisions, retained earnings, tangible assets, development fund and other reserves;
- additional capital, which consists of the general reserve for credit risk, subordinated loans, other funds.

In accordance with Basel I, NBR established the following risk percentages on asset categories in the balance sheet: 0% for cash and deposits with NBR; securities issued by the Romanian central administration and other A countries, international financial institutions, central banks of A countries; loans and cash advances granted to the Romanian central administration and other A countries, international financial institutions, central eligible participants in the country from category A; other claims on the central Romanian government and other A countries, international financial institutions, central banks of A countries; 20% for checks, coupons and other items in collection; securities issued by the Romanian banks, A countries banks, local administration in Romania and A countries; loans and cash advances granted to the Romanian banks, A countries banks, B countries banks with date of payment in one year or less, the local government in Romania and other A countries, governmental organizations in Romania and other A countries; cash and deposits in Romanian banks, A countries banks, B countries banks with date of payment in one year or less; other claims over the Romanian banks, A country banks, B country banks with payment day in one year or less, the local government in Romania and other A countries, government organizations in Romania and other A countries; 50% for loans and cash advances to customers, secured by mortgages on lands and buildings owned by the banking company, for its activity purposes; the total exchange rate position is short; 100% for other securities, other loans and cash advances, equity ownership in financial institutions and other non-banking entities, other tangible assets, other assets. The NBR also specifies the conversion factors for off-balance sheet elements in credit equivalent as well as the risk percentages on the types of beneficiaries.

The bank insolvency issue has become the subject of debate in the international banking world. Thus, in 1988, the Basel Committee on banking supervision issued a set of rules on capital adequacy standards adjusted for risk. These rules took into consideration reducing the risk by setting a minimum rate of solvency for the international financial and banking institutions. The main objective of the Basel I was to improve bank capitalization and to standardize the action field of competing markets, against insolvency or unexpected losses.

Since 1998, directives of the European Union on financial assets require that activities of financial and banking institutions be divided into two categories: actual financial and banking activities and commercial activities. The first category aims for the main activities of the bank, while the second category refers to the times when banks trade assets on their own on any stock market. European Union directives lay down a method for calculating the risk exposure of the bank during transactions that are highlighted in its record keeping. This is done by updating the market value of their daily positions results, which means calculating the difference between the expected earnings for the original transaction and the cost of acquiring an equivalent transaction the same day.

After the Basel I system was applied, the need to improve its stipulations emerged, due to the complexity of risks in the financial markets. Given this conclusion, derived from the practical application of Basel I system, the central banks governors and heads of bank supervisory authorities in the European Union countries, approved on 26 June 2004, the final version of Basel II.

2 CORPORATE GOVERNANCE REQUIREMENTS WITHIN BASEL II

The publishing of the new own funds adequacy system "International Convergence of Capital Measurement and Capital Standards" is the result of the Basel Committee's activity, which began in 1998. The first Basel Accord was therefore amended in 1996 to allow banks to use internal models for market risks. The agreement became an international principle, for the setting of capital standards, being implemented in over one hundred countries. But its conceptually simple rules became increasingly obsolete for a very complex international banking system in terms of risk management and transactions.

The consultation process continued internationally, with the participation of supervisors, central banks, public authorities and banking and financial institutions. Following these consultations, the Basel Committee issued additional proposals for international consultation in January 2001 and April 2003 and developed three studies on the possible impact. Following the publishing of these studies, they modified the original proposals and approved the new agreement of own funds adequacy for financial and banking institutions in June 2004.

The final version of Basel II, global regulation that establishes a direct link between the equity of financial institutions and the risks they take, was issued at the end of June 2005. Changes from the previous version are notable and banks immediately began to prepare implementation strategies for the new form of the agreement. For banks in Central and Eastern Europe, the implementation of Basel II was a test of their ability to integrate into a wider financial market, European and then global.

The important economic and political changes experienced by the countries of Central and Eastern Europe (CEE) at the time constitute a unique background for the implementation of Basel II. The group of ten joining the European Union in May 2004, and then Romania and Bulgaria in 2007, as well as the strong economic growth in recent years encouraged international banks to create networks in the area.

In addition, the local market has a great potential: it is still under-banked and the demand for financial products increased dramatically, especially in 2003 and 2004. Banks' retail divisions had high growth rates, and forecasts indicate that this trend will continue in the future. Consumer credit increased by 300% in 2003 compared to 2002. Banking infrastructure is also growing by creating credit bureaus. Therefore, a large share of national bank assets is held by regional or international scale banks. The largest banks in CEE countries are already held by international banks and the process continues with privatization of banks in Albania, Bulgaria and Serbia.

Basel II is a true catalyst for the development of the regional banking market. The European Directive on Capital Adequacy (CAD III) requires that all active banks in the European area implement the agreement until 2007. But in many countries in the region, risk management is not at a very advanced level. Policies and risk management models must be much improved to reach the level of the large banks that use their own internal risk models. If trading volumes or risks presented by the regional branches of international banks are not very important, a more flexible implementation of the Basel II may be chosen with the consent of the national regulator. The main purpose of the Basel II implementation: CAD III will strengthen the Basel II adoption in those CEE countries which are also members of the European Union. CAD III, which will set provision standards for all financial intermediaries, will contribute to the harmonization of the European financial market.

Risk management infrastructure in CEE countries is growing from a very low level and foreign banks must make significant efforts to raise this level. For example, the comparatively low trading volumes and lack of historical data makes it difficult for a risk assessment model to be applied. Other problems to be overcome are slow data processing and bureaucracy. In addition, reduced volumes lead to extension of the hardware investment amortization, at least in the short run.

Some international banks have already implemented risk management practices within corporate governance, especially the ones consistent with the transparent collection and processing of data. Although these projects required significant investments and lasted between two and three years, the result was the implementation of flexible and reliable solutions and a first step towards meeting the requirements of the IRB (Internal Rating Based Approach) model. There are a number of factors that encourage national banks to adapt Basel II as soon as possible. First of all, a bank about to implement Basel II is more attractive to potential foreign investors and it can obtain a higher price for its shares. Also, it can easily integrate into a global network. Secondly, after applying Basel II national banking markets will become more competitive, although there is a risk of greater sensitivity to external shocks. On the other hand, one must also take into consideration the fact that the 2008 global economic collapse began to generate question marks when it comes to the effectiveness of the risk management in credit institutions under Basel II system.

3 IMPLEMENTATION OF BASEL II IN ROMANIAN BANKING SECTOR

The Basel II capital agreement, adopted by the Basel Committee in 2005, is not an imperative regulation for the national banking systems. However, the Basel Committee's regulations are picked up in international or national standards that are mandatory to apply. It is also the case of the Basel II, picked up by the European Directive, commonly known as CAD III (Capital Adequacy Directive). CAD III has the Banking Consolidation Directive 2000/12/EEC and the Directive for Capital Adequacy of investment companies and credit institutions 93/6/EEC, reconfigured. In the European Union countries, CAD III was implemented starting with 2007 (Matis, 2009).

Once Romania joined the European Union, the preparation of the banking system in order to implement the specific Basel II standards, started. At first, the Romanian banking system, through the decision takers of the central bank and credit institutions, had to understand the stipulations of the new agreement. The next step was to relevantly assess the banking system's development stage, and last but not least, to configure and implement a coherent set of measures in order to adapt the domestic banking system, allowing the application of Basel II system.

The main feature of the new agreement is capital adequacy within credit institutions. In the field of capital adequacy, during the first half of 2006, credit institutions in Romania started applying the national legislation which assumed the stipulations of Basel I agreement, in place since 1988. Banking companies active in Romania, in their capacity of credit institutions, are required to maintain at all times the solvency ratio at a minimum of 12%.

The solvency ratio expresses own funds, as a proportion of total balance-sheet and off balance-sheet assets, net of provisions, adjusted to the risk. The minimum solvency ratio established in our country is higher than the 12% established by the Basel I, which shows an attitude of caution from the regulatory authority in the field.

According to the 2008 Annual Report of the NBR, with respect to the solvency of the banking system, the solvency ratio has slowed down its descending trend, its level being at 12.30% at the end of 2008, because of capital increase in credit institutions and reduction of government credit. This remains above the minimum requirement, which is 12%.

In national law, the NBR Norm no. 17/2003 regulates the management of key banking risks, in accordance with Basel II. This norm stipulates organization and internal control of credit institutions and managing of the significant risks, as well as the organization and internal audit of credit institutions. The regulatory act defines significant banking risks, presents the benchmarks of the internal control system and internal audit that banks must organize. Credit institutions must organize a system of internal control which should identify and assess significant risks.

Identification and evaluation of significant risks should be made at an overall level of a credit institution as well as at all its organizational levels, it must cover all activities and take into account the emergence of new activities. In terms of international provision, the second part of the Basel II Accord presents the calculation of the minimum capital required from the banks, depending on credit risk, market risk and operational risk. Moreover, the new agreement introduces the concept of operational risk, insignificant in the preceding foresights.

Actions taken by the NBR show that the central bank understood the rules of the Basel II system as being complicated and has set up an action plan to meet the challenges of Basel II. The central bank made its concerns in the field public, and established a timetable for implementing the proposed actions.

Understanding the state of the Romanian banking system was the first thing that the central bank established in its priorities as the main pawn of the Basel II in Romania. Being a national banking supervisory authority and having within reach the informational levers with credit institutions, the central bank was able to establish information requirements for banks to report with respect to the current procedures available in the field of risk management. Also, the banks were required to come up with options as to the type of approach they would like to implement in the field of risk management according to the Accord (Matis, 2009).

According to the choices made by the banks in November 2005 in terms of choosing the methods for addressing credit risk, 30 banks opted for the standardized approach, 2 banks for the foundation internal rating-based approach, none for the advanced internal rating-based approach and two banks were not decided at the time. As for the bank’s options on operational risk specific approach, 17 banks opted for the basic indicator approach, 13 banks for the standardized approach, 2 banks for advanced measurement approach AMA and two banks did not decided at that time.

The NBR established a Steering Committee in the field of Basel II, composed of The Ministry of Public Finance, The National Securities Commission and The Romanian Association of Banks, institutions which have an impact on the activity of banks (Matis, 2009). This board is based on the information support coming from the experts of the European Commission, who were consulted to facilitate preparations. The NBR presents as following the regulations on the implementation of Basel II in Romania, organized into three pillars:

Table 1 **Structure of the Basel II Accord**

1st Pillar **Minimum capital requirements**	**2nd Pillar** **Capital adequacy supervision**	**3rd Pillar** **Market discipline**
Flexible and advanced rules for determining minimum capital requirements for: • *credit risk:* -standardized approach;	- Active role of the supervisory authority in evaluating banks' internal procedures regarding capital	More detailed reporting requirements towards the NBR and as a novelty, towards the public, regarding:

-Internal Rating Based Approach - IRB - foundation or advanced version • *market risk* • *operational risk* -basic indicator approach; -standardized approach - advanced measurement approach (internal models)	adequacy to the risk profile; - Checking banks' internal procedures by the supervisory authority; - Requiring that credit institutions maintain capital in excess of the minimum level indicated by Pillar I; -Implementation of early NBR intervention mechanisms.	• shareholding structure • risk exposure • capital adequacy to the risk profile

(*Source:* NBR)

CONCLUSIONS

The implementation of Basel II should lead to the development of the rating agencies, statistical databases and econometric methods for grounding internal models of the banks. As emphasized by Nucu (2011), Basel III, representing a fundamental review of the regulatory and supervision framework of the banking industry in the future, its aim being to strengthen the stability of the financial system, nowadays represents a new challenge for the Romanian banking system. The implementation of the directive on the capital agreement Basel III will be phased in from January 2013 for the European banking system. The process is expected to be concluded by January 2019. The requirements will be introduced in the EU through the Capital Requirements Directive (CRD) 4, which applies to all EU member states. In this regard the Romanian Banking Association (ARB) has set up a commission on Basel III to implement it, make propositions and seek clarifications (Posirca, 2012). Our historical analysis contributes to developing an overview on Basel developments and encourages further investigations into the particularities of the Basel III which is soon to be put into practice.

REFERENCES

Basel Committee on Banking Supervision (2004) Basel II - International Convergence of Capital Measurement and Capital Standards – a Revised Framework. Basel Committee on Banking Supervision.

Basel Committee on Banking Supervision (2011). Basel III: A global regulatory framework for more resilient banks and banking systems. Basel Committee on Banking Supervision.

Matis, E.A. (2009) Managementul performantei si riscului in bancile comerciale din Romania. Cluj Napoca: Casa Cartii de Stinta Publishing House.

Nucu, A.E. (2011) The Challenges of Basel III for Romanian Banking System, *Theoretical and Applied Economics*, vol. 58, no. 12, pp. 59-70.

Posirca, P. (2012) Romanian lenders touch Basel III, *Business Review*, available at http://business-review.ro/featured/romanian-lenders-touch-basel-iii/.

International Journal of
Entrepreneurial Knowledge