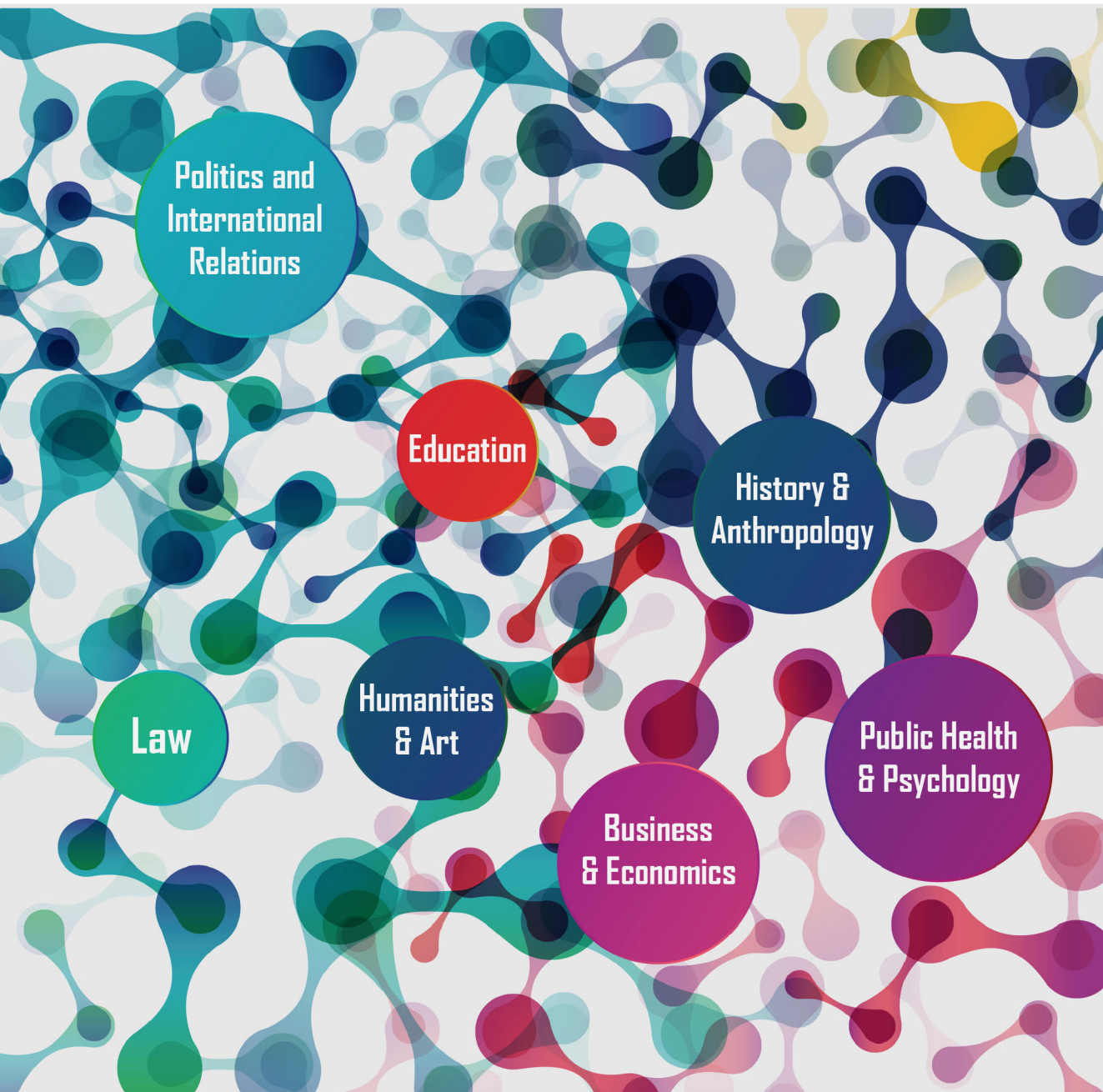


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## History

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### The Dates of the Reign of Vakhtang Gorgasali

Sanadze Manana,  
The University of Georgia

Georgian historiography dates the reign of King Vakhtang Gorgasali to the 2<sup>nd</sup> half of V c. The king is considered to have died in 502 in a fight with Persians. Cyril Toumanoff has expressed an opinion about the identification of Vakhtang Gorgasali with the King of Kartli Gurgen, mentioned by Procopius of Caesarea in 523. Accordingly, he believed that in case of such an identification, Vakhtang Gorgasali should have died in 527 during the big Persian invasion of Georgia. We have noticed that the author of the martyrdom of David and Constantine, who was based on the ancient chronicle ('Dzveli Utskebani' - Old Story) and who created his hagiographic work in the middle of XI c., made a big mistake: erroneously, due to the similarity of names, he identified the sons of Georgian King Vakhtang Gorgasali Darchil and Mirdat and the invasion of Persians in their reign with the sons of the ruler of Georgia (Kartli) Stephanoz III Mirdat and Archil and invasions of Arabs and Marwan ibn Muhammad (Murvan Qru - "Marwan the Deaf") that took place two centuries later, in the 30s of VIII c. Consequently, the author related the martyrdom on the background of Arab invasions. The fact that according to the author of the martyrdom, the sons of Vakhtang Gorgasali were in West Georgia, namely Anakopia, and fought the so-called Arabs there, makes it clear that the historical developments were taking place in the period of the Great Persian-Byzantine War of 542-562. In the title of the work it is mentioned that the invasion, during which the martyrdom of David and Constantine took place, happened in the vicinity of the death of Vakhtang Gorgasali. Thus, it becomes clear that King Vakhtang Gorgasali could not have died during the Persian-Byzantine War of 502-505 and that the Great Invasion of Persians described in the "Georgian Chronicles", in which Vakhtang Gorgasali was wounded, could only have happened in 527; the king must have died during a war between Persia and Byzantium in 527-532, more specifically in 527 when Persians invaded Georgia. Proceeding from the above, the surmise of Cyril Toumanoff regarding the death of Vakhtang Gorgasali in 527 becomes more convincing and well-grounded. Since it is known that King Vakhtang Gorgasali lived 60 years, the date of his birth can be presumed to be 466-467. This gives us an opportunity to establish a more precise date of reign of Vakhtang's father - Mirdat and his grandfather - Archil. The dates of reign we have put forward for kings Mirdat and Archil (Archil - 430-463, Mirdat - 463-473) correspond to the information of the Assyrian version of the Life of Peter the Iberian.

Chronology of kings is one of the central issues in the history of ancient and early feudal Georgia. Restoring the correct picture of the political history of the country depends a lot on a somewhat precise determination of the chronology of the kings. The chronology of Vakhtang Gorgasali has one of the key places in this regard. Some Georgian and non-Georgian scholars have made an attempt to determine the approximate dates of reign of the great king who ruled Georgia on the verge of the late ancient and the early feudal epochs. Research into the timeline has been done on various levels, starting from a more superficial level and ending with profound studies. Nonetheless, the issue is still widely debated, partially due to scarcity in the source studies base, and partially due to the inadequate critical analysis of the existing sources. The objective of the current presentation is to offer a different perspective on the period of rule of King Vakhtang Gorgasali and hence set the correct record of the chronology of Christian Georgian kings of IV-VI cc. I am planning to present my point of view based on the new interpretation of data from sources related to the dating of King Vakhtang Gorgasali.

As we know (Ammianus Marcellinus), by the year 368, for a short while Kartli was split into two parts again, between the Sassanid Persia and the Roman Empire: the left bank of Mtkvari, ruled by the King of Kartli (Eastern Georgian Kingdom) Asparug, fell under Persian influence, while the right bank of Mtkvari called Gugark in Armenian sources (the same Gogarena of Strabo - the name comes from Persian Gorgan as they referred to Kartli - Iberia) ruled by Saurmag, fell under the general Roman jurisdiction, more specifically – it was subdued by Armenia.

In the Georgian Chronicles Asparug is placed before Mirian. As we have shown in our monograph, this is the result of the duplication of the line of kings (Sanadze, 2001, pp. 133-148) and the reading of Varaz-(As) parug (from Varaz-Asparug) as Varaz Bakur as well.

### **Rev, Vache (nickname of Mirian), Bakur, Mirdat, Aspagur**

*Rev, Mirian (the real name of Vache), Bakur, Mirdat, Varaz-Bakur*

If we take out the duplicated names of kings in the second line Rev, Mirian, Bakur, Mirdat we will get the correct version of the line of kings: Rev, Vache (the same Mirian), Bakur, Mirdat, Asparug, Varaz-Bakur.

Varaz in Persian stands for ‘the boar’, so Varaz-Bakur means the powerful, boar Bakur, and is the same as Great Bakur of the Greek version of the ‘Life of Peter the Iberian’.

We have a few footings to determine the chronology of kings after Varaz-Bakur (Great Bakur) who seemingly reign for a short period of time: Trdat, his father-in-law, then his son Parsman, Mirdat (Bosmarios – the father of Peter the Iberian), Archil I (the grandfather of Vakhtang Gorgasar), Mirdat (the father of Vakhtang Gorgasar).



1. First we will overview the chronology of the King of Kartli Parsman V, who became the first king between Varaz-Bakur's (Great Bakur's) sons. Parsman had to escape from Arcadius, the Emperor of Eastern Rome (395 - 408) and leave the capital as soon as the Emperor married Eudocia – the woman that Parsman V had been dating before the marriage of Emperor on her. Eudocia and Arcadius married in April, 395, which means that Parsman was in Georgia that year and he could have become king if not the same year, then at least soon after (Goiladze, 1990, pp. 41-45; Bogveradze, 1999, pp. 60; Beradze, Sanadze, 2003, pp. 80). Arcadius himself could have helped him ascend the throne. In any case, "The Georgian Chronicles" emphasizes the closeness of Parsman V to the emperor and the assistance rendered by the latter to Parsman V in his fight against Persians. Parsman, according to the Georgian Chronicles, ruled Kartli for a short while and passed away shortly after. Thus, he presumably reigned in 395/96-400. In the thirty five year period, from the beginning of 360s till 395 there were four kings in power: Mirdat (Miriban of Ammianus Marcellinus), Asparug, Varaz Bakur (Great Bakur) and Trdat. At first glance, it might look like too many kings for a relatively short period of time, yet, the number of kings will no longer seem suspicious if we take into account the fact that in the Sassanid branch (Khosroians) reigning Kartli, the throne was not passed on from father to son, but to the eldest person in family (the brothers of the king), which explains why kings ascended thrones at quite an old age.

The second chronological footing in the date of birth and the taking hostage of Peter the Iberian. Based on the Asyrian Life of Peter Iberian (Lolashvili, 1988) and some other Byzantine sources (Kaukhchishvili, 1960, pp. 66, 199, 265-266) the birthday of Peter is considered to be in 411/12, while the year when he was taken hostage - 423/424, since it is well-known that Peter the Iberian was taken hostage by Theodosius the Younger (408 - 450) when the former was 12 years old. Bosmarios (Bosorg Mitra in Persian, the same Great Mitra, Mirdat), the father of Peter the Iberian, the same King Mirdat of the Georgian Chronicles (the son of Varaz-Bakur, the brother of Parsman) who reigned after Parsman V personally accompanied his son while sending him hostage to the emperor; thus by 424 he was still on the throne of Kartli. According to the Georgian Chronicles, Persians took hostage of King Mirdat and took him to their land, where he passed away. The same chronicle relates that before the death of Mirdat in Persia, and hence the selection of a new king in Kartli, the throne of Kartli was empty for three years. And after the death of Mirdat, noblemen enthroned his nephew Archil there. Thus, it will not be a big mistake to regard 425/27 - as the time when Mirdat was taken hostage, 428-430 – as the kingless period and the vicinity of 430/431 – the time when Archil was seated on the throne. The dates above can be sub-

stantiated by the strict policy of Iran in the South Caucasus, which was revealed through an aspiration to bring local governments to an end; in 428 Iran abolished the kingdom in Armenia. This is the time when the King of Kartli Mirdat, the father of Peter the Iberian, must have been taken hostage.

Archil must have reigned for quite a long time, because in his reign Kartli had three different archbishops, with the fourth starting to serve still in the reign of Archil. Thus, the reign of the king is supposed to have lasted for at least 25-30 years, i. e. till 455/60. After this, Mirdat, the son of Archil and the father of Vakhtang - ascended the throne. Mirdat was already the king when Vakhtang was born, while at the time of the death of Mirdat, Vakhtang was seven years old. Thus, the reign of Mirdat is supposedly no shorter than 8 years. This way, Vakhtang could not have been born before 462. Such dating is completely different from the versions spread in the Georgian historiography dealing with the life time of King Vakhtang. Indeed, the date of the death of King Vakhtang is generally believed to be 502. (Vakhtang Goiladze even mentions 491 as the death date). In such a case it turns out that Vakhtang was born in 442 (correspondingly, Vakhtang Goiladze points out 431), since, based on "The Georgian Chronicles" Vakhtang was 60 years old when he died. Proceeding from all the above mentioned it becomes clear that the version of the date of birth of King Vakhtang (442), so far prevailing in Georgian historiography, - is absolutely groundless. Changing the date (not earlier than 462) makes a significant change in terms of dating Vakhtang's death, which, therefore, cannot be earlier than 522; it also gives us a different perspective on the identification of the King of Kartli Gurgen, mentioned in the events of 523 in the work of historian Procopius of Caesarea. If Vakhtang is still alive by 523, then we are led to believe that Gurgen, the King of Iberia, who visits the Byzantine Caesar, is actually Vakhtang himself. Seemingly, similar logics led the American historian Cyril Toumanoff to the same conclusion (Toumanoff, 1963a, p. 199-200; Toumanoff, 1976b, p. 286). The point is that the Persian word *Gurgen* carries the meaning "of the wolf"; the pronunciation of Vakhtang's nickname *Gorgasal* is a distorted version of the Persian *go/urg -a- sar* - "having the head of a wolf": *gurg* - wolf, *a* - a vowel connecting two words and *sar/ser* - head; (compare with the Georgian word სერ-ი (ser-i, hill). "R" and "n" are both nasal sounds and are phonetically equivalent in pronunciation. Thus, Greeks could have interpreted *Gurg-(a-s)a/er* as Gurgen; especially as under Persian influence the name Gurgen was familiar to them, in so far as it was a popular name for people of Georgian or Armenian origin.

In which battle with Persians could Vakhtang have perished, especially as the Georgian Chronicles presents large-scale military operations? Hostilities of the scale in those times were only those of the Persian inva-

sion of Egrisi in 527, which was carried out via Kartli. The Persian invasion followed the visit of Gurgen (the same Vakhtang) and Egrisi ruler Tsate to the Byzantine Caesar. The time of Vakhtang's death - 527 allows for determining the precise date of his birth, which is 467. This, in its turn, give us an opportunity to come up with more precise dates for the death of his grandfather Archil and the enthronement of his father Mirdat. Vakhtang was four years younger than his elder sister Khvaramze. Accordingly, Khvaramze must have been born in 463. Mirdat was not yet a king when Khvaramze was born. This can be concluded from the following: when Mirdat married Sagdukht, as a prince he was given the saeristavo (administrative unit in old Georgia) of Samshvilde by Archil. Mirdat and his wife lived in Samshvilde for a while, where Sagdukht built the Sioni of Samshvilde. We should consider that Khvaramze, the first child, was born to the couple in Samshvilde. This point is further substantiated by another circumstance: in the "Georgian Chronicles" there is no reference to Khvaramze having a mamamdzudze (the head of a family to whom a prince is given for upbringing) at all, while in case of Vakhtang and his younger sister Mirandukht, the chronicles offer a detailed account of how the two were raised by mamamdzudze. It is only natural, the story of giving the child of Mirdat - Khvaramze, the daughter of the prince for upbringing would not make a story of top importance; however as for the children of Mirdat as a king, choosing a family that would raise him would already be an issue of domestic policy. Hence, Mirdat must have ascended the throne in 464-466; this is also the time of the death of Mirdat's father Archil.

We would like to touch on the etymology of Vakhtang's name as well. As we know, according to the "Georgian Chronicles", the full name of Vakhtang is Varan Khosrowtang. Khosrowtang can be found in other Georgian sources as well and stand for the Sassanid dynasty on the whole. Khosrowtang have to be a distorted version of Khosrotagn, which should be deciphered as Khosrotag(a)n and mean 'descending from Khosro's', the same 'descending from Sassanids'. As to the Persian name "Varan", it is the same "Guaram" of the later period. Thus, the name Vakhtang is the result of using an acronym while entering the full name Va (ran) Kh(osro) Tag(a)n in the text and the subsequent failure to understand the acronym. This accounts for the absence of the name Vakhtang among Vakhtang's offspring for centuries, while the name Guaram was quite widespread.

After Vakhtang, starting from 527, Kartli was ruled by the eldest son of Vakhtang from his first marriage (to Balandukht) Darchil (Dachi). Vakhtang had the son at the age of thirty-five (502/3). This way, at the time of enthronement, Darchil (in this context we do not mean ascension to throne at the age of five) was 25 years old. "The Georgian Chronicles", seems to reflect the Byzantian-Persian "permanent ceasefire" (532), in

the form of Vakhtang's will, according to which three South-Western provinces of the Kartli Kingdom: the saeristavos of Tsunda, Klarjeti and Odzrkhi came under the Byzantine protectorate. The governor of this part of Kartli was Vakhtang's son from his Greek wife (Helen), the younger brother of King Darchil - Mirdat, the same Mihr//Mir (Mitra), who had the title of a Byzantine Patrician ("Head of Eristavis", according to the "Georgian Chronicles").

Vakhtang's son King Darchil and his half brother patrician Mirdat (Mir) (Erismtavari of the Georgian Chronicles is the Georgian translation of the Byzantine Patrician), fought on the Byzantine side during the Persia-Byzantine War, which is best known as the great wartime and which took place in 540-562; the war was waged on the territory of Georgia starting from 542.

A hagiographic work written in the middle of XI century, and devoted to the martyrdom of princes of Argveti: David and Constantine used the historical chronicle of VI century, but the Persians were interpreted as Arabians by him, as well as, while fire worshippers and the magi as followers of Islam. But this chronological mistake was easy to notice because the hagiographic work offers us information on the participation of Vakhtang Gorgasali's son's Darchil and Mirdat in the war (Sanadze, Arakhamia, 2013. pp. 105-116).

In the battle against Persians at Anakopia, King Darchil and his brother Mirdat suffered defeats and the Darchil got killed. This story was narrated much later by Leonti Mroveli, who identified the sons of Vakhtang Gorgasali Darchil and Mirdat reigning in the mid VI c with Mir and Archil -- the sons of Stepanoz III, Erismtavari of Kartli, who were fighting Arabs in the 1<sup>st</sup> part of VIII c. This way the historian combined the story of the sons of Stepanoz III fighting against Arabs, with the story of Darchil and King Mirdat. Leonti was misled by the fact that in his era, the author of hagiographical work of Martyrdom of David and Constantine already had Arabs as the historical background for his story.

Considering the dates of Davit and Constantan's torture, and considering the difference that is given between Byzantine and Georgian versions "from the beginning of times", we can state that Darchil was killed at Anakopia by Persians in 545. At the time of his death, King Darchil would probably be 43 years old. At the same time, the Kartli throne was to be passed over to his son Bakur, who would be around 20-23 years old at the time of enthronement. The end of Bakur's reign coincides with the end of the wartime. This is the very period when reign was abolished in Kartli and Tbilisi turned into a residence of Persian officer-marzbans. As for the immediate offspring of Bakur and all the following 'kings': Bakur's son Parsman VI, the nephew of Parsman - Parsman VII and the son of the latter Bakur – they still called themselves 'kings', yet out of the royal Kartli territories they only ruled Kakheti.

Thus, in approximately a two-century span, from 375/80 to 562 i. e. after the reign of Asparug and before the end of reign of kings in Kartli, the kings of Kartli are laid out according to the following chronology:

|  |                     |
|--|---------------------|
| Asparug  | aprx. 368–375       |
| Varaz Bakur (the same Great Bakur, the grandfather of Peter the Iberian),            | aprx. 375–385       |
| Trdat (Father –in-Law of Varaz Bakur)  | aprx. 385-395       |
| Parsman V  | aprx. 395/396 - 400 |
| Mirdat//Bosmarios (father of Peter the Iberian)                                      | aprx. 400 – 427     |
| Archil   | aprx. 430/431–463   |
| Mirdat (father of Vakhtang-Gorgasali)  | aprx. 463–473       |
| Vakhtang (the same Varan/Guaram I)   | aprx. 473 – 527     |
| Darchil  | 527-545             |
| Mirdat, brother of Darchil the Patrician and parallel ruler in the South West Kartli | 532– aprx. 550s     |
| Bakur the son of Darchil   | 545– aprx. 550s     |

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## **Linguistics and Culture**

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### **The Center of the Universe and its Symbolic by the Georgian Highlanders**

*Gudushauri Tinatin,  
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*Existence of the center of the universe and its symbolic always used to have great importance in general perception of the world, and consequently it is by various models confirmed in religious thinking of the world people. Georgian ethnographic material, in which sacral nature of the center is clearly disclosed, is not an exception insofar.*

*The first example of this is tree. In Georgian ethnographic reality it represents in static (sacral tree, sacral pillar) or mobile (chichilaki, karachka, sacral flags) forms and mostly is considered as symbol of sacral Centre. In our opinion the micro cosmic model of universe, with clearly expressed sacral center represents the Georgian traditional dwelling with its construction and symbolic –religious meaning and main ritual function of central pillar in dwelling exactly is marking out sacral center. The importance of sacral Centre is proved by mythological legends and ethnographic materials concerning the establishment of shrines of mountain areas of Georgia.*

*One of the key symbols of sacral center are Holy Mountain, hearth and their directly connection with religious traditions. Symbolism of the hearth as Centre plays particular role in wedding ritual, relatively seldom, but still the function hearth appears in funeral ceremony.*

*All these give possibility to conclude the following:*

- *Symbolization of the center is quite distinguishing event for religious thinking of Georgian mountaineers and is realized in different forms in different cases;*
- *The first example of this symbol is holy mountain and tradition of building cultic structures on peaks of mountains, which is general Georgian phenomenon;*
- *Symbolism of the center of universe is clearly reflected in such traditional type of Georgian dwelling as earth dwelling house with central wooden pillar and hole for light and smoke;*
- *Symbolic of the center explains special meaning of hearth in ethnographic reality (traditions of wedding and funeral, reconciliation near the hearth);*
- *Symbolic of the center is declared in Legends concerning establishment of the shrines in mountain areas.*

Existence of the center of the universe and its symbolic always used to have great importance in general perception of the world, and consequently it is by various models confirmed in religious thinking of the world people. Georgian ethnographic material, in which sacral nature of the center is clearly disclosed, is not an exception insofar.

The first example of this is cosmic mountain as the link between earth and sky. Similar mythic and real mountains act important role in culture of many nations of the world, including Georgian culture. The mountain was often perceived as picture of the universe, model of cosmos, in which all parameters of cosmic setting is provided. In many cases it was identified with life tree, which had same or similar meaning. The example of this connection is tradition of worship of mountain existed Abkhazia, which is closely linked with worship of holy trees, growing on mountain slopes and represented sacral objects and the oak growing on the peak of mountain was the domain of supreme deity.

One of the key symbols of sacral center is tree. In Georgian ethnographic reality it represents in form of Chichilaki (Georgian traditional analog of New Year tree), sacral flags and so on. The center symbolism is distinctly noticed in one of the oldest types of Georgian dwelling – hall with central pillar. Special construction, so called crown roofing is its key detail, such system of roofing, which is proved in Georgia from the edge of old and new chronology, reached particularly high level. The roofing is based on the walls of the hall and special pillars called central pillars. Though, basically there are two such central pillars in the hall, existence of 4, 6 and even 8 such pillars is proved in ethnographic materials and historical sources too. Central pillar was cultish center of family in old Georgia, it was identified with life tree and the whole complex of belief – imaginations developed in pre Christian period was connected to it.

The central pillar was in abundance ornamented basically by the groups of figures of astral nature: rotating sun, moon, stars; and besides decorative it had ritual meaning as well. We think main ritual function of central pillar in the hall is marking out sacral center. This is proved by its location – close to hearth, which on its side is symbol of center, as well as aperture in a crown and cosmogony ornamentations of central pillar, which gives opportunity to say that Georgian hall with central pillar with its construction and symbolic – religious meaning represents micro cosmic model of universe, with clearly expressed sacral center.

The importance of sacral center is proved by mythological legends and ethnographic materials concerning the establishment of shrines of mountain areas of Georgia. all scientists working on these issues consider that according to ethnographic data the place where the shrine is located always has meaning of middle, center and is associated with sacral tree. Embodiment of this middle for Pshavi is Lashari oak tree and for Khevsureti – Khmala fir tree, from which according to the legend holy

chrisms were dripping and gathered in wine-jars buried nearby, to be distributed to shrines of whole Khevsureti. The place with chrisms source is considered as the centre of holy universe. The same example is growing of the tree in hearth, this theme is distributed in mountain part of east Georgia and covers all significant shrines of this regions. The tree growing in the hearth on the place of fire, highlights that it is the center and consequently – sacral. Potential sacral nature of hearth is quite well revealed in its function in ceremonies of wedding and in some cases of funerals.

The material related to the mentioned is recorded in materials of German and Georgian researches on Georgian mountaineers. Mostly in all cases, the focus is on hearth and fire, as on the symbols of life and fertility, but we think that one of the most important features of hearth is its cosmogony nature. This is the place where the fixed local center of universe is located and four edges of the universe are crossed symbolically; namely on this place the living space is focused. Exactly, symbolism of the centre plays particular role in one of the details related to wedding ritual, in particular during traditional wedding in Khevsureti, when the new bride is brought to the family, the groom is not at home, mostly he is hidden in neighbors' houses. Guests are looking for him, then bring him home and offer a sit next to the bride near the hearth.

The chief priest (servant of the icon) gives them one wax candle to each, tells them to get up and binds hems of their clothes and prays with chalice full of wine or beer in his hand. The wedding starts only after this. Bringing bride and groom to the hearth, giving seat or taking them around it, is characteristic to all high land areas of East Georgia and not just for them. In fact this tradition shows the trend of general Georgian tradition. We think, the hearth participates in all these rituals not only as symbol of life and fertility, but has meaning of sacral center. It is considered that hearth should give to new family not only fertility, but also peacefulness, because they will start to live not in amorphous but in arranged space, oriented from sacral center – hearth.

Relatively seldom, but still the function hearth appears in funeral ceremony. In this case this is also tradition of Khevsureti – the habit of silence. According to this tradition on the day of funeral the closest relative of the deceased person selects three other two men and one aged woman, again from the relatives, which sit next to the hearth with ritual cakes in their hands and are fully silent until presbyter comes and blesses the bread. After this they circle the bread three times around their heads, take the deceased to the room and only then they have right to break the silence and sit at the table.

In our opinion we still deal with the symbol of hearth as sacral center, which is in close connection with the next world. According to oldest impressions, anthological transformation from one form of life to another



happens namely in the center otherwise in aperture of the universe; and people sitting silent next to the hearth are symbolic witnesses of this transformation. Svanetian (mountain area of Western Georgia) reconciliation ritual also points to mentioned, which is conducted in two options in case of insulting the hearth (pouring water and extinguishing): a) the insulter takes off the clothes and only in underwear lies next to the hearth and b) creeps under the hearth. According to Svanetian information forgiving always ends with adoption of wrongdoer or his/her acceptance as family member. Existence of cosmic aperture on the place of hearth – sacral center is quite obvious here as well as ambivalent nature of nether world – this is domain of death and at the same time beginning of new life, revival of which is possible only from the center. The person lies next to the hearth or creeps under it, otherwise goes to nether world, leaves society – arranged sacral space and after forgiving starts new life again through the hearth – sacral center, and comes back to the society. Symbolic of the three circling ritual cake three times over the head) in funeral ritual shall be analyzed against three levels of the universe, mostly because important religious meaning of this number in Khevsuretian perception of world is well known. We mean three summit and three color understanding, which has so great importance for traditional society of Khevsureti, that it is reflected even in the custom of putting clothes to deceased person (according to Khevsuretian tradition three outer clothes of different colors are put on the deceased person – wine –red, black and white – colorful, which repeat traditional Georgian colors of cosmos). All these give possibility to express opinion that hearth participates as sacral center on two the most important phases of human life, basically as the symbol of wholeness of universe and bridge for going from one form of existence to another.

Ethnographic material related to growing the tree in hearth fits quite well in this context. As it is known this is the theme coming from the oldest mythos and is quite well proved in Georgian folk and ethnographic life. Such myths and oral traditions are widely spread in mountain areas of East Georgia, they are in fact identical and accompanying the history of nearly all big shrines. General scheme of myth which with some alteration applies to the history of nearly all strong shrines of Eastern highland areas is as following: the tree is growing in the hearth, the owner cuts the tree and on the third morning the coming up tree is followed by the snake, which indicates that the family shall leave the house otherwise it will be punished, because this place is designated for establishment of the shrine. Families of three brothers were sacrificed to the establishment of strong Khevsuretian shrine – Gudanis Khati (icon of Gudani), which lived on that place and did not want to live it.

Part of the scientists considers that the tree growing up in the hearth embodies deity, on the name of which the shrine should be established.

Our opinion is different and we think that the tree is not considered as deity, but as cosmogonic axis – world tree, growing of which breaks homogeneity of the space in the hearth (this possibility potentially is already determined by existence of the hearth) and sacral center of the universe is created, which means possibility of establishment of the shrine on this place. This opinion should be proved by the motive of the snake following the tree, which highlights the symbol of sacral tree – center and axis uniting three levels of the universe, the lowest level of which is nether world.

The meaning of the center of universe is clearly defined in the picture of Khevsuretian next world. According to traditional imagination of Khevsuretians the Paradise is multistory white fortified tower, which scrapes the sky. As it is known, tower, tree, column are identical phenomena and represent the variations of the center. This meaning is rather highlighted by huge poplar tree growing next to the tower, top of which reaches the sky, or in some versions it is tied up to the sky with golden chain. White color of the tower should not be occasional as well, white and blue are Lord's colors according to Khevsuretian world perception, while black, dark color expresses nether world.

All these give possibility to conclude the following:

- Symbolization of the center is quite distinguishing event for religious thinking of Georgian mountaineers and is realized in different forms in different cases;
- The first example of this symbol is holy mountain and tradition of building cultic structures on peaks of mountains, which is general Georgian phenomenon;
- Symbolism of the center of universe is clearly reflected in such traditional type of Georgian dwelling as earth dwelling house with central wooden pillar and hole for light and smoke;
- Symbolic of the center explains special meaning of hearth in ethnographic reality (traditions of wedding and funeral, reconciliation near the hearth);
- Symbolic of the center is declared in Legends concerning establishment of the shrines in mountain areas.

In general, it can be said that existence of sacral center was significant characteristic for archaic Georgian world picture, represented by three parts of universe and was presented by varied symbols.

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## **Aporia and Its Narrative Structure in the Novel *The Unnamable* by Samuel Beckett**

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*The article deals with the scientific framework of the less widespread stylistic device aporia, focusing on its definition, peculiarities, function and effect caused by it.*

*Aporia as a stylistic-phonetic device has gained a great power and a new mode of expression in the timeless example of 20<sup>th</sup> century prose – by Samuel Beckett.*

*The Unnamable is a stream-of-consciousness novel, but not like Joyce's Ulysses, where the sights, sounds, smells and human bustle of Dublin are evoked for us, in vivid specificity, through the sense- impressions, thoughts and memories of the chief characters. All we have is a narrative voice talking to itself, or transcribing its own thoughts as they occur, longing for extinction and silence, but condemned to go on narrating, though it has no story worth telling, and is certain of nothing, not even of its own position in space and time.*

*Beckett was a deconstructionist avant la lettre. "I seem to speak, it is not I, about me, it is not about me" Aporia is a favorite trope of deconstructionist critics, because it epitomizes the way in which all texts undermine their own claims to a determinate meaning; but the narrator's later admission, "that I say aporia without knowing what it means", is a trumping of aporia.*

*What is extraordinary is that this bleakly pessimistic and skeptical text is not deeply depressing to read, but on the contrary funny, affecting, and in a surprising way affirmative of the survival of the human spirit in extremis. Its famous last words are: "you must go on, I can't go on, I'll go on"*

"A book neither begins nor ends; At most it pretends to."  
J. Derrida, "Living on in Deconstruction and Criticism"

*The Unnamable*, the first published in French in 1952, is a stream-of-consciousness novel, but not like Joyce's *Ulysses*, where the sights, sounds, smells and human bustle of Dublin are evoked in vivid specificity, through the sense- impressions, thoughts, and memories of the main characters.

Beckett's outstanding achievements in prose during the period were the three novels: *Malloy* (1951); *Malony Dies* (1958); *The Unnamable* (1960). In these novels—sometimes referred to as a "trilogy"—*Molloy* still retains many of the characteristics of a conventional novel (time, place, movement, and plot) and it makes use of the structure of a detective novel.

Aporia is a Greek word meaning "difficulty, being at a loss," literally, "a pathless path," a track that gives out. The term is used in the theory of deconstruction to indicate a kind of impasse or an insoluble conflict between rhetoric and thought. Aporia suggests the 'gap' or lacuna between what a text means to say and what it is constrained to mean. It is central to Jacques Derrida's theory of *differance*. Christopher Norris discusses the central feature of deconstruction as the seeking-out-of those "aporias," blindspots or moments of self-contradiction where a text involuntarily betrays the tension between rhetoric and logic, between what it manifestly means to say and what it is nonetheless constrained to mean.

Deconstruction, so far, has been the most influential feature of post-structuralism because it defines a new kind of reading practice which is a key application of post-structuralism. A deconstructive criticism of a text reveals that there is "nothing except the text". In *Of Grammatology* Derrida makes the now well-known axial proposition that one cannot evaluate, criticize or construe a meaning for a text by reference to anything external to it.

In classical rhetoric aporia denotes real or pretended doubt about an issue, uncertainty as to how to proceed in a discourse. Hamlet's "To be or not to be" soliloquy is perhaps the best-known example in literature. In fiction, especially in texts that are framed by a storytelling situation, aporia is a favourite device of narrators to emphasize the extraordinary nature of the story. It is frequently combined with another stylistic devices like aposiopesis, the incomplete sentence or unfinished utterance, usually indicated by trials of dots.

*The Unnamable* consists of eighteen chapters, seventeen of which remind us the works of Derrida and Nietzsche, their abstract interpretation combined with long talks. We become witnesses of fragmented aphorisms of Nietzsche and taxonomic narration of Derrida. So far as eight-

eenth chapter is concerned, it is a quasi-paragraph consisting of 157 pages.

The anonymous narrator is sitting in some vague, murky space (jar), whose limits he can neither see nor touch, while dimly perceived figures, some of whom seem to be characters from Beckett's previous novels, move round him – or could it be that he is moving round him – or could it be that he is moving round them? Where is he? It could be hell. It could be senility. It could be the mind of a writer who has to go on writing though he has nothing to say because there is nothing worth saying any longer about the human condition. *The Unnamable* seems to fit Roland Barthes' description of "zero degree writing," in which "literature is vanquished, the problematic of mankind is uncovered and presented without elaboration, the writer becomes irretrievably honest."

"Where now? Who now? When now? Unquestioning. I, say I. Unbelieving. Questions, hypotheses, call them that. Keep going, going on, call that going, call that on should mention before going any further, any further on, that I say aporia without knowing what it means."

All we have is a narrative voice talking to itself, or transcribing its own thoughts as they occur, longing for extinction and silence, but condemned to go on narrating, though it has no story worth telling, and is certain of nothing, not even of its position in space and time. This uncertainty is enhanced by means of incompatible lexis like affirm-negate, sooner-later, present-future, knowing-not knowing; contrast and polarization that highlights the exceptional discourse of the novel.

The discourse accretes rather than proceeds, by a kind of self-cancellation, one step forwards and one step back, contradictory statements separated only by commas, without the usual adversative *but* or *however*. "Keep going, going on"- the narrator urges himself, and immediately adds the derisive rejoinder, "Call that going, call that on?" How did he come to be where he is? Can it be that one day ... I simply stayed in. Immediately another question is raised-'in where?'- He drops the original question. "No matter how it happened.", But even this negative gesture presumes too much:" It, say it, not knowing what"

In metafictional narratives like *The Unnamable* aporia becomes a structural principle, as the authorial narrator wrestles with the insoluble problems of adequately representing life in art, or confesses his own hesitation about how to dispose of his fictional character.

Beckett was a deconstructionist writer. He anticipated Derrida's notion of the inevitable "difference" of verbal discourse: the "I" that speaks always being different from the "I" that is spoken of, the precise fitting of language to reality always being deferred."These few general remarks to begin with." That usually bland formula is blackly comic in this epistemological vacuum. How shall the narrator proceed, by affirmations and ne-

gations invalidated as uttered (by self-contradiction) or by aporia pure and simple?

“Help, help, if I could only describe this place, I who am so good at describing places, walls, ceilings, floors they are my speciality, doors, windows, what haven’t I imagines in the way of in my home, instead of any old thing, this place... if I could describe this place, portray it, I’ve tried, I feel no place, no place round me, there’s no end to me, I don’t know what it is, it isn’t flesh... it doesn’t end...”

Aporia is a favourite trope of deconstructionist critics because it epitomizes the way in which all texts undermine their own claims to a determinate meaning; but the narrator’s later admission “that I say aporia without knowing what it means,” is a trumping of aporia.

“There must be other shifts. Otherwise it would be quite hopeless. But it is quite hopeless”. What is extraordinary is that this bleakly pessimistic and relentlessly skeptical text is not deeply depressing, but on the contrary funny, affecting, and in a surprising way affirmative of the survival of the human spirit in *extremis*. Its famous last words are: “You must go on, I can’t go on, I’ll go on”.

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## **Concept of “Beauty” in the Lexical-Semantic Field**

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*Any lexical unit can be viewed in two different dimensions - conceptual and lexical systems. Semantic knowledge represents special type of the conceptual knowledge. Different aspects of any concept are lexicalized by means of the mentioned type of the knowledge.*

*The basic notion of the energetic conception is energy. Any language is the synthesis of the human and the universe. Thus, modern linguistics maintains the inner link with the previous linguistic paradigms, especially with the systemic-semiotic paradigm. It should be also mentioned that modern linguistic paradigm gives new interpretation of the mentioned paradigm.*

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Construction of the “world picture” represents systemic description of the reality. Any natural language possesses its own way of perceiving and conceptualizing the universe. Language as an extensive phenomenon comprises different intensive iposthesis. Languages differ not only in the grammatical structure and lexical constituents, but also in the “world view” determined by the national-cultural peculiarity of the way of semantic segmentation of the universe.

Semantics is not the mechanical agglomeration of semes. It is a complex system viewed as a net of interconnected and interdependent lexical units.

This type of interconnectedness and interdependence creates lexila-semantic field with its nuclear and peripheral segments (centre, transitional zone and periphery).

According to the systemic-semiotic approach to the language the universe is segmented by lingual fields.



The character (graduality/non-graduality) of the structure of the lexical-semantic field is conditioned by the type of semantic relations between the field elements (Gumboldt, 1969, p. 28).

These relations differ in the "power" of maintaining the content represented by the word-identifier of the lexical-semantic field. The power of maintaining the content designs specific configuration of the content-based unit.

Different segments of the lexical-semantic field (center, transitional zone and periphery) differ in the types of semantic relations between their elements.

The type of semantic relations between the elements of the center is considered to be the strongest connection between the elements.

The type of semantic relations between the elements of the transitional zone is considered to be weaker connection between the elements.

Some types of semantic relations typical of the field periphery are not anamnestic for the content-based unit.

The field segment with the mentioned type of semantic relations is called "terminal".

Differentiating between conceptual and semantic spaces is of the actual problems of modern linguistics. Concepts exist in the form of conceptual images, charts, notions, frames and scenarios (Brown, Asher, Simpson, 2006).

Semantic-cognitive approach to the language system implies identification of the relation existing between the language semantics and the nation's concept-sphere. It should be mentioned that the concept-sphere is variable in time and space.

Cognition is the power organizing the process of generating thoughts and regulating the use of concrete meanings within the borders of the culture. Cognition makes these meanings anamnestic for all representatives of the culture. Anamnesy results in the conventional nature of the language. The problem of knowledge representation is associated with the social and cultural experience of the human.

The immense part of the nation's conceptual spaces is manifested in the semantic space. This fact makes semantic space one of the fundamental issues of cognitive linguistic research.

The concept is considered in the prism of language meaning as its objectivation in the language is possible only by means of language meanings. In some sense, semantic space and concept-sphere are two identic phenomena - both of them are associated with the process of thinking. The main difference between the semantic space and concept-sphere lies in the following fact: language meaning (quantum of semantic space) is linked to the lingual sign, while the concept (element of the concept-sphere) is not linked to the lingual sign. Dealing with the analysis of the

concept-sphere the following regularity gives evidence: concept-sphere could be (or could not be) expressed by the lingual sign.

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## A Need for English Language Proficiency for 21<sup>st</sup> Century Diplomats

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*This article attempts to review in brief a need for English language proficiency for diplomats in today's fast moving world and the need of the diplomatic English to communicate effectively and unambiguously to create and maintain successful diplomatic relations.*

*In this paper we would like to introduce some innovative usage of expressions and words commonly used in politics and analyze their usage in the political discourse and to answer the following questions: What language should one use when speaking to diplomats? What language should diplomats use to be more precise? What language/languages should a young diplomat try to learn to be more successful in his profession?*

English is gradually becoming the language of diplomacy, which encouraged a new generation of diplomats to give their high priority to English as the preferred choice of the diplomatic community in the 21st century. The Diplomatic English recognizes the need to communicate effectively and unambiguously to maintain successful diplomatic relations and progression in this field. English is a key international language for inter-governmental relations, for NGOs and for all public bodies of many different types. The ability to contribute to meetings and debates, chair meetings, persuade people to your point of view is an essential means for diplomats, government representatives, officials, members of parliament, civil servants and those on international level. The English language has become the language of international communication, business and legal discourse. Therefore, knowing the basics of the English language is mandatory. In the modern world, fundamental education requires good knowledge of foreign languages for diplomats. In some countries it is compulsory for diplomats to know English in order to join their foreign service. In today's fast moving world, diplomats have many new challenges.

The influence of the United States and Great Britain on political affairs and international relations for the past 100 years has ensured

the acceptance of English as the main spoken language in many centuries for diplomats and high-ranking officials in major countries to better understand international diplomacy.

Political language refers to the language used by political subjects in political activities such as political speech, political interview, etc. One of the major functions of political language is to persuade and control so as to influence the thinking of the audience or the readers. To achieve this purpose, political subjects use various techniques. This article attempts to analyze the use of political vocabulary used in political language from critical discourse analysis, with the aim of disclosing the power relations hidden behind the political language. The usage of political vocabulary is considerable in any assessment of political trends in Georgia. Politics has its own peculiar language that must be understood before you can begin to involve in intelligent discourse. The language of politics can be confusing to those who are just beginning to speak English, but some terms that are casually tossed around also remain enigmatic to those who have experienced English language speaking. Politics is a very complex field, it involves human relationships with a variety of objectives in mind. Politicians have a unique art of expressing the same situation in different words, depending on which side of the table they are.

As George Orwell says "Political language is designed to make lies sound truthful and murder respectable, and to give an appearance of solidity to pure wind."

Politics can be a sensitive topic in any language. If you want to avoid getting into a debate, it's usually best to talk about a less controversial topic with people who may not share your political views. But talking about politics in English is a great way to practice your language skills. If you really feel strongly about a political viewpoint, you will be motivated to make yourself understood.

If diplomats or high-ranking officials want to be clear, and particularly when using a language which he does not master perfectly, it is better to use short, simple sentences. Many political words are similarly abused. The words *democracy, socialism, freedom, patriotic, realistic, justice* have each of them several different meanings which cannot be reconciled with one another. It is almost universally felt that when we call a country democratic we are praising it. Consequently, the defenders of every kind of regime claim that it is a democracy and fear that they might have to stop using that word if it were tied down to any one meaning. Words of this kind are often used in a consciously dishonest way.

In short, in today's world the need to incorporate a rigorous study of English is more and more strongly felt; it is standard for diplomats' to be expected to be proficient in English. Moreover, as the United States' influence on world information is dominant, in recent years, there is an urgent for the adoption of English among politicians in order to compete on an international platform.

Diplomats must be aware of how to communicate effectively and confidently in English to prepare and deliver speeches and presentations on a wide range of topics, to conduct negotiations, to discussing current and foreign affairs. They must consider some rules of diplomatic relations:

1. Diplomats must avoid negative words instead use positive words in a negative form.
2. Diplomats must use positive adjectives with "not" instead of negative adjectives.
3. Diplomats must use short, simple sentences.

Thus, a person working in the diplomatic service is required to develop special skills and background in certain subjects. One of these is being proficient in the English language. Not all diplomats find learning a language easy so there are different levels to attain. Diplomats, like all other students, can therefore brush up and revise their English language skills. A diplomat is the only person who can win the war by words, not weapons. That's what makes him one of the most important people in any country's government. I would also like to mention that not any diplomat is able to play and win the game of international intrigue. Moreover; diplomats must be highly qualified experts to be able to solve any problem even in an unpredictable situation.

The English language is one of the preferred choices of the diplomatic community. In today's world if you are a diplomat or, wish to be one, then the knowledge of the English language is a must.

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## The Role of Interdisciplinary Approach in ELT

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*The paper deals with interdisciplinary approach of teaching English terminologies. Since language competence is linked with career options, status, and so forth, the presence of specific terminological barriers among the students from different faculties also has to be acknowledged. This demands interdisciplinary approaches in teaching process. Specific terminology is the standard vocabulary used in the professional field. Professionals can conduct communication successfully by using terminologies easily and accurately.*

*The research involved gathering data on learners views on their learning needs and expectations, on encountered difficulties in learning English terminologies at university, the degree of importance of proficiency in professional areas of language, and collecting and analysing learners.*

*Empirical research questions relate to:*

- 1. The importance of interdisciplinary approach in the process of teaching English medical terminology*
- 2. How to use an interdisciplinary approach*

This paper tries to explore the learning of English medical terminology by Georgian students which have evolved into a required course for most careers in the allied health field, such as nursing, physical therapy, and clinical laboratory service.

Teaching English Medical Terminology is very important because of the fact that medical research has a global character. In the last 5 years, the world has been faced several times with fast spreading diseases such as “bird flu” and H1N1 virus to have the possibility to exchange professional information. The medical professionals should know some English terminology.

This article focuses on the frequent use of medical terminology within the interdisciplinary approach and identifying difficulties related to the process of teaching them. “Medical terminology is the study of words used to communicate facts and ideas particular to medicine and is chiefly concerned with the present use and meaning of such words” (Davies’ Medical Terminology: a guide to current usage by John Loveday, 1991) Over the past few decades, many changes in medical education particularly at the undergraduate level were introduced. Increasingly, innovative

curricula, methods and educational tools were developed due to the cooperation of medical professionals with pedagogues, sociologists, psychologists, information specialists and those in many other related professions. However, they brought to medical education various concepts, definitions and vocabularies not previously known to medical professionals.

With continued increase of international contacts in various fields, much attention has been attached to the design of ESP/ English for medical purpose (EMP) courses that can prepare students for professional communication with colleagues of other countries. However in the practice of teaching English medical terminology, questions have been raised by teachers and educators again and again, such as: Where should teachers start? What can be done about students' poor motivation? How teaching materials should be selected? Does the interdisciplinary approach make it easier to teach terminologies? Designing a course that can best serve students' interests and needs is a challenge for many teachers of EMP in Georgia. Therefore, the purpose of this paper is to suggest a framework for an EMP approach that will help teachers to solve some of the problems they may come across in teaching English medical terminology.

In brief, this research attempts to clarify the difficulties found most and least frequently by the learners and the role of interdisciplinary approach of teaching terminologies for medical purpose.

### *Method and Materials*

Participants in the current study were 100 intermediate and upper intermediate students at the Medical University and at the University of Georgia. The questionnaires were based on Medical Terminology and the role of the interdisciplinary approach. The categories of medical terminology were arranged according to their medical books they are studying during the semesters. Our goal was to help them learn the tools of word analysis that will make the understanding of the complex terminologies easier. Medical terms are very much like puzzles. This empirical research illustrates the use of such a questionnaire as a tool to:

- A. To define the importance of teaching medical terminology with the help of the interdisciplinary approach
- B. To explore the problems students are facing while studying English terminologies.
- C. If interdisciplinary approach makes methods of teaching terminologies easier.

In order to explore the problems empirical research was done included the following questions:

1. How many terminologies are recommended for studying during one lecture? Why?
2. Is it possible to communicate with a doctor without a basic knowledge of med-



ical terminology?

3. Does professional knowledge help you to catch the meaning of the English medical terminology?

4. Is it possible to get the meaning of the English terminologies without taking the special course of English for medical purpose?

5. Can you catch the meanings of this terminology with the help of interdisciplinary approach in the given passages? And define the difficulties

- a. Smoking ----- The tobacco industry constantly and aggressively seeks new users to replace the ones who quit and the current users -up to half-who will die prematurely from, **heart attack, stroke** or other **tobacco-related disease**.
- b. Healthcare in the USA ----- Being a highly -industrialized nation, finding a doctor in the United States is not difficult at all. There are hundreds of **medical practitioners** to be found in every state.
- d. Epidemiology ----- The science of epidemiology was first developed to discover and understand possible causes of **disease like smallpox, typhoid** and **polio** among humans.

6. Can you catch the meanings of medical terminology without context and define their difficulties?

a. contagious diseases    b. health care utilization    c. top statistic    d. drug innovation

7. Is it possible to get the meaning of the medical terminology based on their definitions?

- a. The branch of medical science dealing with the transmission and control of disease.
- b. Social insurance for the ill and injured

8. Does the interdisciplinary approach make it easy to study English terminologies?

### *Results and Discussion*

We defined four types of groups according to the students' answers. Questions dealt with the difficulties of teaching terminologies and revealed the role of terminologies in enriching the vocabulary and motivation of learning the language. Some questions are dealt with the way of working and discussing the importance of terminologies while learning the language. Some interesting conclusions can be drawn:

- 70% percent of students see the problem in the form of working, they prefer studying the terminologies based on the context
- while 90% percent out of the inquired students consider the interdisciplinary approach as one of the easiest way of teaching special terminologies.
- 85% present of students have come to the conclusion that the professional knowledge helps them to catch the meaning of the English terminologies easier.
- 95% percent of students consider the knowledge of terminologies as one of the most significant aspects in the professional fields.

### *Conclusion*

Our empirical research has shown the great importance of medical terminology to conduct professional communications.

With the help of Interdisciplinary approach it makes easy to catch the meanings of unknown terminologies. Medical terminology covers the specific words and phrases you will need to learn to function effectively and understand the "language" of health care. Whether you deal with the clinical side or the administrative side, everyone involved in health care uses various terms to describe procedures and office practices. Many of the terms used in health care are "built up," which means they are formed from word parts.

An important achievement is when students are able to make intelligent guesses about the meaning of special terminologies with the help of interdisciplinary approach. The results of the experiment indicate that the knowledge of English medical terminology is foundational in learning medical English to provide optimal care for patients in their future career

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## Idea against Others Ideas: Caligula – History of Supreme Suicide

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*French writer Albert Camus (1913-1960) is known for the readers as wise but controversial writer who created novels, stories, plays, philosophical and literary essays. His early literary creations as well as his world outlook were prepared with the characteristics of European philosophic traditions and literary development.*

*Camus is one of the important representatives of French existentialism though he was always objected being called an existentialist or even a philosopher: The former – possibly because that in the evolution of his viewpoints time after time he used to separate its chief statements; and the latter because he did not have the system of philosophical conception.*

*Caligula is the History of Supreme Suicide. Caligula is the killer not by nature but by philosophic principles. He is paradoxical, he thinks that he is right but in fact he is wrong. Caligula refused to escape from genuineness and to hide behind illusions. Human beings' attitude towards death is metaphysical, mysterious and inevitable. The fears of death, mysterious experience and human weakness are the components of Camus' works. The death dominates over the life thus life becomes pointless. The beautiful world is just a glimpse.*

*According to the existential philosophy, fear and death are the definition of human life. Caligula cannot understand that it is impossible to destroy everything without self destruction. It is the most tragic, cruelest truth. The Emperor demands impossible thing. He tries to establish abnormal freedom but he fails.*

This play gives us a clear picture of the author's esthetic attitude as well as about his viewpoint, his artistic method and thus it is easier for us to understand Camus. The author makes the right sign: "I am not afraid to call my works essays and novels about absurd; this is negative and the period that is hard to overcome and that will distinguish all the rest."

The first note "about Caligula" "appeared in 1937: If you gain power, if you like life, you have heart, then you will see how the monster or the angel will cut out it from your body."

*Dostoevsky* wrote in *The Writer's Diary* that if trust of immorality is so essential for the human being and he commits suicide without it thus this belief is normal condition of a human. Therefore if it is this way, then immortality really exists.

It is widely accepted that before Camus R. Roland tried to create Caligula's character in one of his essays but it did not have influence on Camus' Caligula. Both of the plays are focused on the central idea that manipulates the main character – this is the power of death that shadows the essence of life. Camus wanted his play to have the general importance that would exceed the époque borders that is described in the *Twelve Caesars'* life and Camus discovered this by the assistance of the professor Jean Grenier.

He uses Suetonius, the author of the *Twelve Caesars*, by his way. Here Caligula is not only sick, unreasonable and crazy but – Nietzsche – barbarous, for whom God died and he proves the poverty of a superman.

Monterlan is amazed with neurasthenic king eccentric character that is both an angel and a savage. Camus deliberately avoids anachronism. He tries to transfer the tragedy on the stage that will be adequate of epoch. At the center of the tragedy appears the emperor's metaphysical rebellion that coincides with Dostoevsky's characters, which according to Camus are most modern. But according to Dostoevsky, life is worthy if God exists.

In November 1939 Camus was 26. World War II was in progress in Europe but for many French this was a strange war and Camus imagined it as the absurd event that led us to death.

The controversial movement appeared in France, occupied by Hitler. Its active members were Sartre and Camus. They did not believe in God. But time passed and they became the witnesses and then participants of the tragedy in which "million Caligulas" killed people and collapsed the world. Camus and Sartre established a new "order" in Europe compared with which both Nietzsche's revaluation of the values and Caligula became like innocent babies.

France as well as the whole Europe was facing the danger. This was an epoch, a national catastrophe that influenced a certain wise man and they accelerate awakening.

When Caligula was first performed in 1945, in France, the public identified him with Hitler. Caligula consists of 4 acts. The first act is separated from the rest with three years and this allows us the play to be better performed.

The tragedy actions, characters and key points are developing expressionally. The action takes place in 38 AD. The spiritual defeat of the young Roman emperor Caligula is sudden and the main reason of his fall is meeting with the death. Standing in front of his dead sister and beloved Rozila, Caligula discovers a genuine truth. "People die and they are unhappy". They are dying and they find out that it is impossible to establish justice in the world.

Caligula refused to escape from genuineness and to hide behind illusions. Human beings' attitude towards death is metaphysical, mysterious and inevitable. The fears of death, mysterious experience and human weakness are the components of Camus' works. The death dominates

over the life thus life becomes pointless. The beautiful world is just glimpse.

In the beginning of the play the main character does not appear. By the end of the second act everything becomes clear – Caligula returns. Now the epoch, place of action and characters are on the stage. Camus used to say about Caligula: “This was a tragedy of wisdom” (“tragedie de l’intelligence”).

The author tries to show the complex picture of reality but he discovers that the reality is ambiguous and creates illusion.

Caligula trusts himself. During the whole play the main characteristics of Caligula are: cruelty, nihilism, hatred towards values, life, feelings and God.

This is the logical philosophy of suicide and this reveals the existential points in Camus literature. The character fights against himself, with his weakness and wants to change the world, which displays the lack of supreme mind. Life is false. People try not to recognize absurd, God, and immortal traditions, rituals as well and they behave as they love their close persons.

But in reality they are lacking the prospects of immortality. They are indifferent to each other. The author thinks that the essence of life is in solving death problem. Caligula is extremely powerful and tries to use his power to conquer the world. “I am not crazy but on the contrary I have never been so clever.” He refuses to obey his destiny, he wants to create a new trial and he even does not bother himself to explain why he sentences this or that person.

“Now and forever my freedom is endless” and he adds “the freedom can be gained on the expense of others, unfortunately it is reality.” Why did Caligula need all this flattery? Because to establish false and unreasonable steps in the world.

The Emperor’s freedom is unlimited. Caligula regards that to be free means to kill. He humiliates, mocks people and concludes: “this is happiness.” In *Caligula*, Camus acts the same way as in Dostoevsky’s novels with – the idea. Courageous Carea, who used to be Caligulas best friend now confronts the emperor. Carea has different ideas about human beings. He hates when a strange idea comes true in a very short period of time “like a lunge in the breast.”

Camus thinks much about Dostoevsky’s response towards his supreme suicide. The author analyzed Dostoevsky’s supreme idea and expressed it in the play with the character of Carea.

Carea knows that Caligula rejects the human being and the world as well. He understands that we should not disunite the world but on the contrary we must take care of it if we want to live there. Though in the drama Carea’s truth is suspicious. In the struggle he is unable to overcome Caligula’s crazy ideas but at the same time he dreams of killing him. This murder is a symbol of Carea’s freedom from the evil.

In 1939, the manuscript of *Caligula's Competitor* is paradoxical. He shares the "passion" of his former student but he is afraid of its realization. Because this passion threatens his "individual security." The play was staged in 1945.

In the beginning, the French critics envisioned Carea as a prototype against totalitarianism. Those persons that fight for their happiness are always against Caligula. It is impossible for the emperor to stay in former "frames" because he acknowledged his own and public limitations. Caligula as the member of utopian world is alone with himself and from this stage begins his spiritual loneliness. But this is not his topic. "And what is loneliness? Isolation from the poets and disabled people? Nobody leaves an abandoned person alone. People feel for each other. Every meeting in every person awakes a new personality. My freedom failed, says Caligula in the final act.

In 1958, in the introductions of the plays published by American publishers Camus used to write: "Caligula, this is the story of supreme, self killer, who is extremely tragic. Caligula is ready to die when he understands that nobody can survive alone and it is impossible to be free against other people. The freedom directed against people will always fail."

"If Caligula's truth is in his rebellion – his mistake is in rejecting people, it is impossible to destroy and abandon everything without destroying yourself," wrote Camus in 1958. This stupid play is performed to prove that the truth of the world is that "it is not." There exists neither evilness nor kindness. Everybody should do the thing they like.

Caligula is the History of Supreme Suicide. Caligula is the killer not by nature but by philosophic principles. He is paradoxical, he thinks that he is right but in fact he is wrong.

Fear and death – according to the existential philosophy this is the definition of human life. Caligula cannot understand that it is an impossible to destroy everything without self restraint. It is the most tragic, cruelest truth. The Emperor demands impossible thing. He tries to establish abnormal freedom but he fails.

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## **Political Sciences**

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### **The Europeanization of Security and Turkey's Membership of the European Union**

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*Europeanization is a relatively new concept, the roots of the idea of the Europeanization of security in Western Europe go back to the early days of the European Coal and Steel Community (ECSC) and became manifest after the demise of the USSR, which marked the end of the Cold War. Therefore, the process of European integration can also be seen as a Europeanization of the security culture of European Union (EU) member states. This Europeanization is a transition from the classical perception of security, based on state-centric high politics (achieving security by military power), to a modern one, that is, giving priority to low politics (achieving security by non-military power, through economic and political integration). Hence, the Europeanization of security is actually a process of de-securitization which eliminates security and insecurity concerns from perception. However, non-military security problems and dynamics can also be present in that de-securitization.*

*By contrast, the Turkish state's security culture, which takes its roots from the founders of the Republic, gives priority to high - rather than low - politics. The Turkish state's elite are inclined to look at issues through the lenses of security or insecurity. This Turkish state outlook is a consequence of its securitization tradition in which security problems having no military element in their resolution are considered inferior in importance to military ones. Acknowledgement of the contradictory natures of the linear transition of Europeanization of security in Western Europe and traditional Turkish security perceptions is crucial in order to grasp one of the main underlying reasons behind Turkey's continuing exclusion from the EU's Common Foreign and Security Policy (CFSP).*

Although Europeanization is a relatively new concept, the roots of the idea of the Europeanization of security in Western Europe go back to the early days of the European Coal and Steel Community (ECSC) and became manifest after the demise of the USSR, which marked the end of the Cold War. Therefore, the process of European integration can also be seen as a Europeanization of the security culture of European Union (EU) member states. This Europeanization is a transition from the classical perception of security, based on state-centric high politics (achieving security by military power), to a modern one, that is, giving priority to low politics (achieving security by non-military power, through economic and political integration). Hence, the Europeanization of security is actually a process of *de-securitization* which eliminates security and insecurity concerns from perception. However, non-military security problems and dynamics can also be present in that de-securitization.

By contrast, the Turkish state's security culture, which takes its roots from the founders of the Republic, gives priority to high - rather than low - politics. The Turkish state's elite are inclined to look at issues through the lenses of security or insecurity. This Turkish state outlook is a consequence of its *securitization* tradition in which security problems having no military element in their resolution are considered inferior in importance to military ones. Acknowledgement of the contradictory natures of the linear transition of Europeanization of security in Western Europe and traditional Turkish security perceptions is crucial in order to grasp one of the main underlying reasons behind Turkey's continuing exclusion from the EU's Common Foreign and Security Policy (CFSP).

### *Europeanisation of Security*

"Western Europe is a security community. In contrast to the expectations of most contemporary theorists of security communities, this has not been achieved by erecting common security structures or institutions, but primarily through a process of de-securitization, a progressive marginalization of mutual security concerns in favor of other issues" (Waever, 1998, p.69).

Karl Deutsch argued that a security community was formed when actors, especially the political authorities, compromised on peace in a form of international cooperation. Under certain circumstances, this compromise among political elites could lead to integration. The ECSC, which was established by the Treaty of Paris in 1951, emerged as a result of a compromise between the political elites of France and Germany in Western Europe. Creation of this supranational organization was the first step in the institutionalization of the Europeanization of security. Sworn enemies France and Germany sat at a single table and agreed to transfer their



sovereignty rights over resources to a supranational organization on the basis of an equal vote principle. The common goal behind this formation was to combine coal and steel resources, which were crucial for both international security and economic development. It should be underlined that a certain security concern was rooted in the establishment of the ECSC, which sought to prevent history repeating itself on the old continent. In other words, the ECSC was established to prevent the devastating wars the continent has so frequently suffered. During that period, the means of alleviating certain threats (The Soviet threat, the communists as an internal political threat, the economic threat, the German question and the threat to return to old order.) of the repetition of history and to preclude a future war in Europe was seen to be economic and political integration. The ECSC emerged as a non-military response to these security threats. The idea behind the ECSC, which emphasized a low-political solution rather than a state-centered high-political one, brought the transition of security perceptions and the establishment of a brand new security identity for Europeans onto the agenda: the Europeanization of security. The founders of the ECSC believed that cooperation on low-political issues would spill over into analogous cooperation in high-political issues.

“There will be no peace in Europe if States re-establish themselves on the basis of national sovereignty, with all that this implies by way of prestige policies and economic protectionism. If the countries of Europe once more protect themselves against each other, it will once more be necessary to build up vast armies [...] Europe will be reborn yet again under the shadow of fear.” (Monnet, 1978, pp. 221-222).

Before analyzing the Europeanization of security, which is a process of de-securitization, the concepts of securitization and de-securitization should be clarified. “The idea of securitization immediately changes security/insecurity from being an exhaustive set of options (the more security, the less insecurity and vice versa) to being only two out of three basic categories. In the case of de-securitization, we have neither security nor insecurity. To talk of a situation as characterized by security means that a threat is articulated but that sufficient counter-measures are felt to be available, in contrast to insecurity with a threat and insufficient defense” (Waever, *Op. cit.*, p.81).

Securitization is the traditional way of perceiving events. This outlook analyses security in a foreign policy context by concentrating on the military dimension of action. Other dimensions of security are inferior to securitization. In other words, high politics is given priority rather than low politics. This outlook leaves no possibility for functionalist theories to succeed. States that share this viewpoint have little chance of being able to cooperate. Thus, conflict is inevitable.

This European securitization approach caused two world wars prior to 1951 and eliminated cooperation options among them. The need to

transform the European securitization outlook in order to forestall a future war on the continent was evident. The new European security identity would be grounded on de-securitization which would give way to functionalist theories of European integration and lead Europeans to integrate. The ECSC emerged as the first institutionalization effort of this de-securitization of Europeans' security perceptions. Consequently, the European Economic Community (EEC), which was established under the 1957 Treaty of Rome, can be considered the second step in this institutionalization of the transition of the European security identity, the Europeanization of security.

Christopher Coker, an academic at the London School of Economics, indicated that in the 1960s Europeans had gained tangible and intangible perceptions of what WWII had been and sought a new European identity. The security perceptions of this new identity would be based on de-securitization, in which low politics would be given priority. This Europeanization of security perceptions was most visible in relations with the United States.

"President of the European Commission, Walter Hallstein indicated that no longer did Europeans consider the West as the collective political personality during one of his visits to Washington in 1961" (Karaoşmanoğlu, 2003, Mayıs 23, p. 176).

Thus, Hallstein implied that Europeans were transforming their security perceptions; they were Europeanizing their security discernment, and therefore Europe and the United States could no longer be considered one political personality. However, during the Cold War, Europeans did not achieve a foreign policy independent of the United States. The NATO-EC division of labour which ensured European security during the Cold War period prevented Europeans from pursuing an independent foreign policy.

One of the main motives for the establishment of the EU on the basis of low politics was the idea that, unless European states were transformed into parts of a web of economic and political integration mechanisms, security and stability in the continent of Europe would not be permanent. "The EU has been the main format for the continued non-war community and probably for its cultivation of the real security community features in terms of identity and the non-imaginability of war, but this has happened for most of the period in the form of desecuritization! Therefore, the EU has secured the security community not by upgrading joint security activities but on the contrary by doing other things" (Waeber, Op. cit., pp. 91-92).

During the Europeanization of security soft governance, common security practices and non-military methods became the fundamental elements of European security culture. Thus, scholars consider the EU a civilian power (Smith, K. (2000)).

During the early days of the post-Cold War period EU officials expected to pursue a common foreign policy independent of the U.S., whereas Europeans were pleased with the stability underprovided by NATO's umbrella. After the fall of the Berlin Wall, the military threat was no longer considered a primary security concern and the attitudes of EU officials were consolidated. Immigration pressures from East and South, Denmark's rejection of the EU treaty in 1992 and terrorist activities in neighboring countries, especially Turkey, began the fragmentation of the Union which became the primary threat to the European integration process. Hence, these elements, those which could halt the process of integration, were considered the primary security concerns in the post-Cold War period. EU officials attempted to pursue an independent policy and spread their experiences on achieving success within their borders with the second pillar of the EU in the post-Cold War period: the Common Foreign and Security Policy (CFSP). "When these expectations did not turn into realities and especially when the EU officials found it difficult to comply with the politics of the Common Foreign and Security pillar of the EU, past contributions of the EU (the EC, the EEC) to European security were all forgotten" (Bilgin, 2003, p. 203). This incapability of Europeans to comply with the tenets of CFSP inflamed concerns about the fragmentation of the Union and the integration process. Therefore, integration became a goal in itself. Immigration and terrorism were evaluated as fundamental threats to European integration. Thus, it can be asserted that Europeans securitized the issues that had the potential to impede the integration process and lead to fragmentation. Hence, Europeans attributed the highest security concerns to terrorism in, and immigration from, neighboring countries and, thus, they securitized these issues.

In sum, during the Cold War, under NATO military guarantees, Europeans attempted to alleviate their fears through economic and political integration. This integration process put Europeanization of the security cultures of member states onto the agenda through de-securitization. During the post-Cold War period Europeanization of their security cultures lead EU members to pursue a common foreign policy, independent of the U.S., and share their experiences, achieving success within their borders with the second pillar of the EU, the CFSP. Meanwhile, terrorism and immigration from neighboring countries created pressures which could lead to the fragmentation of the Union and hinder the process of European integration.

Therefore, as the zenith of the Europeanization of security in the old continent, immigration and terrorism are securitized in order to sustain the European integration process.

*Turkey's National Security Concept*

Mesut Yılmaz, Turkey's former Deputy Prime Minister and leader of the Motherland Party, made a speech on Turkey's national security syndrome on August 4, 2001. Yılmaz's speech created shock waves within the Turkish national security establishment. "Liberals think that it [security syndrome] is a taboo (Taboo - to a particular person or persons; inviolable, sacred; forbidden, unlawful; also said of people under a perpetual or temporary prohibition from certain actions ) whereas military and pro-military actors treat it as an ethos, (Ethos: the genius of an institution or system) in which the utmost reason of the survival of the state is embedded" (Yücel, 2004, p.10). In his speech, Yılmaz claimed that the national security syndrome causes distress in Turkish politics through its concomitant failure to conduct the required reforms on human rights and democracy necessary for it to join the EU:

"[...] National security is an essential paradigm, which ultimately aims to preserve the survival of a state. Yet the practice of this concept today [in today's Turkey] seems to work quite the contrary. The term 'national security' has become a conundrum that thwarts every single step to enhancing the future of this country. Turkey could have been the only country which could manage to utilize such a term to cut off all the vital veins of the state [...] and so it happened. The key for change is hidden in the term 'national security.' However it has been virtually impossible to take steps in the attempt of reinforcing the survival and increasing the welfare of our state, repeatedly due to reference to national security. If Turkey wants to make progress, she has to overcome the national security syndrome. The content and circumstances of national security should be opened to public debate. The true key and requisite for turning our face to Europe, and hence change, is to redefine the limits and boundaries of national security. National security deals with the whole nation and so should the nation do with it" (Yücel, 2004, p.3-4).

While talking about the national security syndrome, Yılmaz did not intend to refer to the Turkish state's external security problems with its neighboring countries. In contrast, by using the term 'syndrome,' Yılmaz implied that the national security concept, which causes struggles with activities that could harm territorial integrity and secularism, is obstructing Turkey's efforts to comply with the political criteria necessary to join the EU. Moreover, Yılmaz urged the public to discuss and question Turkey's national security concept.

"His primary agenda was to imply that the language of national security was being used as a tool to legitimize the need for a military role. More specifically, it was being utilized by the military establishment and its supporters to prioritize the indivisible and secular character of the

regime as more important than the need for democratic reform" (Cizre, 2003, p. 213-214).

However, the *acquis communautaire* of the EU concerning democracy and human rights, which constituted the most difficult part for Turkey, should be complied with in order to start the accession negotiations with the EU in December 2004. Therefore, Turkey should europeanize its security in order to become a member of the European club. Moreover, Turkey's deficiency in europeanizing its national security concept is one of the main reasons for Turkey's exclusion from the CFSP, despite its military and geopolitical capabilities.

"The meaning of national security is first and foremost related to threats to state identity, core national values and the ability to protect state sovereignty, to preserve territorial integrity and to maintain autonomy as far as the pro-military is concerned. This point stems from an official definition of national security which tends to serve the essential goal of protecting regime security" (Yücel, Op. cit., p. 10).

Mustafa Kemal, later named Atatürk, during the period between the foundation of the republic in 1923 and his death in 1938 attempted to transform a traditional society into the Turkish republic through the Kemalist concepts of state building and nation building. "The Kemalist revolution had to establish simultaneously the Republic of Turkey, the Turkish people as a nation and the Turk as a citizen with an identity different from being a Muslim subject of the sultan" (Kramer, 2000, p. 5). Republicanism, nationalism, populism and secularism constituted the core of Kemalist politics on state building and nation building.

European experiences of nation building were reflected in the developments of republicanism and nationalism: the unequivocal sovereignty of people united in a common nation. Populism was indicated by the communitarian ideas of the Turkish Republic. Secularism legitimized the banning of public activities, political Islamic ones, which could halt the implementation of the Kemalist concepts of state building and national building. "Republicanism, nationalism, populism and secularism not only provided the core of the new state ideology but also served as legitimizing elements for securing the power of the new state elite" (Kramer, 2000, p. 6).

Therefore, the new state elite, on the one hand, attributed to themselves the role of military guardianship in protecting the core principles of Kemalist politics while those same principles legitimized them. "Thus, the Kemalist ideology and military guardianship ethos are the fundamental norms that have determined the survival of all state and non-state institutions in varying degrees. In this sense, the Kemalist ideology is a particular arrangement of political and social concepts, through which the latter obtain specific uncontested meanings" (Yücel, Op. cit., p. 10).

The first three articles of the 1982 constitution, which stressed the principles of secularism and nationalism of Kemalist politics, and the re-

publican character of the state, were neither open to amendment nor could amendment be proposed. Hence, Kemalist principles of secularism and nationalism were given priority over other ones. Moreover, the principle of nationalism was more adequately defined as the indivisibility of the Turkish state's territory and nation.

"Thus the Turkish republic is based on a constitutional and legal system, the core principles of which are heavily tainted by a historically developed authoritarian understanding of the unitary state and its functioning as well as an organic and homogenous understanding of the nation" (Kramer, *Op. cit.*, p. 9).

This outlook of the Turkish Republic is a product of certain internal and external security concerns which date back to the 1920s. Threats are evaluated according to a state-centered and high-politics approach.

Moreover, military means are used to resolve political and social problems rather than the use of non-military options being considered. Therefore, Turkey confronts difficulties when resolving its culturally heterogeneous society's political and social problems.

In the post-Cold War period, the state elite were mainly concerned with the domestic political problems of the Kurdish issue and the growth of political Islam. In the 1990s, the state elites were concerned by both these internal security concerns and external security threats. In effect, Syria, Iraq, Iran and Armenia and, to a lesser extent, Russia, were considered hostile to the Turkish Republic. The national security system was kept on high alert and was capable of ensuring that these internal and external threats would not weaken the Turkish Republic and its core Kemalist principles.

"When these perceptions of internal and external threats are combined, it seems that, contrary to the global trend, the end of the Cold War did not lead to softer security perceptions and a less securitized domestic agenda in Turkey" (Cizre, *Op. cit.*, p. 216).

This has led the Turkish Armed Forces (TSK) to widen its contour in Turkish politics. This enlarged profile has led Turkey to develop solutions on the basis of high politics. However, the EU does not believe that solutions based on high politics will provide a plausible response to the domestic problems of the Kurdish issue and the growth of political Islam. The EU considers violation of human rights as the main reason behind the terrorist activities of Kurds and political Islam and conceives low political solutions as the appropriate response to the Turkish Republic's concerns.

Although Turkey has a lot to offer the EU in terms of strategic location, proximity to oil-rich resources and its military capabilities, Turkey faces a lot of difficulties in its attempts to join the EU. Moreover, the EU does not allow Turkey to take part in the decision making body of the CFSP. That Turkey will take part in the CFSP decision making body when it becomes a member to the EU is not considered a satisfactory response in Turkey. Temporary institutional solutions could any time lead to a proposal for full Turkish participation in the CFSP.

Therefore, this problem is not related to law. "The actual problem was about the relation between legitimacy of the CSFP and the European identity, and Turkey's extemporaneous attempts to adopt the European identity" (Karaosmanoğlu, 2001, p. 163). Europeanization of security leads to the formation of a European identity which attributes priority to low politics. Thus, the current European identity is a product of the process of de-securitization, which eventually led to the emergence of the EU. The CFSP exists on the basis of spreading this understanding and sharing Europeans' experiences with the outside world.

However, Turkey's security perception is based on traditional state-centered high politics. Hence, Turkey's security culture is incompatible with the EU and its window to the outside world, the CFSP. Therefore, it can be argued that the problem of adapting the Europeanization of security to Turkey's security understanding is one of the main impediments to Turkey's membership of the European Club. In conclusion, Europe is a security community, which is based on the Europeanization of security; it is undergoing a transition and transformation process based on de-securitization. During that process, low-political security concerns have been attributed priority rather than state-centered high politics.

European integration emerged as a low-politics response to certain security concerns during the Cold War. Although there is no longer a specific security concern to address, EU officials have set European integration as a goal in the post-Cold War period. The issues which can impede the process of integration or lead to the fragmentation of the Union are given priority in the security concern hierarchy. The CFSP has emerged as a means for the EU to pursue an independent foreign policy on the basis of its unique European identity and spread its experiences to other parts of the world. However, Turkey's security culture contradicts the principles of the Europeanization of security.

Turkey's security perception is a traditional state-centered one which gives priority to high politics and attempts to solve its problems on the basis of military power. In contrast to the global trend, Turkey's securitization tradition has not diminished and the Turkish Armed Forces has enlarged its profile, especially whilst dealing with the Kurdish issue and the rise of political Islam, both of which are threats to the core principles of the Turkish Republic. Therefore, the Turkish security identity is not compatible with the European identity, which is a product of the Europeanization of security. This incompatibility of security identities poses the main impediment to Turkey's inclusion in the CFSP. In sum, Turkey should europeanize its security identity by stressing low-political considerations while dealing with its internal and external threats in order to be a member of the European Club. A peaceful solution to the Cyprus issue has the potential to ignite the process of the Europeanization of Turkish security identity.

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## Unemployment Benefits: Disincentives to Work?

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*The aim of this paper is to analyze the effect that unemployment benefits – an instrument of social policy – have on incentives to work. It will start by discussing arguments that portray unemployment benefits as disincentives. It will continue by analyzing more profoundly how benefits can serve as an instrument to increase employment and mitigate disincentives to work. Finally, it will be shown that when taking into consideration the heterogeneity of elements shaping the unemployment benefit system and structure, substantial replacement rates may contribute to increasing efficiency of labor market.*

*The disincentive effects of unemployment benefits.*

Unemployment is a risk that is faced by any individual in a capitalist society. Unemployment is not a natural phenomenon; it is a man-made dependency created by capitalism (Cleaver, 2007). So, unemployment is politically recognized as a social problem all over Europe and, as part of this recognition, unemployment benefits constitute citizens' social right. But, from the 1970s neo-liberal economists started arguing that benefits had negative impact on the incentives to work, encouraging people to stay unemployed for longer periods of time.

The main reason for the development of this kind of thinking about benefits is considered the mass unemployment that swept Europe in the 1970s as well as the neo-liberal hostility towards social security programs in the 1980s (Clasen, 1999). According to neo-liberals, the persistence of unemployment in a number of countries is partially attributed to more generous levels of benefit payments (Atkinson, 1991, p. 1679).

While unemployment was sweeping over Europe, United States employment was increasing (too?). The US-style flexibility and unregulated market was seen as a panacea for European unemployment problems. Neo-liberal economists thought that the removal of labor market regulations, including unemployment benefits, would end the European unemployment. (Bradley & Stephens, 2007, p. 1486). Classical economists have seen unemployment compensation as having a negative impact on the labor market operation, with high benefits causing the unemployed to

reject job offers and inducing those in employment to quit and become unemployed (Atkinson, 1991, p. 1679).

Johnson and Layard (1986, p. 923) argue that in a simple market clearing demand and supply model of the labor market, benefits increase the level of unemployment. This effect, they note, is observed in every model constructed by them. "Viewed in simplest terms, benefits and taxes reduce the efficiency of the economy' (1986, p. 924).

According to Snower (1995), the two major problems of unemployment benefits are that they boost unemployment and impose a considerable burden on the taxpayer (p. 625). As the Institute for Fiscal Studies found out, people on low incomes face the weakest work incentives as their means-tested benefits or tax credits are withdrawn when they increase their income. Over two million workers in Britain lose more than half of any increase in earnings because of taxes and reduced benefits (IFS, 2006). The fear of an "unemployment trap" – the withdrawal of benefits and imposition of taxes – discourages unemployed people from job search. This "trap" is especially harsh for people who can only find temporary and part-time jobs particularly unskilled workers, since they get comparatively low wages while the opportunity cost of giving up unemployment and related benefits is much higher (Snower, 1995).

Common arguments against unemployment benefits are as follows: (a) benefits discourage job search; (b) lengthen the duration of search; (c) put upward pressure on wages; (d) induce workers to take greater risks of dismissal; and (e) induce firms to increase number of temporary layoffs.

Generous benefits may lengthen the time unemployed people spend on searching for new jobs. The greater the benefits, the longer the unemployed wait before accepting a job offer. This is especially true for long-term unemployed, who constitute the large portion of the European unemployment problem. These workers may have to undergo retraining and change their life styles in order to find a job; unemployment benefits help to avoid such adjustments through satisfying the financial needs.

Unemployment benefits put upward pressure on wages. People refuse to work for less compensation than they would receive if they remained jobless. This factor increases wages and leads to an increase in labor costs, which stimulates further unemployment.

Unemployment benefits permit employees to take greater risks of job loss. This means that, they may engage in industrial disputes more frequently as they have some kind of backup in the form of benefits and are not completely reliant on their jobs for their material well-being (Snower 1994, p. 626-627).

Besides this, in the absence of benefits, firms might be unwilling to lay off workers in response to random demand fluctuations, for fear of losing these workers to other firms. By contrast, in the presence of benefits,

firms will lay off employees for long spells during low demand. So, unemployment insurance increases the number of spells of temporary layoff unemployment (Feldstein, 1978).

Probably the most popular argument about the disincentive effects of unemployment benefits among economists is the behavioral impact of benefits on people's choice between work and leisure. The classical economic model of the individual decision about the working life sees a person as choosing to undertake work on the basis of an income/leisure trade-off. There is a choice between the utility derived from an additional hour of leisure against the extra utility derived from the disposable income which could be earned by devoting that hour to paid work.

The provision of benefits may induce people to withdraw from the labour force and choose leisure instead of work, as the additional return from working might be insufficient to justify effort involved (McClements, 1978, p. 29).

OECD reports on country-specific examples illustrate that those countries which had low replacement rates experienced low levels of unemployment. In Japan and the United States benefit entitlements have remained low for the last thirty years; both countries have avoided rises in their unemployment rates compared to other OECD countries. Norway, Sweden' and Switzerland had low benefit entitlements until the early 1970s, and unemployment in these countries also rose relatively later. France and Ireland increased entitlements substantially between 1973-75 and 1983-85, and unemployment rates in these countries doubled between the late 1980s. In Belgium, Germany, the Netherlands, and the United Kingdom, where benefit entitlements did not increase much after 1973-75, increases in unemployment rates between these periods were smaller (OECD, 1994, p. 177).

In line with these developments, opponents of unemployment benefits suggest that in order to limit the disincentive effects countries should legislate for only moderate levels of benefit, maintain effective checks on eligibility, and guarantee places on active programmes (OECD, 1994, p. 48).

### *"Real World" Benefits*

These are the arguments that portray unemployment benefits as a clear disincentive and an impediment to a flexible labour market operation. But, in order to argue about benefits' disincentive effect, it is very important to consider various factors involved in the unemployment benefit provision such as the benefits structure, different governing principles of unemployment compensation, the welfare system in which the benefits operate, consider households rather than individuals alone, evaluate eli-

gibility requirements as well as the conditionality principle. Considering these and other factors that structure benefits will give a more realistic picture of the effects that benefits can have on the incentives to work. Neo-liberals criticise benefits discussing them as a simple phenomenon without considering the heterogeneity of all aspects involved in the benefit system.

In order to define and clarify the role of benefits in employment creation we should consider the following aspects: (a) Unemployment/inactivity dichotomy, (b) the structure of benefits, (c) eligibility criteria (d) effects on skill formation (e) strength of disincentives in different welfare systems, (f) dissemination of disincentives among different groups, (g) individual/household relationship.

When neo-liberals discuss unemployment benefits and their impact, they only consider the employment/unemployment dichotomy. They omit one very important labor market state - inactivity. This condition is important as large numbers of transitions to inactivity occur among unemployed people. Thus, the relaxation of eligibility criteria for unemployment benefits, may lead people out of the labor market to join the labor force, while disqualification of benefit entitlement may lead to removal from the labor force rather than employment (Atkinson & Micklewright, 1999, p. 1681).

Arguing that benefits constitute disincentives is ignoring their structure and the conditionality principle. Atkinson and Micklewright (1991, p. 1687) argue that when neo-liberals test and provide arguments against benefits they simply use non-real world benefits in their models. According to their models, benefits are of the following "hypothetical" form: the benefits do not depend on the reasons for entry into unemployment, they are unlimited in time and duration, they do not set requirements for an active job search, the unemployed are not penalised because of refusals of job offers, there are no contribution conditions related to employment history, the benefit is paid at a flat rate, eligibility for benefits is not affected by the level of income of other household members.

In reality, in order to become eligible a person should satisfy a set of conditions, which really makes benefits not so much a disincentive to work as a disincentive to apply sometimes. When such features as the qualifying conditions for unemployment insurance are taken into account, it becomes apparent that the benefits do not produce that many incentives to stay unemployed, as a person needs to satisfy certain conditions in order to acquire rights for benefits (Atkinson and Micklewright, 1991, p. 1680).

Social protection does not always mean "politics against markets" as it helps to overcome market failures in skill formation which is the lack of incentives for workers to invest in certain skills. People are risk averse so

they are less likely to invest in industry or firm-specific skills if the risk of losing jobs and wages is high (Estevez-Abe *et al*, 2001).

According to Estevez-Abe *et al* (2001), for industry-specific skills, unemployment protection is very important (p.152). In order to make workers invest in industry-specific skills their 'skilled wages' should be protected. That way workers can move between firms without loss of income and even turn down job offers outside their previous industry and conduct longer and more costly job searches to find employment in which their skills are fully used (Bradley & Stephens, 2007). A high replacement ratio is kind of reward given to workers for their specific skill investment.

Similarly, Sinfield argues that benefits not only maintain aggregate consumer demand, but also enable individuals to search for jobs which are close to their qualifications thus facilitating a better match between supply and demand of labour, reducing the chance of future unemployment and increasing productivity (Clasen, 1999, p. 160).

It can be argued that the absence of benefits may lead to "worsened commodification." According to Esping-Andersen (1990), labour power becomes a commodity when a person can not survive outside the labour market. In case of absent unemployment benefits workers become commodified but, in addition, they have to take on jobs which do not match their skills and qualifications. This contributes to increasing dissatisfaction with work and may cause depletion of human resources as well as emotional exhaustion, instability and even rage.

Adequate replacement rates result in upskilling, the effect of which is reduced structural unemployment. They reduce the scar effects of unemployment bouts and result in longer term employment. They provide an incentive for private risk-taking so that individuals are more likely to conduct appropriate job searches. In information-age economy, this constant upskilling of workers is very important (Bradley & Stephens, 2007).

If there is any disincentive linked to unemployment benefits it is dealt with activation element attached to it. According to Clasen (2005, p. 53), in modern welfare states unemployed people besides income transfers are subject to active labor market policies which aim at returning the unemployed to paid work. The benefits receipt is conditional not only on eligibility criteria such as having paid sufficient contributions or need, but also requires a willingness and capacity to enter employment. Attached to benefits there are services that help people to actively search for jobs and provide trainings for them during the unemployment period in order to increase their employability.

According to Bradley and Stephens (2007, p. 1493), active labor market policies (ALMP) may lessen the potentially negative impact of generous benefits by retraining and reintegrating unemployed into the labor force. Greater spending on ALMP will have a positive impact on employment by increasing the employability of the working-age population.

According to the report of the Commission on Social Justice (1994) in the longer term, the unemployment period should be used for investing time in education and training; “eventually every member should be able to draw on social insurance to help finance a ‘sabbatical’ during his or her working life” (p. 234). These policies, attached to the benefit structure indicate that the ultimate goal of benefits is labor market integration.

Besides that, there is an important distinction between protection against loss of income and loss of job. Together they may cause an exhaustion of financial resources and market rigidities, but welfare states can support the flexibility of the labour market by loosening employment protection legislation and providing relatively generous benefits for the unemployed. Relaxed employment protection legislation enables firms to adjust quickly to new market conditions by laying off staff, during this period social security helps dismissed workers to avoid economic difficulties whilst looking for a new job. People are more likely to search for jobs which best suite their qualifications when they are without work and are less likely to stay with the same employer for security reasons. The combined result is a high degree of labour turnover, which is an indicator for a flexible labour market and an economy (Kvist, 2001).

There is also a very important aspect involved in the debate about benefit disincentive effects. When uninsured people lose jobs the loss of income may impose costs on others, like spouses and children (Bar, 1993, p. 195). This is an important issue as unemployed people are not living in a social vacuum: they have family members who may be dependant on them. So, when considering households unemployment is seen as a risky choice.

In any case, work incentives are affected by many other factors, amongst which the most important are non-economic ones. People work not only for financial motives but for the sense of social integration and self-esteem which jobs provide, so the cost of unemployment is much more than the loss of earnings. Conversely people may give up their jobs and leave the labour force for non-economic reasons. (Atkinson, 1993, p. 20)

There are many more reasons of why people might not participate in the labour market.

Returning to work creates uncertainty for people as income received from various work related benefits is uncertain. The future income risk can be seen as a disincentive for people to participate in the labour market, as there is a possible ‘employment lottery’ not just ‘an unemployment trap’ (Jenkins & Millar, 1989).

Clasen (1999) argues that the country specific roles of benefit programs show positive effects on certain groups of unemployed. In Denmark, benefits replace employment regulations which contribute to labor market mobility. In Britain, they strengthen work incentives and make

wages to fall particularly for younger workers. In Germany, they are used as an instrument for restructuring the workforce.

There are different insurance principles that govern unemployment compensation so disincentive effects can vary according to different welfare systems. Schmid and Reissert (1996, p. 236) identify two basic principles governing unemployment compensation: the insurance principle and the welfare principle. In the former benefits are determined by insurance contributions and by previous earnings. In the latter, the unemployed are provided with a guaranteed minimum income.

In the insurance principle system there is less incentive to be unemployed because the amount of the benefit depends on contributions and previous earnings. For certain groups such as young workers and women employees with low wages, there will be less incentive to quit jobs as they have a weak work history and low contributions: so their benefits will be less generous. In the insurance based system previous contributions and earnings also play a role in pension right accrual. As Clasen (1999) argues, especially in corporatist-conservative welfare states where access to pensions is largely determined by labour market participation, this will stimulate the search for regular paid work. In addition insurance contributions provide incentive for people to take "regular" jobs instead of "marginal" employment (Atkinson & Micklewright, 1989).

As for the welfare principle, the amount of the guaranteed minimum is so low that it can be an incentive only for the minority of workers to quite their jobs. In addition they are means tested which also discourages people who have saved or whose family members are working to apply. In addition to this, there are a lot more benefits derived from working life. Many fringe benefits plus family or child support are connected with work as well as occupational pensions this may lead to less disincentives (Schmid & Reissert, 1996).

### *Conclusion*

The intellectual hegemony of orthodox economists led to blaming benefits for increasing unemployment levels in Europe during the 1980s. These neo-liberal economists tend to see individuals as making choices about their working life based on monetary incentives, so unemployment benefits are seen as a disincentive to work. But, there are very important non economic aspects involved in this kind of decision making as people are not only looking for monetary gains but also for high self esteem and sense of social inclusion that jobs provide.

Claiming that unemployment is caused by the generous benefit systems means ignoring problems connected with identification of unemployment itself. Starting from definition the elements that constitute un-

employment vary across countries, systems and organizations which makes it difficult to argue that unemployment problems are caused by benefits.

Besides neo-liberal economists fail to see that unemployment benefits have productive functions above providing income replacement as elements attached to benefits system such as activation, skill formation, constant up skilling, better match between labour supply and demand and etc. make them economically effective as well as socially justifiable. And if effectively constructed, benefits can serve as an instrument for increasing employment and flexibility of labour market.



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## **Is Multi-Level Governance a Political Choice or a Service Delivery Necessity?**

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*The notion of multi-level governance first appeared with the establishment of the European Union to describe the transfer of power upwards and downwards. Later, the power transfer appeared not only vertically, but also horizontally by involving non-governmental, voluntary and private sector into public policy making. Apparently, traditional model of policy making has been challenged and replaced by a more complex, decentralized structure, better able to accommodate citizens' needs at various levels. However, whether states transfer authority for the purpose of better service delivery or whether they do it under pressure is still unclear. This paper aims at answering this question by examining various types of multi-level governance and analyzing recent developments in the UK policy as a case.*

### *Introduction*

The notion of multi-level governance as “a system of continuous negotiation among nested governments at several territorial tiers – supranational, national, regional, and local” (Marks, 1993, p. 392) first appeared to describe the developments in EU structural policy (Bache and Flinders, 2004, p. 2), particularly, the emergence of partnership principle – “the participation of subnational governmental representatives alongside member-state representatives and the Commission in preparing, implementing, and monitoring development programs” (Marks, 1993, p. 396).

Further, it has been broadened and has encompassed developments not only at vertical but also at horizontal levels by including non-governmental, voluntary and private sectors into the range of actors participating in policy making process (Williams, 2004, p. 97).

There are many arguments for multi-level governance and most scholars agree that the dispersion of power across multiple levels is more efficient than the concentration of governance in one jurisdiction (Hooghe and Marks; 2002; p. 6). The main criticism of centralized government is that it is not well-suited to accommodate diversity; various conditions as well as citizens' preferences may vary from state to state and across the regions within a state. Large jurisdictions are insensitive to

such a varying scale and often “impose a single policy on diverse ecological systems or territorially heterogeneous population,” while “multi-level governance allows decision-makers to adjust the scale of governance to reflect heterogeneity.” Instead of the unitary, centralized government, authority should be distributed among multiple jurisdictions (Hooghe and Marks; 2003; pp. 235-236).

However, it is not completely clear why states allow competences to be ceded to other levels. Are they willing to transfer authority for some reason or are they under pressure to do so in order to assure efficient implementation? The purpose of this essay is to consider different types of multi-level governance and analyze the reasons for transferring authority to several “layers” and “tiers;” to examine why states allow their sovereignty to be weakened, whether it is a political choice or a service delivery necessity.

For this reason the paper proposes the United Kingdom as a case study and attempts to analyze recent developments in the British political reality in order to illustrate the different types of multi-level governance and to observe the main reasons behind them.

### *Emergence of Multi-Level Governance*

The establishment of the Coal and Steel community in 1951, which, according to Hoffmann (1989) “was launched as a way of promoting the reconciliation of France and Germany” (p. 32), turned out to be the first challenge of the traditional pattern of policy making. Since then, “nations could not escape the smell and noises that came from outside through all the windows and doors” (Hoffman, 1995, p. 73), and eventually ended up with the establishment of the European Union, an unprecedented political entity, that “does not fit into any accepted category of governance” (Sbragia, 1993, p. 24).

Being “not yet a state, nor the replacement of states” (Mann, 1993, p. 128), the European Union raised growing confusion among scholars. Neofunctionalists became concerned over the “fate of the nation-states” (Hoffman, 1995, p. 71) under “the logic of spill-over” (Tranholm-Mikkelsen, 1991, p. 4) and started considering which term was more appropriate “the retirement of a nation-state” or its “actual death” (Mann, 1993, p. 115). In contrast, intergovernmentalists claimed that European integration made nation-states more powerful by enabling them to pursue national interests in international arena and bringing domestically defined goals to international negotiations (Moravcsik, 1993, pp. 481-484).

While debating whether European Union was a government-dominated statecraft or a system in which supranational institutions compromised state autonomy, or maybe it was a “swinging pendulum oscillating between two magnetic fields, one country-based and the other transnational” (Wallace and Wallace, 1996, p. 12), Marks (1993) pointed out that “the European community was missing a critical element of the whole picture, namely, the increasing importance of subnational levels of decision-making and their myriad connections with other levels – the emergence of the multi-level governance” (p.392).

As an academic concept, multi-level governance should be defined as a compilation of several theoretical approaches. Jordan (2001) points out that the notion of multi-level governance “contains important residues of neofunctionalism” (p.199) since it emphasizes the new role of the state that is not any more an intermediary link between domestic and supranational institutions. “The presumption of multi-level governance is that [sub-national actors] participate in diverse policy networks dealing directly with supranational actors” (Marks and Nielsen, 1996, p. 42). “Global patterns of governance can hook up with local institutions just as local or regional coalitions of actors can by-pass the nation state level and pursue their interests in international arena” (Pierre and Stoker, 2000, p. 30).

Furthermore, the concept of multi-level governance shares the views with the policy network approach and the “hollowing out” of the state according to which networks play an increasingly important role in governing (Rhodes, 1997; pp. 15, 51-53). As Peters and Pierre (2001) argue “we have been witnessing a development from a “command and control” type of state towards an “enabling state” (p. 131) where government tends to coordinate other implementing bodies rather than assume delivery function itself (Hudson and Low 2004, p. 96).

Peters and Pierre (2001) argue that “multi-level governance is to some extent merely a logical extension of these developments; the combined result of decentralization, the “hollowing out” of the state, a shift from an interventionist towards an “enabling state”, budgetary cutback and a growing degree of institutional self-assertion and professionalism at the subnational level” (p. 131).

Thus, “we are seeing the emergence of a complex, open-texture and fluid situation” (Marks, 1993, p. 404), where powers and capabilities traditionally controlled by states are displaced upward, towards supranational authorities; downward towards subnational governments and outwards, towards private and non-governmental organizations (Pierre and Peters, 2000, p. 77) and the term multi-level governance is the most appropriate to capture these developments in delegation of authority.

### *Types of Multi-Level Governance*

In "Contrasting Visions of Multi-Level Governance" Marks and Hooghe (2004) distinguish between two visions which they brand Type I and Type II multi-level governance (p. 16-19).

Type I multi-level governance takes its root in the federalist thought, which is mainly concerned with the power distribution among central and subnational governments. The main characteristic features of the Type I multi-level governance are that the authority is dispersed between limited number of jurisdictions at several levels (mainly international, regional, meso and local levels); these jurisdictions are general-purpose (they undertake multiple functions); the membership is usually territorial and non-intersecting, "every citizen is located in a Russian Doll set of nested jurisdictions, where there is one and only one relevant jurisdiction at any particular territorial scale;" and finally, Type I multi-level governance is characterized by the stable territorial jurisdictions but the flexible policy competences across levels (Marks and Hooghe, 2004, pp. 16-19).

The second vision which Marks and Hooghe (2004) label Type II multi-level governance is distinctly different. First, it assumes the power diffusion not to a limited number of levels but to numerous territorial scales; further the jurisdictions are task-specific, they are specialized in distinct fields and provide particular services; additionally, Type II multi-level governance is characterized by intersecting membership, so instead of "nested," hierarchical structure, it conceives of overlapping jurisdictions. "There is no up or down, no lower or higher, no dominant class of actor; rather, a wide range of public and private actors who collaborate and compete in shifting coalitions"; and finally there is no durability in the existence of Type II multi-level governance, instead it is characterized by the flexible design, so the jurisdictions are produced and abolished according to the citizens' choice and requirements (pp. 20-22).

An example of the Type I multi-level governance is the regionalization - the strengthening of meso- or middle-level or regional governments/institutions. In case of the United Kingdom, if we observe the factors encouraging the empowerment of regional authorities, it will be clear that there was not an apparent necessity for these kinds of changes; rather it seems to be a political decision.

John (2001) divides the forces for regionalization into two categories, top-down and bottom-up factors. According to him, both forces contribute to devolution of state, but the bottom-up factors play the decisive role - they *drive the changes*, whereas the top-down forces *respond to those changes* (p. 111).

According to John (2001), although there are some technocratic reasons behind the top-down forces (such as to find the best means for ser-

vice delivery), they are mainly mobilized to retain and “pre-empt” bottom-up regionalism (p. 111).

So the bottom-up factors consist of the national political movements driven by regional elites and they are demanding for more autonomy or even for independence for regions. In response, central government seeks to mollify those demands by introducing regional autonomy. In other words, central governments tries to “buy off” regional elites (John, 2001, pp. 111-119).

### *Development of Multi-Level Governance in UK*

The New Labour’s devolution program is an example of this strategy. Labour’s reform package consisted of five major parts. It established the Northern Ireland Assembly, the Scottish Parliament, the National Assembly for Wales, the Greater London Authority, and the Regional Development Agencies in England outside London (Pierre and Stoker, 2000, p. 31).

Although it is generally recognized that the devolution of authority to subnational levels was an appropriate response to the complexities of the newly-emerged system of multi-level governance, Stoker outlines some other specific driving forces behind Labour’s reform package apart from the general factors (Stoker, 2004, p. 156).

He argues that the creation of the Scottish Parliament was a response to the rise of Scottish nationalism and its political expression since the late 1960s. According to him the key driving factor was the ability of the Scottish National Party to win a considerable portion of votes which gradually led to the consensus that some form of political devolution for Scotland was necessary (Stoker, 2004, p. 156).

The case of the Northern Ireland is similar too. In response to the growth of extremist politics in Northern Ireland, the Blair Government decided that political devolution would be the best means to restrain nationalist forces and regulate ethnic conflicts (Stoker, 2004, p. 156).

Thus, it becomes clear that the creation of the Northern Ireland Assembly and the Scottish Parliament are examples of “buying off” or that was a political choice.

On the other hand, institutions that follow the logic of the Type II multi-level governance seem to be the result of the complexity of policy problems and the increased pressure to solve these problems efficiently; in other words their creation is caused by the service delivery necessity.

To support this argument it would be useful to discuss in more detail the transformation of the local government into the local governance which is based on the network approach of policy making; and to identify the factors behind the emergence of networks and partnerships (the de-

velopment of the “joined-up government”) which are the examples of the Type II multi-level governance.

In the post-war period in the United Kingdom the local government followed the traditional model of public administration and was the dominant player in delivering services of the welfare state. However, the traditional pattern was first challenged during the 1980s by the Conservatives’ attempt to transform councils from service providers into “enablers” (Bochel and Bochel, 2004, p. 134). The aim of the transformation was “to introduce a new, more managerial style with strategic planning that would operate in a framework more conducive to rational decision making” (Bochel and Bochel, 2004, p. 115).

The sub-national government undergone considerable changes under the New Public Management which stressed the efficiency and the customer care. As a result of the consumerist orientation, the New Public Management attempted to make service delivery more efficient. For this purpose the Conservative government introduced market forms and used the competition to choose the cheapest service provider and to save taxpayers’ money by keeping down the cost of the service. “Better management meant putting the customer first” (Stoker, 2004, p.13).

Consequently, the 1980s and 1990s witnessed the creation of enormous number of public-private partnerships and the involvement of the non-governmental entities in the governing process. First partnerships were introduced by the Conservative government and they were particularly important in areas such as urban regeneration and crime prevention (Bochel and Bochel, 2004, p. 132). However, the real growth in the number and importance of the partnerships occurred under the Labour leadership. The idea of partnership formed the central part of the Third Way and it was the New Labor’s approach to introduce partnerships as a form of governing (Newman, 2001, pp. 103-104).

The main goals of joined-up government were to engage public, private and voluntary institutions in order to find holistic solutions to the local problems; to deliver better policy outcomes; to assure better service delivery by bringing together the experience and knowledge of different partners (Newman, 2001, p. 109). As the Commission on Public Private Partnerships argued, there was a need to “manage a diverse public sector effectively so that it enhances social equity by improving the quality of, and commitment to, publicly funded services” (as cited by Bochel and Bochel, 2004, p. 133).

According to John (2001) there were several factors that propelled these developments and one of the factors were social and physical changes of society (such as high level of migration; the degrading of the environment and the aging of the population) that directly affected local public bodies as regulators and providers of welfare services. He claims that the local government on its own was not any longer able to respond



to these policy challenges and tackle the complex social problems efficiently without the outside assistance and it had to concede some of its functions to non public bodies. "The holistic solutions required many sorts of agencies to be involved" (p. 12).

Besides, the shift in political participation played an important role in this process. The involvement of private and non-governmental sectors in policy-making process is also due to the increased public pressure. Since 1970s, in many western European countries, citizens have become more dissatisfied with the outputs of government, more cynical about politicians and more inclined to form various types of associations and coalitions seeking for the better outcomes (Norris, 1999; cited by John, 2001, p. 13).

In response, the public sector sought to find alternative ways of governing. Under the consumer pressure it had to open up boundaries for private, voluntary and non-governmental organizations and improve service delivery (John, 2001, pp. 12-13).

Thus, the complexity of social problems combined with the growing criticism and the active citizenship proved to be a good incentive for government to find holistic solutions to public problems. In the context of social, economic and political changes government was challenged "to be flexible, innovative, adaptive, and to reinvent themselves" (Andrew and Goldsmith, 1998, p. 105).

### *Conclusion*

We have discussed the emergence of the multi-level governance and the responsive changes in the British policy. The examination of the processes and the institutions following the logic of the different types multi-level governance makes clear that there is no blueprint for action and we can not argue that generally the emergence of the multi-level governance was a political choice or a service delivery necessity, instead it we can conclude that there are various reasons behind the different types of multi-level governance.

While regionalization and the devolution of authority to the meso level in the United Kingdom seems to be a political choice, the creation of the multiple Public Private Partnerships and the involvement of the non public bodies in the policy making process is more likely to be the result of the increased complexity of policy problems and the necessity to find holistic solutions to them.

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## **The Practice of Competition Regulation in the International Procurement and State Procurement Administration in Georgia**

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*Under conditions of the emerging economy, together with the mobilization of the state income, it becomes increasingly important to rationalize the expenses. Under the market economy the government has to intervene in the market functioning in order to protect competitive mechanisms that ensure democratic choice. The regulations of the government includes the implementation of state economic policy, as well as addressing the issues that otherwise are impossible to be solved with self-regulating market mechanisms. The function of supervision the competition legislation is shifting to the judiciary and the special regulatory institutions, but the state procurement administration and anti-monopoly regulations still remain the prerogative of the executive body (the government).*

*In the international practice the systems of the international procurement differs from each other, though they have common characteristics mainly regarding the general principles and applied methods. In addition, the level of procurement centralization and the administration quality varies from country to country. Also in each state there is at least one governmental body (in form of an agency, department, office, etc) that regulates and exercises the overall coordination of the procurement policy throughout the country. Generally this very body is responsible for the monitoring state procurement and administrating the signed contracts. In some countries additionally a special governmental office of public provision is made up that carries out the procurement of standard products and services through tenders on the basis of orders placed by state managing bodies and different organizations and then supply appropriate companies. As it turned out, the similar body is to be established in the near future in Georgia.*

*In order to successfully introduce in Georgia the positive experience existing in the international procurement-management practice, it is equally important to have high quality law, also appropriate institutional infrastructure, the support from the authorities. In addition, it is essential to ensure the availability of the information necessary for public monitoring and the professionalism of the parties participating in the procurement process. In Georgia the law regulating the state procurement is mainly harmonized with international standards, though some indirect related legal acts need further refinement. The experience of the international procurement proves that it is equally important to correctly plan the state procurement, as well as correctly organize the procurement procedures and sign fair contracts. In addition, it is important that obligations written in the contracts are fully implemented and public monitoring requires that the accountability system is strictly defined.*

Under the market economy the government has to intervene in the market functioning in order to protect competitive mechanisms that ensure democratic choice. Competition is not only resource-saving means for national economic development, but is also the precondition for ensuring the public welfare. The regulations of the government includes the implementation of state economic policy, as well as addressing the issues that otherwise are impossible to be solved with self-regulating market mechanisms. This is admitted by all economic ideologies from classical to institutionalist, neoclassical and neo-Keynesian schools (Mark Blaug, *Economic theory in retrospect*, Cambridge university press, 1994).

Adam Smith was one of the first to emphasize the balancing role of the competition in the optimal division of inputs that was recognized as the foundation for the commercial activity. D. Ricardo described the theoretical model of the perfect competition where there was no place left for the state regulation. J. S. Mill and other classics further perfected the above mentioned model, while the neo-classical school led by A. Marshall drew attention to the competition impact on price system and the importance of economies of scale. All above mentioned approaches focused only on price competition and a coordinating role of prices on market balance that did not describe the real context of the phenomenon. J. Schumpeter discussed the production innovation and product quality indicators as the foundation for entrepreneur success and competitive advantage. As for J. Robinson, he placed emphasis on so called "natural monopolies" where because of certain industry's technical exceptionalism, it was doubtful to achieve efficiency if rival companies operated on the market. The idea believed by classics that self-regulated economy functioned more efficiently if the state did not get involved, was undermined by the economic crisis in 30s and the Great Depression. J. Keinz came up with the fundamentally revolutionary theory about the state role in market economy: unlike classics, he believed that the state could regulate the economic development by influencing the aggregate demand. According to this notion, the increase of state investments and expenses (expanding the procurement) would entail consequent GDP growth and in the end the rise of employment. From economic tools more preference was given to budget regulations rather than monetary ones. In the 70-80s of the previous century the followers of the monetarism presented new principles about state-regulated economy. Under the stagflation of that period, inflation together with the unemployment caused serious problems that Keinzinas failed to overcome. Milton Friedman regarded monetary relationships as the starting point and he believed that with the regulation of money supply it was possible to stabilize the economy, of course under free market primacy. According to F. Hayek market balance is a static state and the competition process is its

dynamic model, which, as he believed, was the basis for the social progress. Therefore, the role of the state is not only to correct the market tools, but also to promote the competition and only with this in view utilize the regulating influences. Otherwise the state will create a noncompetitive environment. Certainly on macro, meso and micro levels the concrete tools and scales of economic regulations are determined with the national economic development levels and with those social-economic problems that exist in the country at a certain period.

In the modern mixed economy more and more western researchers emphasize the inability of the market self-regulation in the global development and agree that in cases where market failure is expected, the regulating leverages should be taken by the state and civil sectors. This leads us to recognize the democratic values and the primacy of the social policy of the welfare. In this circumstances it becomes essential to make better living standards and quality for the population, to protect customers' rights, to protect the environment and to ensure the sustainable development, and etc. All these require a strong authority in all directions: legislative, judicial and executive. Naturally, the strength of the government does not exclude flexibility, relevance and adaptability of state entities' system under effective management.

Under conditions of the emerging economy, together with the mobilization of the state income, it becomes increasingly important to rationalize the expenses. Though most of the foreign leading countries have worked out their own principles of procurement for effective management of state resources by generalizing the state procurement practice, international regulating laws in this field becomes increasingly harmonized that is set forth in the international agreements and acts. In this respect especially important is the framework law on "Product (Labor) and Service Procurement" passed by the United Nations Commission on International Trade Law (UNCITRAL), the agreement on governmental procurement reached by the World Trade Organization and the European guidelines and guiding rules set out by the World Bank. All above mentioned serves for the formation of united market of state orders in a specific geo-economic space.

Different terminology is used for describing the state procurement process and procurement system: together with the State Procurement, the terms of Public Purchasing and Government Procurement are also used. However, in any case State Procurement stands for all expenditures by governmental bodies or the public offices at any level that are spent on purchasing the products or service necessary to meet the public needs. The term "State Procurement" no longer describes the specific meaning in the modern situation, as today it means not only the efficiency of state spending, but also the public welfare and consequently has certain social implication, too. Government procurement is even more limited term as it

is only applied to the purchase done by only the executive body. Therefore, today no-one argues against establishing the term “public procurement” as it is adopted in the EU countries. Thus, according to the 2<sup>nd</sup> paragraph of the UN UNCITRAL Model Law, State Procurement is defined as procurement of any goods, services and construction works by a procuring entity in the cases through any means. The Law of Georgia on State Procurement is mainly developed on the basis of UN Model Law and the rules defined in this law are applied to any state procurement except for the state procurement related to a state secret set forth in the Law of Georgia on State Secret.

In terms of Euro integration, it is essential for Georgia to make its system of state procurement in accordance with the general rules and guidelines of EU public purchase. These guidelines require to be implemented at the level of member states and they aim at coordinating those procedures that EU Members must follow in case they want to make purchase that in value exceed the monetary limits set by those guidelines. The set standards include construction works, agreements on purchasing products and service which are required by all state organizations, as well as public, semi-public and private entrepreneurships working in water, power, transport and communication field. The fact that one side is regarded as the representative of the social interest determines the specific character of the contracts related to the public purchase compared to the private agreements. The process of formulating state order of public purchase, limited budget and political factors of the contractual relationships, social interest and the need of social monitoring represents the reason for introducing specific regulatory rules and principles. It is noteworthy that the European guidelines are aimed not at harmonization all national rules of public purchase sphere, but through setting minimal common requirements for those contracts that exceed certain limits, coordinate national procedures for reaching contracts. These requirements include conducting the procedures related to public procurement on non-discriminative bases, rationally distributing public funds through selecting the best offer by tender, strengthening the healthy competition among European enterprises so that taxpayers’ money are saved. All companies should enjoy the equal right to obtain state order. All above said is beneficial for governments as well as for business entities and population who will believe that state funds will be spent efficiently and the service will be of high quality. Thus, economic, political and legal factors are equally important for the state purchase.

It is vital for Georgia as for Member State of the World Trade Organization to timely join the Government Procurement Agreement (GPA), where since 2000 Georgia has the status of an Observer. According to the obligations, Georgian side first started negotiations with the parties and presented the project of annexes of the agreement to the WTO secretariat, however, later this project was stopped. WTO agreement on state pro-

curement first of all promotes free trade including in government purchase and envisages the establishment of the regime that will foster market economy in the member states. According to those high monetary levels that are affected by standards and procedures related to state purchase, it can be said that joining the agreement will not restrict local suppliers and will enable successful local entrepreneurs to get orders of different countries. The agreement envisages fostering national regimes, especially for developing and emerging countries, however, at the same time excludes the discrimination against the foreign suppliers. It also envisages technical support from the developed countries and promotion of transparency through establishing information-methodology centers in the member parties. In addition, to consult and help inexperienced suppliers make and translate all necessary documents.

In Georgia the law regulating the state procurement is mainly harmonized with international standards, though some indirect related legal acts need further refinement. In most cases certain laws refer to the state procurement system and do not consider the specificity of the sphere or lack of capacity. Certain governmental bodies still pass the normative acts that are not in accordance with the valid legislation. It is clear that in such situation there is no point to take new international responsibilities until there is no appropriate political will and the supremacy of the law. Otherwise, the international economic sanctions will overlap all the effect reached by joining the above mentioned agreement.

The reform of state procurement, as well as national economic restructuring, is carried out with the support of the World Bank who helps Georgia with quite a big amount of money. The concessional loans as well as grants given by the World Bank are defined in details for urgent activities and are spent in accordance with the plans approved by the government. The main objective of the World Bank regarding these purchases is to ensure that they are done economically, efficiently and transparently; to foster the economic development of the fund receiver country; to make sure that the potential suppliers participate in the procurement procedures. In this respect so called "procurement guidebook" was worked out and standard tender documentation was developed for competitive bidding done by the Bank. Though the World Bank requires from the order contractor that goods or service are purchased on the bases of the international standards, in certain circumstances it is still possible that the contracts are tied up through price quoting, direct procurement or limited tender. The simplified methods of procurement are mainly used for small scale purchase.

The experience of the international procurement proves that it is equally important to correctly plan the state procurement, as well as correctly organize the procurement procedures and sign fair contracts. In addition, it is important that obligations written in the contracts are fully



implemented and public monitoring requires that the accountability system is strictly defined. This issue has its mental side too, as during the Soviet Union all state procurement was done in accordance with strictly developed plan through state orders, in the post-Soviet period procurement retained the same character and it became necessary to develop special laws regulating this sector. At the same time in the developed countries the role of the public sector was more and more increasing. In most countries the laws regulating state procurement first of all protected national entrepreneurship and only after that fostered legally defined preferences.

In the second half of the 20th century with increase of state spending, the tendency of the international relationships on the national procurement system became more obvious. Exactly at this time the Agreement on Tariffs and Trade was developed, and in 1979 under this agreement the main players signed the special Agreement on Government Procurement (GPA) that was quite limited in the beginning. In 1994 at the Uruguay Round within the framework of the World Trade organization, The Government Procurement Agreement was further perfected and it entered into force on January 1, 1994. At the same time the regional integration schemes were developing and its logical result became the establishment of European Economic Community in 1957 by the Treaty of Rome. Though it did not contain separate provisions on public purchase, but it forbade the member states to discriminate against suppliers and to restrict the free trade. The special standards related to public purchase were adopted since the 70s of the previous century: At first in 1971 European standards were adopted for labor procurement and in 1976 the same standards were recognized for products. These standards were mainly based on the regime of informing the Community about the purchase, neutrality principle on giving the technical specification and the necessity of using impartial criteria while selecting the contractor. In the 80s European countries developed laws regulating public purchase and constantly monitored how the commitments were met by the parties. Within the EU even more attention was given in order to increase transparency level, to impose a strict control on implementation of the requirements defined in the guidelines, to widen the working area of the state procurement rules among which the emphasis were made on service purchase, too.

International fiscal institutions and UN played a huge role in forming a modern state procurement system in the countries with emerging economy. UN Commission on International Trade Law started working on state procurement in 1986 and finished its work in 1994 with the adoption of UNCITRAL Model Law that together with general provisions defined procurement methods and procedures in details. This document comes with the guiding recommendations which significantly simplified

the process of developing procurement regulating laws in Georgia. As the result of the harmonization of the national legislation with the international standards, the World Bank makes more and more procurement in accordance with the laws working in beneficiary countries if these laws do not collide with the rules of the World Bank. On the other hand, more and more international tenders are held in conformity with the procedures set by the World Bank. Lately there are less and less bureaucracy barriers in procurements carried out by the World Bank and governments promptly get correspondent technical support.

As for the international procurement, it represents the unity of practical methods and procedures that ensure maximal protection of the interests of buyer organizations and the society through tender selection. It is based on the principles of publicity, equality, economy, effectiveness and accountability and at the same time widely uses international standards and rules.

In the international practice the systems of the international procurement differs from each other, though they have common characteristics mainly regarding the general principles and applied methods. In addition, the level of procurement centralization and the administration quality varies from country to country. Also in each state there is at least one governmental body (in form of an agency, department, office, etc) that regulates and exercises the overall coordination of the procurement policy throughout the country. Generally this very body is responsible for the monitoring state procurement and administrating the signed contracts. However, in some countries these responsibilities are taken by controlling bodies and /or auditors.

In some countries additionally a special governmental office of public provision is made up that carries out the procurement of standard products and services through tenders on the basis of orders placed by state managing bodies and different organizations and then supply appropriate companies. As it turned out, the similar body is to be established in the near future in Georgia. Besides the above-mentioned, in all state procuring organizations the office of state procurement functions (for example in ministries there are departments) which conducts the purchase of specific products, labor and service for this state institution. Clearly, on the one hand, with this policy the problem of procurement staff qualification is solved for the procuring organizations and by conducting big-scale purchases through tenders the spending per product is cheapened. However, on the other hand, all these require well organization and big managerial expenses. In most countries there are procurement staff preparing and training centers, also consultancy bureaus and in some places consulting methodology centers too. Besides, at least one specialized weekly newspaper is regularly issued, where announcements on forthcoming procurement are published and periodic bulletins offer reviews, reports and oth-

er information about procurement environment. Exchanging the information and also doing e-commerce through global nets (the Internet) represent huge technical resources for further development of the state procurement system. However, unlike the commercial firms, the striking the governmental contracts is characterized with significant procedural restrictions and formal rules.

In Georgia the present state procurement system is decentralized and state procurement organization is in charge of its implementation. This organization is responsible for lawfully carrying out the state purchase.

At the initial stage of the formation of the state procurement system (in 1998-2000) it was important to create a legal basis for the state procurement in Georgia and for this end the law on "State Procurement" was adopted, the state procurement department was set up in the Ministry of Economy and appropriate normative acts were published. Although this document was developed with the participation of the international experts, at the initial stage of the reform, most of the procuring organizations ignored the standards defined in the state procurement regulating laws. It was often caused by the fact that there were not set standards for conducting the state procurement and in most cases procuring parties differently interpreted the law. At that time because of budget limitations budget cuts were very common and practically organizations were not funded under the articles of "other products and services", as well as "capital expenses" (mainly salaries were given), and the country mostly existed with credits and grants allocated by the international organizations. As a result, the law on state procurement was practically unimplemented in the economic life of the country. Considering the above mentioned, by 2001 the program of procurement system institutionalization was agreed to the World Bank and the action plan for reforming the state procurement system was determined. Within the framework of the World Bank structural reformation credit - SAC III, at the initial stage the Georgian side took the responsibility to refine the state procurement regulating law in order to harmonize it with the international legal standards and to implement is in reality. Thus, the bill of "amendments and additions to the law on state procurement" was prepared, which was adopted in March, 2001 by the Parliament of Georgia. In 2001-2004 the agency of state procurement organized the training-workshops for procurement specialists. They also published and distributed the methodology materials and legal normative documents related to the state procurement. In order to share leading foreign experience business visits and learning tours were organized in Lithuania, Poland, the USA, Italy and Kyrgyzstan; in addition, the office of the state procurement was equipped with modern facilities, the provision on "the implementation rule of state procurement" was developed with the participation of the international expert-consultants, the provisions of state procurement agency and its Supervi-

sory board were passed. The normative act of “the provision on the implementation of state procurement and its documentary appendix” adopted in October, 2001 together with the general provisions determined the standard forms of the documentation related to conducting the state procurement. It also contained instructions, methodology and rules connected to the state procurement and the ways of their implementation. On the basis of researching Georgian state procurement environment, the World Bank experts wrote an evaluating report the final recommendations of which were specified on June 4-6, 2002 at the joint workshop of Georgia and the World Bank with the name of “Perfection of State Procurement in Georgia” and were reflected in the action plan of the agency. In 2002-2003 with the participation of the World Bank experts the national strategy of trainings was developed for purchase coordination, as well as for procurement specialists. Moreover, the web-site of the state procurement agency was created where all important information about the agency, state procurement regulating legislation, also about the different normative and methodology materials, tender announcements, supplier lists, the weekly analysis of the state procurement throughout the country, the annual report of the state procurement agency, etc, could be seen.

After the Rose Revolution, as a result of ambitious and subjective attitude and nonqualified and in certain cases provocative actions of some politicians, qualified staff were fired and staff protectionism policy was carried out that caused the censure of the ongoing reform and breaching the international commitments. The purchasing standards were reviewed according to the bill prepared by the Soros Fund. The rules recognized in the international procurement practice were ignored, the autonomous agency was abolished and it was turned into an average governmental subdivision. It became a common practice to show favoritism towards the procuring entities, to destroy the system of accountability and monitoring, to ignore the market principles and incorrectly interpret the legislation, to discredit the existing positive experience and to support the dishonest staff, to justify the facts of competition restrictions and to abuse the public trust. As a result in 2005-2011 the people working in this system were focused on carrying out the political orders and the publicity and transparency of the implemented procurements were limited.

The “updated law” which entered into force in 2006 enabled the government to use the funds on various pretext in order to finance interested spheres, meetings and visits of the president of Georgia, the chairman of the Georgian parliament, the prime minister, the minister, the state minister of Georgia and/or Tbilisi mayor, also to organize the delegation receptions in the Parliament of Georgia, the visits of the Georgian parliamentary delegations abroad, the delegation reception in the Ministry of Foreign Affairs of Georgia and the visits of delegations of the Ministry of

Foreign Affairs of Georgia abroad, also money allocated from the reserve funds of the President of Georgia, the Georgian government and Tbilisi mayor office for state procurement; state purchasing of electricity, guaranteed power, natural gas and water supply; state procurements related to the implementation of monetary-credit and monetary fund policy by the National Bank of Georgia in accordance with the organic law of Georgia on “the National bank of Georgia” and also for ensuring the state economy with the cash; state purchasing of real estate; also the state procurements of granting the right of utilization of the real estate; the purchase of certain service by the legal entity of the public law – the Georgia Public Broadcaster; the procurements of sovereign rating service and credit – rating service related to the bonds and also covering the costs connected to the credit-rating service to the service supplier; state procuring of the service related to the keeping of lottery ticket, realization and/or free distribution of promoting materials by the lottery organizer or an agent envisaged by the law of Georgia on “organizing lottery, gambling and other winning games”; and other similar procurements during which by granting the exclusive contracts on the noncompetitive basis the environment of illegal agreements was created. Certain officials violating the law with negotiating only with one person lobby the large-scale contracts and then without any arguments try to justify it with different circumstances. As a result, the market of state procurement is divided among competitors on unhealthy basis. Under such conditions because of the lack of the proper transparency the facts of bribery were quite common. There were the facts of favoritism based on different reasons and other unhealthy practice. There is still a significant distrust towards the state procurement system in the society.

Although by introducing the electronic procurement system in 2011 the availability of the information on tenders increased, but important procurements (almost the same quantity that are in this base) are still conducted in non-transparent way. Since December 1, 2010, the paper tender was abolished and all state tenders are held electronically. According to the information provided by the state procurement agency, at the end of 2011 already 10,417 users were registered in the e-system, 3,052 of which are procuring organizations and 7,365 suppliers. As a result of the tenders announced during 2011, 17,717 contracts were granted, the total value of these contracts is 1,156,191,457 GEL.

In 2011 the agreements on state procurement are reached on 2,662,663,113 GEL and 66% of which were made through e-tender. E-system is bilingual and the data there is available to any user of the system in Georgian and English languages. In particular it provides the following:

- the annual plan of the procurement;
- tender announcements;
- the estimated value of the procurement;
- tender documentations and their amendments;
- the tender offer of the supplier and the offer price;
- minutes of the tender committee and the correspondence with the supplier;
- agreements and their amendments;
- information on the payment.

In order to identify the procurement objects, the state procurement service introduced procurement object search system designed by the EU (before it was done according to the UN classification on economic activity). In this system each object has its own identification code. These codes are arranged hierarchically. The uniformity of procurement objects and monetary margins are determined according to this hierarchy.

In order to successfully introduce in Georgia the positive experience existing in the international procurement-management practice, it is equally important to have high quality law, also appropriate institutional infrastructure, the support from the authorities. In addition, it is essential to ensure the availability of the information necessary for public monitoring and the professionalism of the parties participating in the procurement process. Procurement transparency and protection of the rights of the participants are equally vital under the liberal legislation.

The present legislation defines general legal, organizational and economic principles for state procurement implementation. The body responsible for carrying out these principles is the independent legal entity of the public law the chairman of which is appointed and dismissed by the Prime Minister. The main functions of the agency are: develop and pass sub-legal acts and standard tender documents required for the operation of this Law, harmonization thereof with international standards; on the basis of reports received from procuring entity perform study; analysis of situation in the field of procurement within the country on a regular basis and submission of suggestions to the Government of Georgia to inform the making of relevant decisions; develop special training programs, training-methodological materials and standard forms of documentation, holding workshops and trainings for central authorities and local self-governing bodies, mass media representatives and other interested entities; develop, refine and exercise oversight over the unified procurement information base; provide advisory-counseling services to procuring entities; provide support in the introduction of modern information and communication technologies within the procurement system; ensure availability of relevant sub-legal acts and special bulletin manual to ensure the publicity of procurement; consideration of disputes arising during pro-

curement; conduct oversight over the legitimacy of procurement procedures and establish the policy for regulation of procurement process; Maintenance of the Black and the White List of the suppliers; in special cases, under a written request by a procuring entity or at own decision, under an individual administrative-legal act perform the identification of a procurement object and/or integration in the classification; identification of the facts of artificial splitting of state procurement and taking relevant response measures.

Under the present legislation the State Procurement Agency was replaced by the Competition and Procurement Agency and with this the latter became responsible for ensuring the implementation of the law on competition as well as the law on state procurement. However, overseeing the implementation of the law on competition, organizing and monitoring of the state procurement process, except for regulation of the natural monopoly, is conceptually different and imposing these responsibilities on one agency hinders the effective implementation of the appropriate policies. It should be also considered that EU countries (the Czech Republic, Sweden, Denmark, etc) where we have such practice are absolutely different from Georgia. Georgia represents the country with small-scale economy. According to the data of the National Statistics Office, the territory of Georgia is 69.7 thousand square kilometers and the population is 4,497.6 thousand people. In 2011 GDP per capita was 3231 USD Dollar and the increase of GDP was 7.2%. The infrastructure still needs development, import exceeds export much; the membership of the World Trade Organization obliges the country to ensure free market that in case of abusing market power by certain corporations causes inefficiency of the market structure. The production capacity of the country is quite small and it faces technological lagging, the availability of resources is quite limited and the level of poverty and inequality of income significantly decreases the purchasing power of the population. Unlike the countries mentioned above, Georgia is characterized by specificity of rules and applied tools for anti-monopoly regulations and state procurement administrations. As it is mentioned in the strategy document of the competition policy developed by the Georgian government on the basis of the European Commission recommendations, at present the institutional framework of the competition in Georgia consists of the following institutions:

- Competition and State Procurement Agency.
- Sector regulators in the non-liberal field:
  - The Georgian National Communication Commission which represents the sector regulator in the field of electronic communication and postal service. It was established in 2000.
  - Georgian National Energy and Water Supply Regulatory Commission represents the sector regulator in the field of energy, natural gas and water supply. It was established in 1997.

The competition policy in the non-liberal sectors (for example, electronic communications, electricity power, gas and water supply) is regulated by the sector laws that are executed by relevant sector regulators. Because of the absence of the liberalization, the tariffs and other market terms in these sectors are determined by the sector regulators who are responsible for economic and technical regulations and protection of the competition in the non-liberal sectors. In addition, they must ensure the regulation of agreed activities and misuse of the dominated position. Thus, the function of supervision the competition legislation is shifting to the judiciary and the special regulatory institutions, but the state procurement administration and anti-monopoly regulations still remain the prerogative of the executive body (the government).

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## Bank's Credit Risk Modeling

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*The article reviews the Bank's credit risk modeling issues. The substance of the article analyzes the credit risk structure and methods for measuring its components. Credit risk is measured as a loss, that is the function of several variables. The amount of open credit risk position in case of default, expected probability of credit default and recovery ratio after the default are the main variables of the given function presented in the article. These variables are reviewed as random values and methods are given for its evaluation and integration as one indicator.*

*The article also reviews the tasks of forming the bank's internal credit ratings and issues related to the use of these ratings in credit risk evaluation model.*

### Introduction

Recently, the size of the exposure has become a problem for banks throughout the world. Loans for majority of banks are the most vivid and primary source of Credit Risk. Credit Risk can be simply defined as the second party's failure to meet the obligations assumed as per to the agreed terms. Bank's Credit Risk Management aims at maximizing risk-weighted earnings by adjusting the exposure to the allowed level of control parameters. Banks have risks at two levels in terms of loans: at Credit Portfolio and at Individual Loans. Bank's Effective Credit Risk Management implies the both levels and ensures the achievement of short- and long-term goals. According to the Credit Risks Analysis, the main reason for banks' bankruptcy in most cases was large credit losses.

Given the Credit Risk's significance, a bank must be able to identify, measure, monitor, and control it. Besides, a bank must evaluate the capital adequacy of the assumed Credit Risk. The Basel Committee has set forth the main principles based on which it is recommended to build a reliable system for Credit Risks Management (Basel Committee on Banking Supervision, 2000). These principles require the following: (1) creating a

relevant Credit Risk Environment; (2) using reliable credit disbursement process; (3) adequate credit administration, evaluation and monitoring; (4) adequate Credit Risks Control.

As the task of the Credit Risks Modeling, we review the Credit Risk Evaluation and Aggregation by Credit Products. Modeling outputs can also be used in Risk Management and evaluation of activity outcomes, as well as in client's profitability analysis, pricing considering the risk factor and defining the recoveries linked to the results. Credit Risks Model has recently been used in Credit Portfolio Management and Capital Structure related decision-making. If the model is conceptually accurate, reliable, empirically tested and results in adequate evaluations for the Banks' Capital Requirement, Regulation could rely on it and define Capital Requirement based on it.

A Market Risk Model is widely used in practice. On the basis of it, risk equivalent requirement on capital is defined. Credit Risk Model can not be a simple expansion of the Market Risk Model due to two reasons. The first reason is the insufficiency of data. Majority of Credit Risk bearing instruments are not marketable, because of this the price forecast for these instruments based on the Model will not be the output of the statistical evaluation of the historical prices in full. Credit impairment cases are not distributed symmetrically. This is truly a random variable, but its distribution is shifted positively.

The second reason is Model validation. A Market Risk model includes only several days whereas the Credit Risk Model typically covers one year or more. This makes evaluation of the accuracy of the Model difficult. If we take the confidence level into consideration, the noted difficulty increases. Numerical validation requires a number of years, which is not practical, since it includes several credit cycles. However, the cycle component can be removed from the time-span (Hanke, Wichern, 2009), we will refer to this issue below.

Credit loss is a random variable, which has a distribution function. The main outcome of the Credit Risk Model should be the deriving of distribution function. Credit loss is divided into two components. One is the expected loss within the selected period or the average loss, which evaluates the amount of the expected credit loss for the concrete period. The second component is the unexpected credit loss, with this amount total actual credit loss exceeds the expected one.

The first component is covered by the bank's credit reserves, which is created according to the Bank's Reserve Policy and reflects the numerical and qualitative status of the Credit Portfolio within the specific timeframe. This part does not require the allocation of the Economic Capital. The latter is for the second component of the credit loss – the unexpected credit loss, so that the predefined rate of the bankruptcy can be achieved. This is shown graphically:

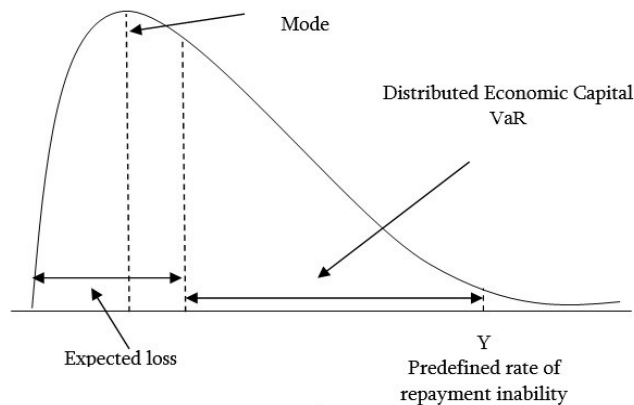


Chart 1

Unlike the market risk, this is not the normal distribution. It is skewed to the right and is the result of the repayment inability or lowering of the credit rating. Therefore, credit loss distribution modeling is necessary. Probability, that VaR exceeds the unexpected loss at the given confidence level equals to zero.

Apart from the Economic Capital, Bank has the Supervisory Capital Requirement (Lemonjava, 2009). Majority of banks review these capitals separately. If the Supervisory Capital is less than the Economic Capital, there is no problem, the used capital will be considered in pricing in full. But the problem arises, when the Supervisory Capital exceeds the Economic Capital. In this case, surplus is not distributed by Banking Products and the price does not include the recovery component of the regulation expense. Coming from the size of the bank and its business structure, this difference might be so big, that without its adjustment the bank's fair value will decrease significantly.

A Credit Risk Model, created and implemented on the basis of the relevant principles and methods, grants a reasonable privilege to the bank. With this model, bank can identify, measure and manage the risk promptly. Individual loans can be reflected in the model jointly, which makes it available to consider the composition effect and better reflects the concentration risk. As it is known, economic environment, market factors, bank's business structure is changing, which is reflected in the model and their results will be evaluated promptly. Finally, important model outcome can be the reduction of Regulatory Capital Requirement if the regulatory body is convinced in the reliability of Credit Risk Model and the bank's Risk Management System in whole.

Bank's Management is responsible for the Credit Risk identification, evaluation, management and monitoring, as well as launching the Internal Control Monitoring System. To fulfill these tasks, bank should have accurately and thoroughly identified credit risks and defined Risk Allowance Level. If we measure risk in two dimensions, in terms of output and probability, Management's tasks will be graphically presented as in chart 2.

Risk Allowance Level is approved by Top Management or Supervisory Board. A Credit Risk Model and Internal Systems of Credit Rating are a great assistance in fixing the Risk Allowance Level and its performance control. The Model connects Regulatory Capital Requirement, Capital with acceptable risk level and Economic Capital with Residual Risk. In case of the relevant management and control, a bank's Management can not exceed the acceptable Credit Risk Level. Herewith, Management has a chance to reduce the Regulatory Capital Requirement significantly, which will be positively reflected on the bank's profitability. Only for this it is necessary for the bank to have adequate Credit Risk Management System. Two interrelated components of this system are the Credit Risk Model and Internal Rating System. Given article aims for integrating these two instruments in the general Credit Risk Management Model.

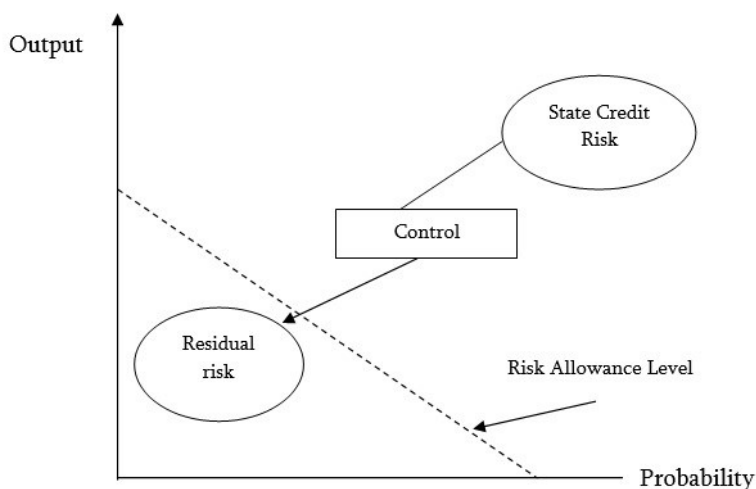


Chart 2.

### *Credit Risk Model*

A Credit Risk Model includes several elements. These are the following: 1) time interval; 2) Credit Risk Measure - default or market method; 3) conditional/unconditional models; 4) Credit Aggregation Method; 5) Correlation among the default events. There is not any widely accepted standard for choosing a model. When making the selection, bank's Credit Portfolio features and its credit culture should be taken into account. Generally, it is necessary to analyze some conceptual issues, which are critical in selecting any model or method.

One principal output of the Credit Risk Model is the Credit Loss Distribution Function. Expected Credit Loss, Unexpected Credit Loss and Loss with targeted Confidence Level are determined within the scope of this function (see Chart 1.). It is true that the last section is characterized by low frequency, but the probability of their occurrence is real and respective loss is equal to bankruptcy. Thus, shrinkage of the Confidence Level will increase VaR sharply and the latter will limit the business. VaR represents the Capital, which covers unexpected losses above the expected ones.

Credit Risk has several drivers, which are the Credit Risk Model variables. These are: 1) exposure; 2) migration risk; 3) default risk; 4) credit loss recovery risk.

Exposure equals the amount that can be directed to the other part. This can be measured by book value, which is client's balance liability or by market value, which implies the Migration Risk. Credit Risk Model, which implied the Migration Risk, evaluates the Credit Loss more accurately and thoroughly. However, it should be considered, that the Credit Risk component becomes harder to single out clearly.

According to the definition, only the future exposure is under risk. In this context, future exposure is not the predefined measure, it is a random variable, the source of which is withdrawals from Credit Lines.

When evaluating the Default Risk, default's definition is important. It has an impact on default's probability and its frequency. Default Payment can be considered if the payment is 3 months overdue. Bankruptcy and business restructurization can be considered as the default case. As for funds, default can be considered breaching the covenants breaching the terms (of a loan agreement?) may be considered a default .

Default-related loss equals to material loss with reduced recovery. Migration probability is calculated using the historical data. In any other class status rather than the default, Migration does not cause the Book Value impairment, even if the default probability changes. It is impossible to define the expected loss using the historical data, because of this data from Rating Agencies is often used. Agency ratings do not measure the

default probability of liability issuer, it measures the credit grade of the issued instrument. To overcome this issue, banks use Internal Ratings (IBR) frequently. The latter is envisaged by the new resolution of the Basel Committee, which is known by Basel II (Basel Committee on Banking Supervision). Credit Risk grade and significance increases if it relies on the smooth Internal Rating System of the bank. Bank's Internal Rating will be reviewed in details down below.

Credit Risk Model should give us the Credit Loss Distribution Function (PDF). Bank's Credit Risk Model should give the reliable evaluation of PDF. Probability of the Credit Loss exceeding Y equals to the area below PDF, right-side of Y. Credit Risk Portfolio grade is characterized with this interval/area: if it is high, Credit Risk Portfolio should be considered of high risk and if it is low-low risk. Bank reviews the unexpected part of the Credit Risk as a Credit Risk.

As it was said, given that the distribution will not be normal, we need to find a corresponding function. We consider the log-normal distribution

(Lazrieva, Mania, Mari, Mosidze, et al. (2000)  $X - \text{Log}(x, \mu, \sigma)$  as a good approximation for PDF. Its density is

$$f(x) = \frac{1}{x\sigma} \varphi(\ln x - \mu) / \sigma, x \geq 0$$

And parameters:

$$\mu \in (-\infty; +\infty), \sigma > 0.$$

To derive the function it is necessary to evaluate them based on the sample. Distribution Function accuracy will depend on sample representation and size, which is the function of two parameters (Robert, Mason, & Douglas, Lind, 1996):

$$n = \left( \frac{z \cdot s}{E} \right)^2$$

where:

E – allowable error

Z – respective z evaluation of selected Confidence Level

s - sample variance

We have mentioned about some difficulties of creating the model. One of them was the lack of data. Limited number of observations of small-sized banks is a general problem. Even in Georgia's largest Banks there are only several hundred medium- and large-sized business loans and mortgage loans. Consumer loans account for a comparatively greater

share of the overall loans. It is almost impossible in first two cases to take the sample size providing the accurate evaluation of the Distribution Function Parameters.

The second problem is attributable to Managerial Information Systems, which are used by the banks. Along with the other necessary data, they do not record the credit default and losses. This is a problem characteristic to the beginning stage of the Credit Model implementation, which can be solved by postponing the model implementation or using expertise evaluations.

Using the Distribution (1) Function we can calculate expected and unexpected Credit Losses. Expected Credit Loss is:

$$EL = \exp(\mu + \sigma^2 / 2) \approx \sum EDF_i \cdot EAD_i \cdot LGD_i$$

Where: EDF is the expected probability of credit default; EAD- total credit balance of the default; LCG- impairment rate of the given default.

This part of the loss is covered by the Credit Reserves, which does not consider the default occurrence. This component is not involved in the distribution of Economic Capital, but the unexpected loss is. Credit Loss Distribution Function (1) includes two parameters, one of them evaluates the average component ( $\mu$ ) of the Credit Loss and the second- deviation ( $\sigma$ ) of the unexpected loss. The size of the Capital to be allocated is determined by certain standard deviation multiple for Credit Loss:

$$UL = \gamma \cdot \sum_i \{ \exp(2\mu_i + 2\sigma_i^2) - \exp(2\mu_i + \sigma_i^2) \} \approx \gamma \cdot \sum_i EAD_i \sqrt{EDF_i(1 - EDF)LGD_i^2 + EDF_iVOL_i^2}$$

(Basle Committee on Banking Supervision, 1999)

Where: VOL is the standard deviation of the LDG, but  $\gamma$  - the coefficient of the standard deviation multiple, which is determined at the selected Confidence Level.

Formula (2) does not consider the correlation. If the correlation of one credit instrument is more important than the correlation of other instruments, it will be necessary to aggregate the individual credit loss

risks with the respective coefficient of correlation ( $\rho_i$ ). Considering the latter, formula (2) will be as follows:

$$UL \approx \gamma \cdot \sum_i \rho_i \cdot EAD_i \cdot \sqrt{EDF_i(1 - EDF)LGD_i^2 + EDF_iVOL_i^2}$$

Presented model is based on the following estimations: 1) Credit loss occurs only in case do the credit default; 2) time interval is the same for all credit instruments; 3) exposure for each credit instrument is known; 4) client default and loss for the given default (LGD) are independent variables; 5) LGD is a variable by clients.

### *Internal Credit Risk Rating System*

The Rating System measures the credit risk, differentiates the individual credits and groups of credits according to their credit risk level. Using the Internal Rating System, the bank's Management can monitor the risk level fluctuation in an operative manner, assess and recognize trends promptly. Credit Risk Rating helps the bank to fulfill the following functions in an accurate and timely manner: 1) loan approval and disbursement; 2) loan pricing; 3) creation of loan reserves; 4) adequate capital coverage of credit risk; 5) Credit Portfolio management.

The bank makes concrete definition for the rating, designs the processes and sets criterias (Guidelines on Internal Credit Risk Rating Systems, 2007), with the help of which the respective rating grades are assigned to each concrete credit risk. Rating grades should be differentiated sufficiently, so that each loan can be attributable to the rating class with respect to its risk. To avoid the concentration surplus, at least seven grades should be assigned for the current loans and one for bad debts (Basle Committee on Banking Supervision, 2004).

Retail loans are divided into baskets and are classified into the respective rating classes of assumed risk. Credit loss features (PD, LGD and EAD) are determined for each basket. Due to the number of this type of loans, given parameters of the model can be evaluated accurately even in the small sized banks.

Credit Rating is influenced by three factors: business risk, financial risk, and macroeconomic environment. We use three variables in business risk evaluation: 1) size of the firm, 2) systemic risk of the capital - Beta component and 3) nonsystemic risk of the capital-non Beta component.

Size of the firm can be evaluated by the market value of the firm's capital or the actual value of total assets. The second variable is evaluated by the Capital Market Model, the third - by the standard error related to the Market Model. Size of the firm is in negative correlation with the market risk, but the second and third variables are in positive correlation. In the countries with developed market economy, where capital market is



well-developed,  $\beta$  coefficients are available. But we shall use other variables in the countries with different situation. For instance, number of sales, raw material cost, competition, market share and other.

Financial Risks Analysis is based on the main financial ratios. For this reason, rating agencies use different number and type of financial ratios. For instance, S&P uses 8 main financial ratios, BLM – 4. First out of these four is ‘interest expense coverage ratio’; second- operating income to sales; third- long-term loans to assets; fourth- total liabilities to assets. The first two are in positive correlation with the rating and the last two in negative correlation. To exclude the impact of economic cycles, it will be reasonable to use several years of average for the given ratios. The above-mentioned rating agencies use the three years’ average.

The Rating Agencies use different numbers of grades: Moody’s has 9 different qualities ([www.moodys.com](http://www.moodys.com)), Standard & Poor’s - 10 qualities ([www.standardandpoors.com](http://www.standardandpoors.com)), Fitch - 12 qualities ([www.fitchratings.com](http://www.fitchratings.com)). Bank shall determine and use that number of qualities that will correspond to the existing and expected risk level. Slight differentiation of ratings will cause the concentration of loans with different risks at one rating class level, which will decrease the reliability of evaluating the credit loss parameters. On the other part, large differentiation of ratings will make it difficult to set clear criteria for assigning the ratings and different ratings will be assigned to the borrowers with the same risk. Clear definition and details of ratings is necessary also for the third party (Internal Audit, Supervisors and others), so that they can understand why that specific rating was assigned to the borrower. Criteria for assigning the ratings can not be dependent on the bank’s internal credit standards and policies.

When the bank assigns rating to the borrower and the credit instrument, it uses all the essential information on hand. In case of the lack of information, which is frequent, the bank shall use a conservative approach. If there are external ratings and the bank is confident in its reliability, it can be used for assigning the internal ratings. But they should check the equivalency of their own ratings with the agency.

It is important, that a borrower’s rating class shall be reviewed by taking the expected results of the borrower’s future business into account, rather than using only the credit history. Rating shall measure the risk, which evaluates the probability of the borrower meeting the assumed liabilities for not less than one year. Generally, the results of the borrower’s future business depend on the financial background, which reflects actual and budgeted financial accounts (Balance Sheet, Income Statement). Liabilities are met by money, therefore borrower’s creditability is focused on available cash resources and its stability.

Credit Rating is not a fixed structure. It is characterized by certain fluctuations, which is reflected in the borrower’s migration from class to class. Thus, it is necessary to create the matrix of rating migration and to update it periodically. The general structure of this matrix can be presented as follows:

|     | AAA               | AA                | A                 | BBB               | BB                | B                 | CCC               | D<br>(Default)  |
|-----|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-----------------|
| AAA | mp <sub>1,1</sub> | mp <sub>1,2</sub> | mp <sub>1,3</sub> | mp <sub>1,4</sub> | mp <sub>1,5</sub> | m <sub>1,6</sub>  | mp <sub>1,7</sub> | DP <sub>1</sub> |
| AA  | mp <sub>2,1</sub> | mp <sub>2,2</sub> | mp <sub>2,3</sub> | mp <sub>2,4</sub> | mp <sub>2,5</sub> | mp <sub>2,6</sub> | mp <sub>2,7</sub> | DP <sub>2</sub> |
| A   | mp <sub>3,1</sub> | mp <sub>3,2</sub> | mp <sub>3,3</sub> | mp <sub>3,4</sub> | mp <sub>3,5</sub> | mp <sub>3,6</sub> | mp <sub>3,7</sub> | DP <sub>3</sub> |
| BBB | mp <sub>4,1</sub> | mp <sub>4,2</sub> | mp <sub>4,3</sub> | mp <sub>4,4</sub> | mp <sub>4,5</sub> | mp <sub>4,6</sub> | mp <sub>4,7</sub> | DP <sub>4</sub> |
| BB  | mp <sub>5,1</sub> | mp <sub>5,2</sub> | mp <sub>5,3</sub> | mp <sub>5,4</sub> | mp <sub>5,5</sub> | mp <sub>5,6</sub> | mp <sub>5,7</sub> | DP <sub>5</sub> |
| B   | mp <sub>6,1</sub> | mp <sub>6,2</sub> | mp <sub>6,3</sub> | mp <sub>6,4</sub> | mp <sub>6,5</sub> | mp <sub>6,6</sub> | mp <sub>6,7</sub> | DP <sub>6</sub> |
| CCC | mp <sub>7,1</sub> | mp <sub>7,2</sub> | mp <sub>7,3</sub> | mp <sub>7,4</sub> | mp <sub>7,5</sub> | mp <sub>7,6</sub> | mp <sub>7,7</sub> | DP <sub>6</sub> |

Each non-diagonal element of the matrix (mp<sub>i,j</sub>) shows the credit movement of one class rating into the other. Diagonal element (mp<sub>i,i</sub>) shows the probability of the credit remaining in the same class. The last column shows the probability of credit defaults of each class.

This kind of matrix must be created for each credit product, which requires the classification of large number of loans and takes minimum 5 years (Greg M Gupton, Christopher C Finger & Mickey Bhatia, 1997). Basel II (Basle Committee on Banking Supervision, 2004) gave a great stimulus to large international banks to implement the Credit Risk Model and Internal Credit Risk Ratings System. It took 5 years on average for them to implement this system and within the scopes of this process they had to restructure and develop the bank’s Risk Management, Control and Managerial Informational Systems with respect to the requirements of new tasks.

And finally, it should be mentioned, that the creation and implementation of this difficult system is not the end of the process. The next step is the matter of its viability and sustainability, which is quite complex and requires resource and organizational support. For the activity of the model outcomes, it is important that the bank have the adequate system for its monitoring and outcome evaluation that will disclose the new trends and errors promptly, make recommendations for improvement and monitor their implementation. Constant testing of Internal Rating Systems is important as it evaluates the risk with default probability and expected

loss. Testing is based on historical data and shows if the model results correspond with the actual figures.

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## **Cross-Country Analysis of the Impact of Financial Systems on the Accounting Framework**

*Mamukelashvili Ioseb*

*Implementing one set of accounting standards worldwide is challenging because accounting and regulatory frameworks must reflect market dynamics of each country in the world. While the adoption of International Financial Reporting Standards (IFRS) in Georgia and the convergence to IFRS in China were successful in benefiting the banking sectors of those countries, the IFRS adoption promoted earnings management in Hong Kong. The fact that the IFRS was only successful in Georgia and China, where financial markets are not as developed as they are in Hong Kong, raises concerns about the effectiveness of the IFRS in the United States.*

### *Introduction*

Globalization increased the need of one unique accounting framework throughout the world to simplify financial reporting for multinational companies. However, the nature of countries' financial system is a major determinant of regulatory effectiveness and crafting an accounting framework that will work in every country is a challenging task. In other words, financial markets in each country must shape countries' regulatory and accounting framework to ensure proper financial reporting. In order to illustrate this argument, Georgia's and China's adoption of the International Financial Reporting Standards are analyzed as positive events because they promoted transparency and accountability in countries that suffered from corruption and authoritarianism throughout the 20<sup>th</sup> century. On the other hand, the adoption of the same IFRS standards by Hong Kong had a negative effect because it allowed greater flexibility to manage earnings and to inflate stock price in an economy that has one of the strongest financial markets in the world (So & Smith, 2009, p. 103). Finally, the idea that financial markets shape accounting and regulatory frameworks in different countries will be considered from the point of view of the United States because the IFRS convergence is a highly controversial topic in the US (Kenealy, 2010).

## Analysis

*The Rose Revolution was a turning point for Georgia politically as well as economically*

The 2003 Rose Revolution, which displaced Eduard Shevardnadze's government because of his alleged corruption, was a turning point in Georgia's history economically, as well as politically (Political Conditions: Georgia). In 2005, Georgia launched tax reforms to encourage foreign investments: after Georgia replaced a progressive income tax system with a flat income tax of 12%, taxation reached 80% of government revenues in 2008 (PricewaterhouseCoopers, 2009, p. 17). Following the Rose Revolution in 2004, Georgia fully adopted the 2004 version of the IFRS. The IFRS became the reporting standard that all the companies in Georgia must follow, with the exception of small privately-held businesses (p. 15).

*Financial reporting is governed by the Accounting Standards Commission of Georgia*

In Georgia, "accounting is governed by the Law on Regulation of Accounting and Reporting, and is regulated by the Accounting Standards Commission" (p. 15). The primary responsibility of the Accounting Standards Commission is to approve Georgian IFRS translations and interpretations, approve temporary accounting standards for organizations that are not covered by the IFRS, and approve chart-of-accounts structure based on the IFRS (p. 15).

*Audit is governed by Audit Activity Council of the Parliament of Georgia*

Audit in Georgia is governed by the state regulatory branch of the Georgian Parliament, called the Audit Activity Council. The Council requires mandatory audits for banks, insurance companies, special state foundations, stock exchanges, security issuers, investing institutions and other organizations that are designated by the Ministry of Finance of Georgia (p. 15). In considering the impact of audit on Georgian organizations, it is important to consider that Georgia's financial markets are relatively young and still developing.

*Georgia's financial markets are at an early stage of their development*

The Georgian Stock Exchange (GSE) was founded in 2000 and as of 2009, there were five companies listed on GSE and 250 companies were admitted to trading (p. 10). This implies that equity-financing is not a major source of funding for most Georgian companies and debt-financing is a preferred way of obtaining funds. The fact that Georgian financial markets are not well-developed also suggests that the role of the audit profession in Georgia is different from the role of the audit profession in the United States, where one of the primary responsibilities of an auditor is to ensure transparent financial reporting of publicly-traded companies.

Although the GSE is relatively underdeveloped, the banking sector in Georgia went through tremendous reforms since the early 1990s and es-

pecially after the Rose Revolution. For instance, in the early 1990s, political chaos and economic depression significantly reduced liquidity and established a feeling of distrust towards financial institution in Georgia. "At the end of 1994, Georgia had 228 banks. Many of these have since been liquidated, as a result of efforts to increase transparency, improve the quality of assets and services, and strengthen the banking system generally" (PricewaterhouseCoopers, 2009, p. 10) In addition to liquidating many of the smaller banks in Georgia, the Central Bank of Georgia (NBG) reported that a series of reforms were being undertaken to bring Georgian banking closer to the European Union standards. In 2003, NBG reported:

"To gradually increase a level of capitalization, and move towards the European standards, the National Bank increased minimum amount of required capital for Georgian banks, guided by a Euro Directive for minimum capital requirement of 5 million Euros; the president of the National Bank of Georgia issued a decree on defining the minimum capital requirement at GEL 12 million for commercial banks. Already licensed commercial banks and foreign bank branches should start increasing their capital in a given timeframe in order to fully comply with the new requirement by the end of 2008. Those commercial 66 National Bank of Georgia banks and foreign bank branches seeking to obtain a banking license need to meet GEL 12 million minimum capital requirement as it is one of main preconditions for a license to be granted points. This was due to the risk factors that characterize the developing economies" (Bank of Georgia, p. 65).

Given the fact that the banking sector is far more important to the Georgian economy than Georgia's financial markets, the success of Georgia's IFRS adoption must be analyzed uniquely from the point of view of Georgian economy.

*The adoption of IFRS in Georgia was effective because it reflected the country's market dynamics*

In highly-industrialized countries such as the United States and Hong Kong, the primary concern with the IFRS is that it allows greater flexibility in financial reporting. Some authors like Paola Paglietti argue that IFRS can potentially encourage earnings management, or smoothing, to reduce stock price volatility (Paglietti, 2009, p. 97). Although Paglietti's research findings are mixed regarding a direct relationship between

earnings management and IFRS, greater flexibility under IFRS remains a concern in countries with relatively strong financial markets (p. 97). On the other hand, the adoption of IFRS in Georgia does not raise concerns about transparency because the adoption coincided with economic liberalization and democratic political change. This reconciles the thesis of this paper in the sense that accounting framework must reflect market dynamism in order to be effective.

*China's convergence to IFRS improved transparency in the banking sector*

In addition to the fact that IFRS promoted transparency in Georgia, Ping Luo offers an interesting view about China's financial markets' convergence with the IFRS. He argues that the convergence to IFRS specifically benefitted the banking sector in China because before IFRS, local banks had to comply with regional standards, as well as international accounting standards (Ping, 2007, p. 47). He said that after the adoption of IFRS, "local banks are intended to better allocate their budget along business lines with some consideration for branches rather than branch by branch and region by region" (p. 47). Ping concludes by stating that IFRS helped to build investors' confidence and improve transparency in the banking sector of China.

*China's banking sector is relatively young*

Historical similarity of the financial markets and banking in Georgia and China explains the relative success of IFRS in the banking sectors of both countries. Like Georgia, China has liberalized its economy in the past twenty years. "Prior to 1984, commercial banking as we know it (personal & business lending, settlement, transfer of funds, etc.) was virtually non-existent in China. The banking landscape in China was very simple before economic reforms were introduced in 1978 — there was only one bank operating in all of China, the People's Bank of China (PBOC)" (BernsteinResearch, 2010, p. 6). In 2004, People's Bank of China (PBOC), which is the central bank of China and the primary regulator, established Industrial and Commercial Bank of China (ICBC) to specialize in commercial financing. Notably, ICBC is the largest bank in the world in terms of market capitalization (Exhibit I illustrates China's loan and deposit growth since 1984) (p. 6). Therefore, given the fact that the financial industries in Georgia and China are relatively young and both countries share the history of authoritarianism throughout the 20<sup>th</sup> century, the adoption of IFRS was a significant step in liberalizing their financial markets.

*Hong Kong has one of the most developed financial markets in the world*

In order to contrast the adoption of IFRS in Georgia and China, where capital markets are not well-developed, one can analyze Hong Kong's adoption of IFRS in 2005 as a country with one of the strongest capital markets in the world. Hong Kong is known as one of the world's financial centers, with 2007 market capitalization of approximately \$2.7 trillion (Datamonitor, 2009, p. 6). Exhibit II illustrates that pre-recession market capitalization of \$2.7 trillion was the highest in past 9 years. In addition, Ernst & Young projected that Hong Kong's initial public offerings to reach a record of \$47.7 billion in 2010, as the country is emerging from the global financial crisis (Hu, 2009).

*Hong Kong fully adopted IFRS in 2005*

Hong Kong fully adopted IFRS in 2005, a year after Georgia's 2004 adoption. "Starting in 2005, Hong Kong Financial Reporting Standards (HKFRSs) are identical to International Financial Reporting Standards. "While Hong Kong had adopted many of the earlier International Accounting Standards (IASs) as Hong Kong standards, some had not been adopted, including IAS 32 and IAS 39. And all of the December 2003 improvements and new and revised IFRSs issued in 2004 and 2005 will take effect in Hong Kong beginning in 2005" (Deloitte). Before fully adopting IFRS in 2005, one of the primary differences between Hong Kong accounting standards and IFRS was the treatment of investment property, where IFRS allowed companies to report their investment income on the balance sheet, whereas gains and losses would show up on other comprehensive income section of the balance sheet under previous Hong Kong accounting rules (So & Smith, 2009, p. 104).

*The adoption of IFRS in Hong Kong could have promoted earnings management*

The issue of reporting gains from investment property on the income statement instead of reporting it under other comprehensive income is very important because it can fundamentally alter the firm's financial position. Considering the fact that fair value measurements are based on subjective criteria, management can use its bias to report higher earnings in order to beat the analysts' expectation. NiuWuijun claims that Hong Kong's adoption of IFRS treatment for property investment increased HSE companies' financial ratios such as return on assets, return on equity, and debt to assets (Weijun, 2007, p. 3). Therefore, one could argue that management is incentivized to use the fair value treatment to exaggerate their companies' financial position, and by doing so, increase stock price.



*IFRS has a tendency to promote undue price volatility*

While there is a concern that management can use its discretion to manage earnings under International Accounting Standard (IAS) 40 for investment property, So and Smith point out that the introduction of HKAS 40, which is an equivalent of IAS 40, could cause undue volatility in stock price (So & Smith, 2009, p. 104). They state: “The former International Accounting Standards Committee (IASC) argues, however, in its Basis for Conclusions on IAS 40 (2000) that such presentation provides the most relevant and transparent view of the financial performance of investment properties (IASCF, 2008c). After all, the objective of financial statements is not to smooth profit figures (McBride, 2006), but to reflect economic reality for economic decision making (IASCF, 2008b)” (p. 104). This point of view is radically different from the point of view in the previous paragraph that suggested that fair value measurements can be used to manage earnings. In order to understand the impact of IFRS on Hong Kong’s financial markets, So’s and Smith’s paper will be analyzed in the subsequent paragraphs.

*So and Smith studied 92 companies in Hong Kong’s property industry to examine the impact of IAS 40*

So and Smith conducted a study to analyze if reporting fair value gains and losses on income statements had any impact on stock price. They chose companies from the property industry. They stated: “Companies are eligible for selection if throughout the sample period 2003–2006: (1) they are in the property industry; (2) they are listed in the Main Board of the Hong Kong Stock Exchange; (3) they report investment properties in their financial statements; and (4) there is no change of accounting year-end. This sampling criteria yields an initial sample of 92 companies” (p. 107). First, they analyzed those companies’ financial position before the IFRS adoption and then after the IFRS adoption. Furthermore, they analyzed the impact of IAS 40 in the short-term, which was defined as a period less than 12 months, and then they studied the impact in the long-term, defined as a period longer than 12 months period. Additional variables that So and Smith considered were firm size and leverage because they claimed that firm size and leverage are commonly used in value-relevance studies (P.107).

*Investors respond positively to reporting fair value gains on income statement in Hong Kong’s property industry*

The biggest finding of So’s and Smith’s research was the notion that investors react positively to fair value income reporting on the income

statement (p. 117). In other words, the fact that companies report changes in fair value on income statement is viewed positively by investors because it maximizes their value. One could argue that this gives management a tremendous market manipulative power because they can manage investors' expectation by reporting higher earnings based on questionable fair value estimates. While discussing So's and Smith's study, it is important to mention that all of the companies in their sample chose to adopt the fair value method and they did not research companies that did not follow the fair value method for investment property (p. 115). Exhibit III provides a complete list of the companies in So's and Smith's sample.

*The adoption of IFRS damaged transparency in Hong Kong, whereas it promoted transparency in Georgia and China*

In contrast with Georgia and China where the adoption and convergence to IFRS was a shift towards greater transparency, the adoption of IFRS provided means for managers of property companies in Hong Kong to report higher earnings under IAS 40. This finding reaffirms the thesis of this paper in the sense that financial markets shape the nature of accounting and regulatory frameworks. While the adoption of IFRS was a success story in a country with relatively underdeveloped financial markets, the adoption of the same accounting framework damaged transparency in one of the strongest financial markets in the world. Therefore, it would be hard to implement one unique set of accounting standards worldwide because of extreme dynamism of global financial markets.

*The United States is concerned about the impact of adopting IFRS*

The United States is particularly concerned about sharing the destiny of Hong Kong because the adoption of IFRS and fair value accounting has a potential of damaging the quality of US companies' earnings. However, the opinion about the IFRS convergence in the United States is rather mixed: on one hand, authors like Anne Fosbre, Ellen Kraft, and Paul Fosbre argue that it is an imperative to have a globalized set of accounting standards in the midst of globalization (Fosbre, Kraft, & Fosbre, 2009, p. 61). On the other hand, authors like Sidney Gray, Cheryl Linthicum, and Donna Street state that the adoption of IFRS will create serious problems for US financial markets in terms of significant gaps in earnings between US GAAP and IFRS (Gray, Linthicum, & Street, 2009, p. 431). Exhibit IV provides the list of countries that have adopted IFRS.

*Fosbre, Kraft, and Fosbre argue that convergence between US GAAP and IFRS is inevitable*

Fosbre, Kraft, and Fosbre claim that “the movement of world economies and the expansion of corporate America overseas with dramatic financial results brought forward the need for a single set of global accounting standards that could be used for domestic and cross border financial reporting of foreign and US multinational companies” (p. 431). They discuss that more than 50% of revenues of Honeywell International, Coca Cola, Pepsi Cola, and IBM come from overseas. In addition, convergence to IFRS will bring the worlds’ regulators together in fighting fraud and corruption throughout the world. The authors cite that in 2007 the Securities and Exchange Commission enabled foreign companies listed in the United States to issue their financial statement according to IFRS, instead of mandating them to use US GAAP (Fosbre, Kraft, & Fosbre, 2009). They conclude their paper by stating that it is almost inevitable for the US GAAP and IFRS to converge because US multinational companies have reached a point where more than half of their revenues come from abroad.

*Gray, Linthicum, and Street are concerned about earnings quality during the convergence process of US GAAP and IFRS*

Gray, Linthicum, and Street take a different approach in their research in the sense that their argument revolves around the notion that the adoption of IFRS in the United States will provide an opportunity for management to manipulate earnings through the application of fair value accounting. They also don’t disagree with the idea that IFRS is effective for some countries. For instance, they state that the adoption of IFRS for most of the EU countries was a success story because “the European Union’s (EU) adoption of International Financial Reporting Standards (IFRS) for the consolidated accounts of listed companies from 2005 marked a major shift from the use of numerous national accounting standards towards the acceptance of global standards established by the International Accounting Standards Board (IASB)” (Gray, Linthicum, & Street, 2009, p. 431). The authors discuss the SEC’s roadmap that plans to mandate IFRS reporting for publicly listed companies in the United States by 2014. Gray, Linthicum, and Street also mention that Senate Banking Committee Chair Dodd and Senator Reed are critical of the SEC’s plan to mandate the US companies to use IFRS (p. 432). Furthermore, the authors outline that when the SEC developed a roadmap in August of 2008, the agency was led by a different chairperson and the current chairperson of the SEC, Mary Schapiro, is very concerned about the implementation of the roadmap (p. 432).

In conclusion, Gray, Linthicum, and Street find by examining data set from 2001 to 2006 that a significant gap exists between reporting of equity and income under US GAAP and IFRS (p. 444). However, the authors do not oppose the idea of US GAAP and IFRS converging at some point in the future, but rather they argue that fundamental issues need to be resolved before the convergence can happen.

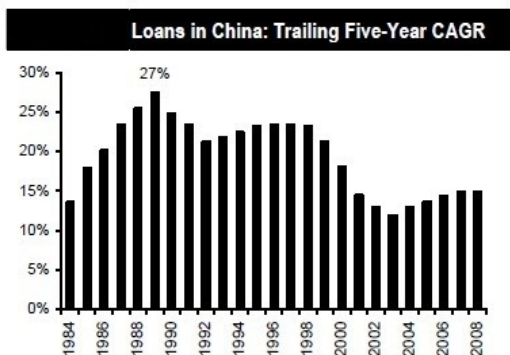
### *Conclusion*

The major finding of this paper is that crafting a one set of unique accounting standards is a complex task because of dynamism of financial markets worldwide. While IFRS help to improve transparency in the banking sectors of Georgia and China, this study suggests that IFRS has a potential to damage transparency in financial markets of Hong Kong and the United States. After considering positive contributions that IFRS has made to Georgian and Chinese economies, one could argue that IFRS has been very successful in economies that suffered from corruption and authoritarianism throughout the 20<sup>th</sup> century, whereas in economies such as the United States and Hong Kong with strong financial markets, IFRS has a tendency to promote earnings management. In summary, it is hard to implement one set of financial reporting standards for multinational companies because accounting standards should reflect financial systems of different countries.

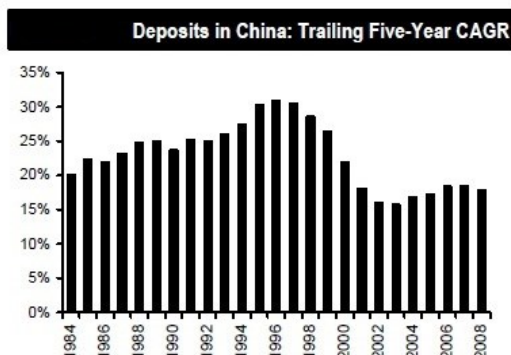
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Exhibit I: China's loan and deposit growth since 1984



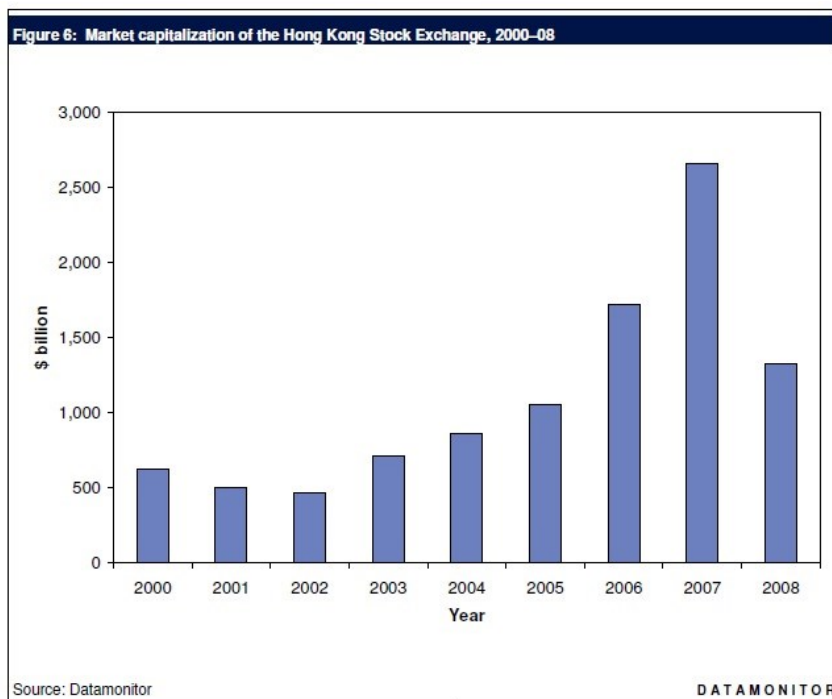
Source: CEIC, PBOC and Bernstein analysis.



Source: CEIC, PBOC and Bernstein analysis.

BernsteinResearch. "Chinese Banking: A Primer on the Market." *Business Source Complete*, 2010. P. 7.

Exhibit II: Market Capitalization of Hong Kong Stock Exchange



Source: Datamonitor

DATAMONITOR

Datamonitor. "Country Analysis Report: Hong Kong." 2009. P. 40.

**Exhibit III: List 92 companies studied by So and Smith**

| 92 companies in the sample (184 firm-standard) |      |  |                     |                             |                                     |
|--|------|--|---------------------|-----------------------------|-------------------------------------|
| SEHK Code                                      |      |  | Accounting Year-end | Last time Following SSAP 13 | First time adoption of HKAS 40 2004 |
| 1  | 1    | Cheung Kong(Holdings)Ltd               | 31 December         | 2003                        | 2004                                |
| 2  | 154  | Beijing Development (Hong Kong)Ltd     | 31 December         | 2003                        | 2004                                |
| 3  | 758  | Junefield Department Store Group Ltd   | 31 December         | 2003                        | 2004                                |
| 4  | 35   | Far East Consortium International Ltd  | 31 March            | 2004                        | 2005                                |
| 5  | 172  | Gold bond Group Holdings Ltd           | 31 March            | 2004                        | 2005                                |
| 6  | 277  | Tern Properties Co Ltd                 | 31 March            | 2004                        | 2005                                |
| 7  | 412  | Heritage International Holdings Ltd    | 31 March            | 2004                        | 2005                                |
| 8  | 735  | Oriental Investment Corporation Ltd    | 30 April            | 2004                        | 2005                                |
| 9  | 10   | Hung Lung Group Ltd                    | 30 June             | 2004                        | 2005                                |
| 10   | 12   | Henderson Land Development Company Ltd | 30 June             | 2004                        | 2005                                |
| 11   | 83   | Sino Land Company Ltd                  | 30 June             | 2004                        | 2005                                |
| 12   | 97   | Henderson Investment Ltd               | 30 June             | 2004                        | 2005                                |
| 13   | 101  | Hang Lung PropertiesLtd                | 30 June             | 2004                        | 2005                                |
| 14   | 131  | Cheuk Nang (Holdings)Ltd               | 30 June             | 2004                        | 2005                                |
| 15   | 247  | Tsim Sha Tsui Properties Ltd           | 30 June             | 2004                        | 2005                                |
| 16   | 488  | Lai Sun Development Co Ltd             | 31 July             | 2004                        | 2005                                |
| 17   | 1125 | Lai Fung Holdings Ltd                  | 31 July             | 2004                        | 2005                                |
| 18   | 14   | Hysun Development Company Ltd          | 31 December         | 2004                        | 2005                                |
| 19   | 24   | Burwill Holdings Ltd                   | 31 December         | 2004                        | 2005                                |
| 20   | 28   | Tian An China Investment Company Ltd   | 31 December         | 2004                        | 2005                                |
| 21   | 34   | Kowloon Development Company Ltd        | 31 December         | 2004                        | 2005                                |
| 22   | 41   | Great Eagle Holdings Ltd               | 31 December         | 2004                        | 2005                                |
| 23   | 56   | Allied Properties(HK)Ltd               | 31 December         | 2004                        | 2005                                |
| 24   | 66   | MTR Corporation Ltd                    | 31 December         | 2004                        | 2005                                |
| 25   | 68   | Lee Hing Development Ltd               | 31 December         | 2004                        | 2005                                |
| 26   | 75   | Y.T. Reality Group Ltd                 | 31 December         | 2004                        | 2005                                |
| 27   | 89   | Tai Sang Land Development Ltd          | 31 December         | 2004                        | 2005                                |
| 28   | 106  | Shenzhen Hing-Tech Holdings Ltd        | 31 December         | 2004                        | 2005                                |
| 29   | 115  | Grand Field Group Holdings Ltd         | 31 December         | 2004                        | 2005                                |
| 30   | 123  | Guangzhou Investment Company Ltd       | 31 December         | 2004                        | 2005                                |

So, Stella, and Malcolm Smith. "Value-relevance of presenting changes in fair value of investment properties in the income statement: evidence from Hong Kong." *Accounting and Business Research*, 2009. P. 115-117.

|    |      |   |             |      |      |
|----|------|---|-------------|------|------|
| 31 | 127  | Chinese Estate Holdings Ltd               | 31 December | 2004 | 2005 |
| 32 | 132  | China Investment Holdings Ltd             | 31 December | 2004 | 2005 |
| 33 | 141  | Great China Holdings Ltd                  | 31 December | 2004 | 2005 |
| 34 | 156  | Lippo China Resources Ltd                 | 31 December | 2004 | 2005 |
| 35 | 169  | China Fair Land Holdings Ltd              | 31 December | 2004 | 2005 |
| 36 | 171  | Silver Grant International Industries Ltd | 31 December | 2004 | 2005 |
| 37 | 173  | K.wah International Holdings Ltd          | 31 December | 2004 | 2005 |
| 38 | 184  | Keck Seng Investments (Hong Kong) Ltd     | 31 December | 2004 | 2005 |
| 39 | 201  | Magnificent Estate Ltd                    | 31 December | 2004 | 2005 |
| 40 | 219  | Shum Ho Technology Holdings Ltd           | 31 December | 2004 | 2005 |
| 41 | 230  | Onfem Holdings Ltd                        | 31 December | 2004 | 2005 |
| 42 | 242  | Shun Tak Holdings Ltd                     | 31 December | 2004 | 2005 |
| 43 | 251  | SEA Holdings Ltd                          | 31 December | 2004 | 2005 |
| 44 | 257  | China Everbright International Ltd        | 31 December | 2004 | 2005 |
| 45 | 258  | Tomson Group Ltd                          | 31 December | 2004 | 2005 |
| 46 | 286  | G-Prop (Holdings)Ltd                      | 31 December | 2004 | 2005 |
| 47 | 366  | Luks Industrial (Group)Ltd                | 31 December | 2004 | 2005 |
| 48 | 373  | Allied Group Ltd                          | 31 December | 2004 | 2005 |
| 49 | 431  | Greater China Holdings Ltd                | 31 December | 2004 | 2005 |
| 50 | 588  | Beijing North Star Co Ltd                 | 31 December | 2004 | 2005 |
| 51 | 604  | Shenzhen Investment Ltd                   | 31 December | 2004 | 2005 |
| 52 | 617  | Paliburg Holdings Ltd                     | 31 December | 2004 | 2005 |
| 53 | 635  | Playmates Holdings Ltd                    | 31 December | 2004 | 2005 |
| 54 | 649  | Shimao International Holdings Ltd         | 31 December | 2004 | 2005 |
| 55 | 683  | Kerry Properties Ltd                      | 31 December | 2004 | 2005 |
| 56 | 688  | China Overseas Land &Investment Ltd       | 31 December | 2004 | 2005 |
| 57 | 730  | Shougang Concord Grand(Group)Ltd          | 31 December | 2004 | 2005 |
| 58 | 878  | Soundwill Holdings Ltd                    | 31 December | 2004 | 2005 |
| 59 | 898  | Multifield International Holdings Ltd     | 31 December | 2004 | 2005 |
| 60 | 1200 | Midland Holdings Ltd                      | 31 December | 2004 | 2005 |



|    |      |                                       |             |      |      |
|----|------|---------------------------------------|-------------|------|------|
| 61 | 1207 | Shanghai Real Estate Ltd              | 31 December | 2004 | 2005 |
| 62 | 2355 | Baoye Group Company Ltd               | 31 December | 2004 | 2005 |
| 63 | 20   | Wheelock and Company Ltd              | 31 March    | 2005 | 2006 |
| 64 | 22   | Mexan Ltd                             | 31 March    | 2005 | 2006 |
| 65 | 49   | Wheelock Properties Ltd               | 31 March    | 2005 | 2006 |
| 66 | 88   | Tai Cheung Holdings Ltd               | 31 March    | 2005 | 2006 |
| 67 | 129  | Asia Standard International Group Ltd | 31 March    | 2005 | 2006 |
| 68 | 160  | Hon Kwok Land Investment Company Ltd  | 31 March    | 2005 | 2006 |
| 69 | 163  | Emperor International Holdings Ltd    | 31 March    | 2005 | 2006 |
| 70 | 164  | Premium Land Ltd                      | 31 March    | 2005 | 2006 |
| 71 | 166  | New Times Group Holdings Ltd          | 31 March    | 2005 | 2006 |
| 72 | 202  | Interchina Holdings Co Ltd            | 31 March    | 2005 | 2006 |
| 73 | 213  | National Electronics Holdings Ltd     | 31 March    | 2005 | 2006 |
| 74 | 224  | Pioneer Global Group Ltd              | 31 March    | 2005 | 2006 |
| 75 | 237  | Safety Godown Co Ltd                  | 31 March    | 2005 | 2006 |
| 76 | 278  | Wah Ha Realty Company Ltd             | 31 March    | 2005 | 2006 |
| 77 | 287  | Winfair Investment Company Ltd        | 31 March    | 2005 | 2006 |
| 78 | 298  | Chuang's China Investment Ltd         | 31 March    | 2005 | 2006 |
| 79 | 480  | HKR International Ltd                 | 31 March    | 2005 | 2006 |
| 80 | 499  | Hycomm Wireless Ltd                   | 31 March    | 2005 | 2006 |
| 81 | 711  | Chun Wo Holdings Ltd                  | 31 March    | 2005 | 2006 |
| 82 | 1036 | Winsor Properties Holdings Ltd        | 31 March    | 2005 | 2006 |
| 83 | 1124 | Costal Greenland Ltd                  | 31 March    | 2005 | 2006 |
| 84 | 2340 | Synergies Holdings Ltd                | 31 March    | 2005 | 2006 |
| 85 | 288  | Berjaya Holdings(HK)Ltd               | 30 April    | 2005 | 2006 |
| 86 | 16   | Sun Hung Kai Property Ltd             | 30 June     | 2005 | 2006 |
| 87 | 17   | New World Development Co Ltd          | 30 June     | 2005 | 2006 |
| 88 | 54   | Hopewell Holdings Ltd                 | 30 June     | 2005 | 2006 |
| 89 | 659  | NWS Holdings Ltd                      | 30 June     | 2005 | 2006 |
| 90 | 917  | New World China Land Ltd              | 30 June     | 2005 | 2006 |
| 91 | 193  | Capital Estate Ltd                    | 31 July     | 2005 | 2006 |
| 92 | 1191 | China Rich Holdings Ltd               | 31 July     | 2005 | 2006 |

Exhibit IV: List of Countries that Have Adopted IFRS

Table 1: Countries and Regions Using IFRS

| Country                   | Country               | Country          | Country              |
|---------------------------|-----------------------|------------------|----------------------|
| Abu Dhabi United Emirates | Dominican Republic    | Jamaica          | Nicaragua            |
| Anguilla                  | Dubai United Emirates | Japan 2011       | Norway               |
| Antigua and Barbuda       | Ecuador 2008          | Jordan           | Oman                 |
| Armenia                   | Egypt                 | Kazakhstan       | Panama               |
| Austria                   | Fiji                  | Kenya            | Papua New Guinea     |
| Australia                 | Finland               | Korea South 2011 | Peru                 |
| Bahamas                   | France                | Kuwait           | Poland               |
| Bahrain                   | Germany               | Kyrgyzstan       | Portugal             |
| Barbados                  | Georgia               | Latvia           | Qatar                |
| Belgium                   | Ghana                 | Lebanon          | Romania              |
| Bosnia Herzefovina        | Grenada               | Liechtenstein    | Serbia (Republic of) |
| Botswana                  | Greece                | Lithuania        | Slovenia             |
| Brazil 2010               | Guatemala             | Luxemburg        | Slovak Republic      |
| Bulgaria                  | Guyana                | Macedonia        | South Africa         |
| Chile 2009                | Haiti                 | Malawi           | Sweden               |
| Canada 2011               | Honduras              | Malta            | Tajikistan           |
| Chile 2009                | Hong Kong             | Mauritius        | Tanzania             |
| Costa Rica                | Hungary               | Montenegro       | Trinidad and Tobago  |
| Cyprus                    | Iceland               | Namibia          | United Kingdom       |
| Czech Republic            | Iraq                  | Netherlands      | Venezuela            |
| Denmark                   | Ireland               | Nepal            |                      |
|                           | Italy                 | New Zealand      |                      |

Fosbre, Anne B., Ellen M. Kraft, and Paul B. Fosbre. "The Globalization of Accounting Standards: IFRS vs US GAAP." *Global Journal of Business Research*, 2009. P. 65.

## ROI (Return on Investment) on Human Capital

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The University of Georgia*

*In the 21st century, the success of proactive organization is no longer evaluated by tangible assets like cash, plants, equipments and buildings. The outdated approach was quantifying the contribution of human resources in organization. For better presenting a real picture, a Human capital scorecard tool has been developed for measuring human resources contribution within the organization, which is innovation for Georgian business market. The topic is outlining the main concepts, theories, hypothesis and application process of the Human capital evaluating tool, the primary goal of which is to measure financial and non-financial effects of investment and expenditures in human resources. By implementing relevant evaluation tool of human resources contribution within Georgian organizations it means to acquire a value of understanding the human resources usefulness in company. By using the HR scorecard, managers are able to determine what has affected the trend and forecast the future.*

The classic books of management have ignored, avoided, or thrown platitudes at the question of human value in the business environment (Fitz-Enz, 2009, p. xvii). The era of the Industrial Revolution in the mid-eighteenth century had sown the “tangible” organization theory, which claimed that key industrial success was in tangible assets, such as cash, plants, equipments and buildings. This type of thinking had pushed early management theorists like Fayol, Weber, Taylor to examine the aspects of management and define the scientific management approach, which was focusing on human resources contribution and considered that the key to industrial success was the effective management of workers at all levels. Both, Fayol and Taylor tried to apply “scientific method” to the problems and concentrated primarily on the worker level, but none of the approach has been developed a reliable way to quantify the contribution of human capital to corporate profit till now. The only exception has been human resources accounting, which has not approved as a practical management tool.

The first sign of qualitative aspect of economics of “human capital” originated with Theodore Schultz, who claimed that recuperating the prosperity of people did not depend on energy, land or equipment, but rather on knowledge. (Schultz, 1979). We might describe the theory of “human

capital” as a unification of the intelligence, creativity and team spirit factors. There is no doubt that the human component adds the greatest economic value, but at the same time it is the most awkward asset to manage and evaluate, as the huge number of variables of human beings are creating complexity. Without the power of a human being none of the dependable variables such as, energy, plant, equipment and cash would work properly. People itself are mechanism which adds economic value and all other variables by their character add nothing (Fitz-Enz, 1990). Another angle from which we can see the perspective is not only the productivity level of human resources in organizations, but rather the satisfaction level of people at work. It has been acknowledged that as fulfilled is the work the more productive workers become. The driving force of fulfillment is knowledge, which helps accomplish tasks with higher quality and automatically the well finished job attracts attention of managers. Hence, investing in workers’ knowledge leads to job fulfillment and increased productivity level, but without implementing tangible quantitative metrics to reveal the costs and productivity of HR at three levels: 1) Organizational (contributions to corporate goals); 2) Functional (impact on process improvement); 3) Human resources management (value added by HR department activities) it is almost impossible to measure the affect.

For Georgian business market, the Human capital scorecard tool for measuring human resources contribution is new. The importance of Human resources in Organization is well-documented in various economic and business books. They play significant role as drivers of innovation and generators of respectable portions in Revenue. This is a major reason why implementing business tool for measuring the percentage of contribution in overall business processes and revenues per each worker is important. For modern HR managers in Georgia, it is essential to have a balanced set of measures to reveal the value of human resources contribution. To provide persuasive data on the human resources contribution in business processes, measuring it by Human Capital Scorecard (HCS) is favorable and promising tool. In western practices it is widely used in measurement mix, but not in Georgian business market.

Level of Education, knowledge and skills in HR is fastest-growing field in Georgia. Westernization has increased the need for individuals with specialized knowledge and skills to manage effectively business processes in the rapidly changing environment. Along with experienced staff, it is necessary to know their contribution in business and performance level.

The general trend in Georgia towards accountability with all staff members is creating a measurement metric for evaluating their contribution. Beside accountability, the pressure from managers and competitive economy are powerful drivers for introduction of HCS in human resources management. Widely spread process improvement tools in Geor-

gia, such as Total quality management (TQM) and Business process reengineering (BPR) have generated an interest in measurement and evaluation, including quantifying the capability of human resources. Those factors have created wave of applying HCS in measurement process, which has become one of the most challenging issues in HR field. The critical issue of the process is the nature and accuracy of its development. (Philips, Stone, 2001). Huge amount of formulas and statistics are increasing the confusion and misapply of HCS techniques. Implementation and application of HCS in measurement process is unavoidable for Georgian business community, as the organizations are striving to develop their external and internal processes via people, without HCS tool it cannot be measured the impact of Human resources and processes will not add value. For the proper implementation of HCS tool logical approach is needed, and what is most important, fundamental understanding of its nature and utilization.

The Human Capital Scorecard (HCS) tool in HR is concerned with measuring financial and non-financial effects of investment and expenditures in human resources. As we have already outlined, the contribution of human resources is most important for business and fortunately Georgian decision-makers are cognizant this fact. There are a number of reasons, why organizations should approach Human resources management with performance-based assessment. First and foremost is that measuring human resources performance allows decision-makers evaluate effectiveness of their investments and expenditures. Secondly, it supports the human resources productivity growth and thirdly, it assist to adjust with overall corporate goals. Accordingly, for modern business organization it is essential to have a performance based approach to every function, not only for human resources and choose appropriate metrics for better understanding the current position.

But the important factor is the effect of performance measurement techniques on organizational goals. In our case, we should ask if those companies which are measuring the effectiveness of human resources are comparatively successful or not with the ones which do not perform measuring? None of the literature or survey outlines comprehensive answer to this question, but there is no doubt about those who measure know exactly their current position on marketplace and are informed about their human related process effectiveness. Bohlander, Snell(2010) pointed out that measuring human resources by HCS metric, has positive effect on organizational performance and on decision makers satisfaction with human resources. Miller (1994) is sharing the same consideration and despite the differentiation in years of their work, both authors are claiming that the performance measurement has strong effects on managerial behavior and attitudes.

As the world was moving forward and corporations were expanding, the level of complex challenges was increasing. People became inevitable part in creating and running a business. In response to growth of people's contribution in managing organizations, the personnel changed its name to human resources. Nowadays, in intelligence age, people are recognized as a foundation of the organization. A simple and traditional personnel concept of proving service is no longer effective. Human resources are positioned as a capital of organization, which must be quantified as a tangible assets. The question is now to how can we quantify and increase the Human Capital Scorecard in human capital? The good news is that modern vision, attitudes and skills had implemented comprehensive model of measuring human asset, but for Georgian business community it is a truly new provoke. This paper is not about human resources, rather it focuses on human capital and the greater challenge of this topic is to apply successful model to Georgian organizations and observe its consequences.

Human resources management as a conventional discipline does not have a long history in Georgia. In the mid-1990, when companies started expansion, demand for personnel started growing, but along with dynamic development of business more skillful and experienced human resources became more desired, rather task executers. Current position of development changes from organization to organization, they are striving for westernization but still are far from maturity. As the world business is developing so rapidly, and Georgian business community is affected by global movements, it is necessary to learn and adapt more quickly. Unfortunately, modern reality does not give us chance to learn from our mistakes, so it is better to analyze and apply others successful approach for better managing our organizations, where the indivisible part of processes are human resources. Time to time, expenditures in human resources increases and companies are investing more, nevertheless tools to measure its performance is not evolving correspondingly. It is crucial for each organization to form human resources budget, manage activities and measure its failure or success. By the character and nature of human resources, it is the hardest process to measure its affect and value, but at the same time the most needful for business functioning.

As the challenge of 21<sup>st</sup> century is to manage human capital within organizations, there is no doubt that "HCS in human resources" is number one research priority for majority of investigators. This topic will investigate of how the randomly selected companies in Georgia are measuring investment/expenditure in human resources and then suggest alternative ways of how it is successfully done by someone else. We are currently preparing organizations for duties that do not exist yet.

### *Key Concepts*

What is Human Capital Scorecard (HCS) in human resources (HR)? It represents a revolutionary approach to evaluate HR programs that yields various types of measures representing a scorecard of measures. Philips, Stone (2001:2) None of the books, topics or individuals characterize HCS straightforwardly as the best tool for measuring HR function, but the hypothesis exists and it states that “by understanding the drivers of HCS process and implicit weaknesses and advantages of HCS makes it possible to take a rational approach to the issue and apply appropriate combination of evaluation strategies within the HR function”. Philips, Stone (2001, p. 2) According to Fitz-Enz (2009, p. 36) the HCS in human capital is essential, since in 21<sup>st</sup> century, management needs a system of metrics that describes and predicts the cost and productivity curves of its workforce. If we back up the Greenspan’s uncertainty principle – Every model, regardless of its perfection are the expression of the world that we experience with all its complexity, it means that the HCS concept has been interpreted not for following the fashion, but it was necessary tool to measure results in organizations. The leading management theorist Peter Drucker alleged, that the greatest challenge for organizations today is to respond to the switch from industrial to a knowledge economy. Those theorists, who followed the same approach, had interpreted plenty of knowledge assessment tools. Unfortunately, we cannot judge which performance measurement tools are the best, as they are based on assumptions and some of them have much success stories about comprehensive HR evaluation programs and some of them failed in appliance process. Application of the concept by organizations should not be mandatory, but if decision makers are realizing the need for accountability of human resources expenditures, the HCS metric will be appropriate to utilize for assessing human resources investments.

Almost 15 years ago, when first the Balanced Scorecard framework was developed by Kaplan and Norton, organizations were arguing on its benefits as the major problem was in evaluation approach. Executives were unable to deliver what they wanted to deliver, but time to time they have analyzed the advantages and disadvantages of Balanced Scorecard (BS) measurement approach and today a majority of organizations, both public and private use this tool to manage organizational strategy via junction measures and assess the financial and non-financial key performance indicators (KPI). With the same framework human resources have equipped itself to reveal how policies and drivers of human resources add value to the company. Some years later, in 2001, the “HR scorecard” has been implemented by Becker, Huselid and Ulrich.

Those two models “HR scorecard” and “Balanced Scorecard” should be considered in appliance process HCS metric as they take into account

sensitive issues and intangible assets. Despite the fact that, there is no substantial information or survey proving that HCS model is widely used metric by multinationals, plenty of growing literature and topics are altering the significance of HCS. Nowadays, in practice, two general models exist for human resources management Human Capital Scorecard calculation. The first model, which was developed by Kaplan and Norton in 1992 is Balanced Scorecard, which is performance measurement system connected to organizational strategy and in 9 years later it has been grown into HR scorecard, developed by Becker, Huselid and Ulrich in 2001. Second model was developed by Jac Fitz-Enz in 2002 Human performance benchmarking, which till now is merged into organizational strategies and used as a measuring tool for evaluating Human Capital Scorecard in human capital and no other alternatives had been interpreted yet. Both of those models are measuring HCS in human resources management and underlines that this metric is not easy financial transaction, rather it demonstrates that the performance and value creation of human capital must be fundamental components of HCS model in human resources.

HCS model it complex and difficult to assess as it draws a line between what issues are measured and what issues should be measured. Currently, it is simple to find in annual reports of organizations the quantitative issues on personnel, but the trend of transiting the qualitative issues becomes inevitable. Due to intangible nature of the HCS model, the measurement of softer issues is getting more difficult and complex, as the justification is based mostly on personal feelings and intuition, but no matter how complex the variable should be, a decision maker should focus on knowledge retention, which is key factor of organizational success is best encouraged by balance scorecard model. The same attention level must be dedicated to brand recognition and economic value creation, by which organization can advance its financial performance measures with general HRM functions. No doubt that HCS model is the combination of soft and hard issues evaluation, which might be carried financial characteristic or strategic nature. Why combination? The answer is simple: Managers want to know how the organization is doing rather detailing on family issues of each worker. Of course it might lead to disastrous effects, but the aim of metrics is to show current position of company, how it has grown/decreased compared with previous year or competitor(s) and what should be done for development? Those questions are answered by mobility programs, which are executed by human resources department and its affect should be measured by HCS metric. The more decision makers and HR specialists are looking for advancement and improving indicators, the key aspect they are facing, lies behind measuring intangible assets.

Strong interdependence between financial and human performance has been revealed by The Hackett Group (2007), while assessing the hu-



man assets and its impact on organization. Research proved that, companies, which are better managing the human capital and their efforts on customer satisfaction, profits and productivity outperformed regular companies by four financial metrics: Significant distinction in net profit margin (22%) and EBITDA (2%), nearly half percent improvement in return on assets and advancement in return on equity by (27%). Research also found that, top companies according to the human capital management efficiency had several areas in common, such as: strategic workforce planning (determining the skills), Staffing (recruitment, hiring, and firing) Labor development (trainings) and Effectiveness (including relations and performance management). Those key areas are making top companies to be distinctive in process management, which automatically leads to increased market share and net income.

Usually the advancement of financial performance by HR is driven by decreased employee life cycle costs, effective HR strategic plan, process management and outperformed performance measurement. According to Geary Rummler and Alan Brache (1990) "without performance measurement we cannot see expectations, know the matters inside organization, analyze gaps, provide feedback, reward and support decisions". Hence, we may conclude that if organization (CEO) doesn't know how to measure the human capital by using scorecard, which generates great value on outcomes, it cannot be managed.

In 21<sup>st</sup> century, the top priority of executives should be excellence in execution and growth initiative, rather cost reduction and technological innovation. Company mission and values should be focused on creating value and strong human capital leverage. Contribution of human resources in overall strategic goals is inevitably necessary, as it directly correlates with future feasibility and general costs. There is no doubt that each CEO, during his/her execution (no matter the difference in vision or personal attitudes) wants to create a brand from existing organizational resources and place the company at the top of the market. Without contribution of human resources, none of the expression of brand, such as stability, quality, innovation or service would be achieved. Company executive should clearly define how the brand would be expressed and accordingly how the human resources would act? It is important to ensure that all organizational assets, including human assets are oriented to serve for enterprise goals. It is common, that after outlining the strategy, mission and values, executives are starting their performance by targeting on increase shareholders investments. If we follow the extreme view of Milton Friedman (1970) about scope of business responsibility, he sees maximization of profit for shareholders as the only moral responsibility of a business, but we can clearly see the difference between increased profit and creating value. One is the outcome of some inputs, and second is the importance of those inputs. By targeting on effectiveness of inputs,

in our case on employees, assigning them personal performance targets and alignment with strategic goals, finally organization gets outputs, which are creating value. Hence, the primary action of executives should be ensuring that all organizational resources are aligned with strategic goals and business needs. Assess whether the existing human workforce is acting accordingly as the brand promise and evaluate how successful it is met and achieved. Hence, we will proceed to design a system of measurement that outlines those necessary connections.

The first step is to develop financial ratios to formulate connection between human resources and financial results. The basic combinations include: operating cost, revenue, pay, profit and employees benefits from bottom to high level. Inputs of human resources aspects are taken to draw up financial performance. Direct variables which are affecting on productivity, customer service and product are operating variables, such as remuneration, staffing strategies, trainings, turnover rates and etc. But we cannot deny the influence of indirect variables in finished goods. For that reason, we will suggest a system that will connect human resources performance and financial results closer. In general, financial results are calculated separately and only few paragraphs are dedicated to evaluate human resources performance (example: revenue per employee cost of educational programs, etc). In those financial results we don't see the effects and human capital efforts. In other words, the relationship between investment in human capital to corporate financial results. "When we are looking at metrics, we are looking at result, not a cause. So, we need to add human capital analytics to the list of delivery systems." (Fitz-Enz, 2001, p. 40). The evaluation of human capital should be as basic activity as calculating revenue or expenses. Unfortunately, those numbers are not talking about from which business unit or functions they derived and how the human capital affected on those numbers. Who can assess primary drivers of final results? Maybe it was outcome of outstanding work of human resources, or due to price reduction, maybe affects of marketing campaign or increased customer loyalty. The list of possible factors would be never ending. The aim is to find causes and separate metrics to see what was driver of the result. In our case, assess the human capital effectiveness, as considerable amount of money are invested in there (remunerations, training and educational expenses, bonuses, quality topics, etc) and it is vital to see the how it has affected on overall financial results. If the organizational goals are the most important among business units and human capital, the value can be added. The human, financial and market goals should be interdependent and moving together. Kromling (1993) Goals are achieved through actions of human resources and all other variables are not valuable until applied by people. For this, the appropriate strategic level metrics of human resources functionality

evaluation and monitoring human capital effects on business unit goals are needed.

Donald Kirkpatrick (1994) has developed a concept of calculating HCS in human resources. At first level he evaluated the reaction and satisfaction of participants involved in HR programs. Then, skills, knowledge or attitude changes are measure related to HR program implementation. On third level he suggested to measure changes in behavior on the job and evaluates business impact changes related to HR initiative. At final stage, the actual HCS metric is presented to compare monetary value of business impact with costs of the HR program (Benefit/cost ratio %).

The thoughts of Kirkpatrick was mainly focused on evaluation of training and educational programs, but as the organizations were developing and human being was becoming inevitable part of the processes, more comprehensive and advanced metric was needed to gather more different sources for developing measures. Wyner W.E (1996) through employee surveys has added to the concept of calculating HCS in human resources basic performance measurements such as turnover rate, benefit package, remuneration rate and hourly rate payment to express human resources contribution in numbers. Lately, Pauly D (1997) has transformed existing theory into more practical tool by assuming the human resources existence in organization as a new profit center. He implemented coefficient approach to the employees, such as number of years worked, educational background, organizational and technical skills to weight the actual cost of human capital, which company owned. This method was comprehensive and needful, but the existence of scaling involved too many personal attitudes and bias, so it wasn't widely accepted by organizations. The existing human performance reporting system, which nowadays is accepted by organizations, was implemented by Jac Fitz-Enz (2000) and due to its multidimensionality is commonly used by executives and HR professionals. Gary Hamel claimed that the key point of HCS process is to understand what factors should be selected before valuing and this hypothesis has been outstandingly transformed into tangible metric by Jac Fitz-Enz.

### *Human Capital Scorecard*

Research has confirmed that, those managers who are using balanced approach to human resources and capital management; they surpass value oriented managers and decrease the managerial barriers. This concept was developed by W. Edwards Deming (1990). Lately, in 1996, the formulation of long-time surveys, methods and concepts has been transferred into practical approach by Robert Kaplan and David Norton and as a result we got the balanced scorecard approach. Till now, it is popular man-

agement tool for monitoring strategic goals execution. Over a time, it has transformed into strategic map and released from standard financial practices fetters. Key challenge became sustainable growth and learning, which was directly affected on business processes, customer satisfaction and financial performance.

Creation of The balanced Scorecard gave opportunity to transform the concept as a human capital valuation interpretation. The creation of HCS was the outcome of total ignorance of human factors in basic accounting system. From my point of view, modern managers now realize that standard accounting system is no longer representing sufficient data, by which the organization might be managed successfully. Increased level of competition, sustainable growth and continuous change has become key challenge for 21<sup>st</sup> century business organizations. It has lead to the formation of new key indicators and metrics, which will enable top managers to measure even intangible assets and processes within organization.

As we are targeting on human capital measurement indicators, the widely used balanced scorecard should be transformed into human capital scorecard, where the synthesis of financial and human performance will be matched. Table is divided into two separate sides, according to the time of impact and effect on financial performance of the organization.

Table 3: Human capital Scorecard. Source: Jac Fitz-Enz (2009: 61)

| Immediate impact on Financial Performance  | Deferred effect on Financial Performance  |
|--|---|
| <p><b>Human Capital Revenue</b><br/><i>Revenue divided by FTE</i></p> <p><b>Human Capital Cost</b><br/><i>Cost of pay, absence, turnover, contingents</i></p> <p><b>Human Capital HCS</b><br/><i>Revenue – (expense- total labor cost)/ total Labor cost</i></p> <p><b>Human Capital Value Added</b><br/><i>Revenue – (expense- total labor cost)/ FTEs</i></p> <p><b>Human Economic Value added</b><br/><i>Net operating profit after tax – Cost of capital/FTEs</i></p> <p><b>Human capital Market Value</b><br/><i>Market Value – Book value/FTEs</i></p> | <p><b>Exempt Percentage</b><br/><i>Number of exempt FTEs as a percentage of total FTEs</i></p> <p><b>Contingent Percentage</b><br/><i>Number of contingent FTEs as a percentage of total FTEs</i></p> <p><b>Accession Rate</b><br/><i>Replacement hires and hires for new positions as a percentage of the workforce</i></p> <p><b>Separation (Loss) Rate</b><br/><i>Voluntary and involuntary separations as a percentage of head count</i></p> <p><b>Total labor Cost Revenue Percentage</b><br/><i>All labor costs as a percentage of total revenue</i></p> <p><b>Employee Development investment</b><br/><i>Cost of all training and development as a percentage of payroll</i></p> |

The list of financial and human performances should be enhanced by adding growth section or HCS in workforce development. Norton made a brilliant definition of balanced scorecard, which has distinguished its functionally form other business performance measurements. He claimed that the BS was story teller about organizational strategy, rather simple set of measurement metrics. The challenge of 21<sup>st</sup> century managers is to unify the quantitative and qualitative data as a coherent reference set. Of course the qualitative data would not be used for everyday purposes, like quantitative (costs, sales, production), but qualitative aspects should be properly monitored for measuring the corporate culture balance. Benchmark the movement of qualitative indicators to quantitative and if the parallel is visible, that it should be harmonized. As much advanced would be the synthesis of financial and human performance, more strongly executives will become intimately linked with. This is a matter of experience and time. Key point of this measurement is to feel the things, which has not been seen before. Metrics should not be used for getting numbers and putting it into financial statements, it should talk about performance, productivity, change needs and contribution. It should indicate about probable danger and opportunity to develop. This is the true successful approach towards organization as a whole.

According to Gerard Blokdiik (2008), the human capital measurements should be included in financial reports, as they are most important resources of the organization and HC cost can occupy up to 40% of revenue. Simplistic methods for calculating human contribution are decrepit. Modern management followers must view the human capital as an investment of organization rather cost and more advanced tools should be invented for measuring their influence and contribution towards organizational performance.

The human resources capital evaluation need has been created, while companies start dealing with internal and external factors more effectively. It is important for every single top manager in Georgia to know the capacity of its human capital, what they need, what they can handle, how to use them in best manner and what the outcome should look like, especially in times of economic fluctuations, which happens in common on local business market. The problem is that most top executives are looking at human resources as to respond timely on their request and assist in times of trouble, without considering that the 30 to 60% of sales revenue is spent on labor cost. Giving such significant number of expenditures, it is becoming clearer why the profitability of valuable HR should be measured. Once it is achieved, the next step of cost reduction, increased productivity and net income follows with organizational processes. Unification of tangible and intangible assets brings more powerful indicator for maximizing the shareholders value and brand recognition. Once the volume of HR output and input increases, cost of

hiring decreases, people acquire new skills and knowledge which adds value, those issues directly affects on factors such as: customer satisfaction, quality, reduced production or service costs, improved market reputation, ROI, unit cost, happier customers, saved marketing expenses for obtaining new customer, increased profit margin and human capital assets.

### *Application process*

The creation of best processes or solutions is the result of successful respond to the particular problem. This single solution might become well-known key or method to success, but the most crucial aspect in using secondary method is the benchmarking danger. It is common that the widespread solution is not working or being used properly by organization and one day, managers might discover that the processes and strategy are no longer working towards achieving common goal. This is the reason of copying one's successful solution to another organizational practice, without application on situations and not taking into consideration organizational characteristic. Hence, we can conclude that one's successful method or solution does not automatically apply to other circumstances or companies.

We have outlined the key concepts regarding to the importance of human capital in organizations, impact on strategic goals and metrics that are used to measure HR contribution. Now we have come to the part that is the most crucial: *it is how to apply human capital scorecard on existing business processes and how to monitor its impact on overall performance?* This can be achieved by four-step process, which calls: process value analysis. The first step involves situation analysis, which strives to identify business problem in four key areas: quality, service, productivity and innovation. Second step is – intervention, which involves identifying problem and possible barriers for implementation of the best solution. Third step called impact focuses on change management, how the solution has changed business processes and what positive/negative impact does it brought. Last and foremost vital point is value analysis, as it strives to identify the internal and external effects on quality, service, productivity and innovation. If the executive level manager realizes that human capital can play a giant role in improving overall performance and business processes, than it cannot be difficult to see and feel the value added at the end.

Table 4: Metrics for process evaluation. Source: Jac Fitz-Enz (2009:99)

|  |  |
|--|--|
| <p style="text-align: center;"><b>Administration</b></p> <ul style="list-style-type: none"> <li>• Administrative costs as a % of sales</li> <li>• % of topics completed in top-iced time and budget</li> <li>• Internal customer satisfaction level</li> <li>• Outsourcing cost/benefit</li> <li>• Average topic response time</li> </ul> <p style="text-align: center;"><b>Safety and Security</b></p> <ul style="list-style-type: none"> <li>• Rates of security incidents</li> <li>• Safety and security costs as % of sales</li> <li>• Level of lost days</li> <li>• Accident rates</li> <li>• Worker compensation costs</li> </ul> <p style="text-align: center;"><b>Facilities</b></p> <ul style="list-style-type: none"> <li>• Employee complaint level</li> <li>• Recycling %</li> <li>• Maintenance cost as a % of</li> </ul> | <p style="text-align: center;"><b>Customer Service</b></p> <ul style="list-style-type: none"> <li>• Service Cost as a % of sales</li> <li>• Service unit cost</li> <li>• Customer satisfaction level</li> <li>• Mean time to respond and repair</li> </ul> <p style="text-align: center;"><b>Marketing</b></p> <ul style="list-style-type: none"> <li>• Marketing cost as a % of sales</li> <li>• Advertising cost as a % of sales</li> <li>• Sales administration cost as a % of sales</li> <li>• Distribution cost as a % of sales</li> </ul> <p style="text-align: center;"><b>Purchasing</b></p> <ul style="list-style-type: none"> <li>• Inventory cost</li> <li>• Purchasing cost as a % of sales</li> <li>• Average time and cost to process</li> </ul> |
|--|--|

### *Index Value and Application*

Having human capital financial index means to acquire a value of understanding the real picture of human resources usefulness in company. By using the HR scorecard, managers are able to determine what has affected the trend and forecast the future. This leads to more successful plan for obtaining increased revenues. If one third of Georgian organizations had used HEVA (human economic value-added index) for assessing the value of human resources against technology and equipment, the economic environment could have been more sustainable. All of modern business companies in Georgia are striving to follow the trend of XXI century – computerizing the employees, but none of them are measuring properly the productivity of their actions/investment. Executive level managers must understand that by equipping the business with state of art technology and spending huge capital, does not guarantee the productivity. If the process improvement or failure is not assessed, the economic value will not be added to strategic moves.

The important questions managerial level should ask in the index application process are:

- What was the key factor to sales/service income?
- Ratio of investment in technology and convenience to people?
- How the investment improved productivity?
- Was there any tangible effects?
- Is company supporting competition for increasing human resources productivity?
- Is outsourced and regular knowledge of employees managed?
- What is the average salary of employees?
- How does the remuneration is increased according to the growth of revenue or
- Correlation with industry or competitor companies
- Ratio of benefits to payroll
- Turnover of absenteeism and human resources
- Profit per employee
- Ratio of Profit per employee and revenue per employee
- Comparison of economic value added (EVA) with competitors



If answers on those questions are provided, effective future planning can be done.

All of those above written measures are processes, which involves people. The impact and contribution of employees should be outlined, analyzed, fixed and given the opportunity to add value on existing business processes. The most intangible and unseen asset of business processes are human related. Financial department can give a figure, which indicates current financial performance of business in terms of financial metrics, but can Georgian HR managers give the same figures regarding to the human resources metrics and outline their contribution towards achieving the positive or negative results? Most of Georgian executives are thinking that if company is running well financially, this is the cause of new technology or increased budget on advertising. Once the processes fails, which results in lost customers, employee dissatisfaction or manufacturing delay, nobody knows exact percentage of HR contribution in that circumstances, what, when, where and how they have affected on it. Organization comprises from processes, which are key engine of business units and due to its complex nature, it is difficult to manage. In order to identify better ways for managing them modern manager must look from three dimensions (strategic, operational and task) Peter Keen (1997). Processes are consumers of resources and the economic value added must be measured in order to outline the worth of processes. Effective process measurement is the outcome of continuous improvements Chris Ashton (1997). Process improvement is not a dogma, it has its own values, when something is done it causes effect. When company increases the output from the same input, it leads to cost reduction, when the satisfaction level of customers is increasing, the percentage of sales is increasing, when company saves time, it saves money, etc. Indivisible part of process optimization is human resources contribution and qualitative/quantitative effect of human capital investment is converted into financial and market value.

We all see that without human being none of the function of organization would have worked, even atomized business units. Value is inside employees and every time organization find values added, it ought to know: How the employees added value - by improving performance via personal inputs/trainings or leveraging the tools given by organization? After applying human capital scorecard tool, the answer becomes apparent. By describing the ongoing processes of organization, indicating the source of the problem and finding solution for it, it becomes clear that human capital is primary profit crowbar and their impact is no longer puzzling task.

## **Tourism Policy and Strategy: Developmental Trends of Tourism of Georgia**

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*The economic policy of tourism of Georgia must be based on the theoretical foundations of economics and tourism development. The tourist market must be competitive, i.e. it must be maximally free, and the legislation must be oriented toward the protection of the competitive market. The tourist market development must be ensured at the expense of small business development in the first instance. For the tourist industry of Georgia to develop, the tourist product production technology (production culture) should be developed.*

*The policy of tourism development of Georgia must be oriented toward the regulation and promotion of tourism education system and innovations. Establishment of the innovative environment in the country is possible only in terms of vast scientific potential and state support.*

*The policy of tourism development must ensure the right view of the branch development, i.e. national traditions, values and trends so that to make tourism, as an interbranch complex, the basis for the economic development in the country.*

### *Introduction*

Travel & Tourism is one of the world's leading industries, or economic sectors, representing a major source of GDP, employment, exports and taxes. In 2011, the World Travel & Tourism Council (WTTC) expects it to contribute almost US\$6 trillion to the global economy, or 9% of global gross domestic product (GDP).

The rapid rise in global demand for Travel & Tourism over the past few decades has been spurred by the rise in living standards, in turn fuelled by growing wealth, coupled with the increased affordability of air travel. According to the World Tourism Organization (UNWTO), international arrivals worldwide have more than doubled since 1990, rising from 435 million to 675 million in 2000, and to 940 million in 2010. And these figures do not take account of domestic tourism which, by all accounts, generates up to ten times more arrivals than international tourism.

The impacts of Travel & Tourism run deep into our economies. It is not just about the money visitors spend on travel, accommodation, activities and souvenirs – visitor exports – which, in 2011, was US\$1.2 trillion around the world. But, by its very nature, the industry stimulates the engagement and collaboration of communities, tourists, governments, local suppliers and businesses throughout the supply chain. And the 260 million estimated people around the world whose jobs are supported by Travel & Tourism (100 million of whom work directly in the industry) all spend a proportion of their own income on goods and services from all parts of the economy.

Furthermore, demand for Travel & Tourism – both international and domestic – stimulates investment. In 2011 4.5% of total capital investment, or some US\$650 billion, will be driven by Travel & Tourism.

Travel & Tourism is one of the world’s largest industries accounting for 9% of global GDP. This is more than the automotive industry which accounts for 8.5%, and only slightly less than the banking sector which accounts for 11%.

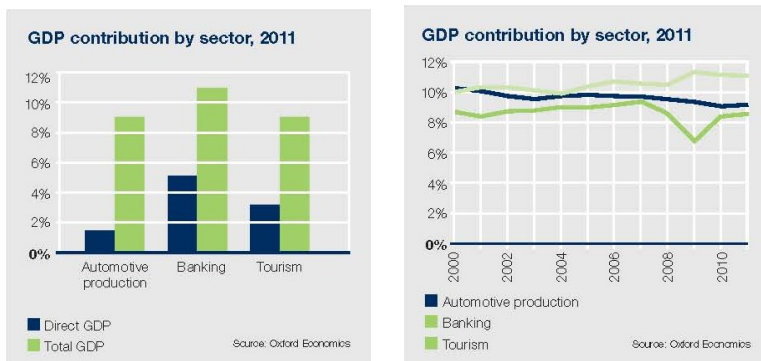


Figure 1. GDP contribution by Sector

([http://www.wttc.org/site\\_media/uploads/downloads/traveltourism2011.pdf](http://www.wttc.org/site_media/uploads/downloads/traveltourism2011.pdf))

More significantly, while the last ten years have seen strong global growth helped by a rising share of the fast-growing high-tech industry, as well as rapid growth in service sectors such as banking and global finance, the next ten years are forecast to see a slower performance from these sectors. Continued growth in Travel & Tourism will therefore result in an increase in the sector’s relative share of GDP. Travel & Tourism will become more important to the global economy over the next years.

WTTC’s latest Economic Impact Research shows that world Travel & Tourism continues to grow in spite of continuing economic challenges (WTTC, 2012).

- Despite progressive downgrades to growth forecasts through 2011, the industry grew by 3% over the course of the year (in terms of Travel & Tourism’s contribution to GDP).

- Tourism's direct contribution to GDP in 2011 was US \$2 trillion and the industry generated 98 million jobs.
- Taking account of its direct, indirect and induced impacts, Travel & Tourism's total contribution in 2011 was US\$ 6.3 trillion in GDP, 255 million jobs, US\$743 billion in investment and US\$1.2 trillion in exports. This contribution represented 9% of GDP, 1 in 12 jobs, 5% of investment and 5% of exports.
- Growth forecasts for 2012, although lower than anticipated a year ago, are still positive at 2.8% in terms of the industry's contribution to GDP.
- Longer-term prospects are even more positive with annual growth forecast to be 4.2% over the ten years to 2022.

Many countries have included the tourism development within the limits of the policy and strategy of economic development of the country, as its integral part. The developmental strategy implies planning the branch development at every level so that it should discharge its functions effectively. This means that besides meeting the tourists' needs, the developmental strategy implies employing the tourism to bring economic and social benefit to the destinations (places of destinations, tourist centres) and bring the ecological and social-economic impact to minimum.

The practice has demonstrated that where tourism was developed without any planning and control, the destinations faced not only a number of ecological and social problems, but after some time they found it difficult to attract tourists.

The development of tourism at the modern stage is characterized by the differentiation of the tourist product and growing competition on the tourist market. Under a long-term plan, the competitiveness in tourism is synonymous to the sustainability of the economic development of the branch.

The competitiveness in tourism is, first of all, defined by economic efficiency and high profitability of the branch. If the tourism of the country fails to make an economic contribution to the preservation of the natural resources and cultural heritage and solution to the social problems, its development will be unstable over a long period of time.

A great volume of tourism activity based on the sustainable development is associated with the preservation of the cultural uniqueness of the nature, historical heritage and relevant territory. If the state of the mentioned resources deteriorates or the resources are destroyed, the tourist regions will be unable to attract tourists and the tourism therefore, will fail to discharge its function.

Tourism, as an integrated system has an increasing influence on the sustainable development of the society, improvement of the economic state and meeting spiritual needs. As the social-economic category, tour-

ism is a universally recognized sector of the world economy and a leader in the trade of international service.

The analysis of the economic, legal and organizational factors of the operation of the tourism branch, evaluation of its developmental peculiarities and trends and determination of its role in the country's economy has a special importance for the development of the national economy. A set of economic activities of tourism may be subject to analysis. For the economy of individual countries tourism is a significant source of foreign currency flow. In the countries with the developed tourist industry, the increase in the role of the input tourism creates the trend limiting the balance of payments deficit.

At Johannesburg Summit 2002 (the World Summit on Sustainable Development), tourism was officially included in the process of sustainable development of the world economy. Tourism, as a branch, makes a significant contribution to the UNO General Assembly "Millennium Development" world action plan 'Sustainable Development – Overcome of Poverty'.

By now, governments of many countries of the world, including that of Georgia have recognized the tourism as a priority sector in the development of the national economy, which should realize extremely important objectives of the social-economic progress of the country.

### *Tourism Policy: Developmental Trends of Tourism of Georgia Background*

The development of tourism in Georgia is generally promoted by Georgian traditions, national and folk customs and traditions, great experience in hospitality; diversity of religious and historical monuments, attractive wild nature less succumbed to the civilization. The unique landscape of the Caucasioni, snowy peaks, Subtropical climate of the Black Sea, open valleys and high mountains are important factors to attract tourists.

The climatic factors are formed by moderate, wet and dry climate of the Mediterranean shore on the one hand and by Continental Caspian Sea basin, on the other hand. The climate in West Georgia is mostly wet and Subtropical and it is transient from Subtropical to moderate in East Georgia. The average air temperature in January is +3°C to -2°C, and that in August is +23°C to +26°C. The annual precipitations in West Georgia, which borders the Black Sea, are 1000-2800 mm, and 300-600 mm in East Georgia.

For such countries as Georgia is, tourism and resorts are closely interwoven. Every tourist route runs across a resort or resort zone. Similarly, resting, curing or health improvement on any resort seems impossible

without cultural-cognitive, nature awareness or other trends of tourism (Metreveli and Timothy, 2010).

The tourist potential of Georgia, by considering the natural, geographical and climatic conditions is determined by:

- (1) Black Sea coastline, with its length of 318 km along the country.
- (2) Greater and Smaller Caucasioni (Caucasus) Ranges, stretched from the Black Sea to the Caspian Sea with the length of 1.500 km. The mountainous region of Georgia creates extremely favourable conditions for the development of downhill skiing tourism and alpinism in the country. The Greater Caucasioni contains the peaks with the height of 4.000 meters.
- (3) Resorts and recreational sites. The rivers of Georgia belong to the basins of the Black Sea or Caspian Sea and the vegetation cover of the country is rich. The forests occupy more than 1/3 of the whole territory of the country. The broad-leaved forest (oak, hornbeam, beech and others) grows in the lower zone and coniferous trees (fir tree, spruce) grow in the upper zone, with the pine-tree forests growing in high mountains. Alpine meadows grow above 1800 meters. There are reserves created to protect flora and fauna on the territory of the country.

According to the health resort and recreational resources, there are 6 zones identified in the country:

- (1) Seashore health-resort zone (Georgia has 315-km-long seashore). There are wonderful climatic resorts located along the seashore – Gagra, Bichvinta, New Athos, Gudauta, Sukhumi in Abkhazia; Batumi, Kobuleti, Makhinjauri, Green Cape in Adjara; Ureki in Guria; Maltakva, Paliastomi in Megrelia. The bathing season in these resorts lasts for 5-6 months per annum.
- (2) Balneotherapeutic health resorts at 700 m above sea level (Nabeghlavi, Akhtala (412 m), Nunisi, Tskaltubo, Zvare, etc.).
- (3) Balneoclimatic resorts at 700-1000 m above sea level (Sairme (950 m), Surami (800 m), Borjomi (850 m), Betania (900 m), Utsera and others).
- (4) Mountain-climatic resorts within the range of 1000-1500 m above sea level (Abastumani (1500 m), Kojori (1400 m), Manglisi (1200 m), Tsaghveri and others).
- (5) Zone of mountain-climatic resorts and mountain-tourist routes at 1500-2000 m above sea level (Bakuriani (1700 m), Shovi (1600 m), Bakhmaro (2000 m), Lebarde, Gudauri and others).
- (6) Zone of mountain tourism and alpinism over 2000 m above sea level.

Until 1990, the basis for tourism in Georgia was mostly mineral waters and therapeutic course during one's leave. This was the time when Georgia hosted up to 4 million tourists. Tourism operated by the state means of tourists' accommodation and hotels and guesthouses owned by

the trade union. The tourist flows were organized around the year in a centralized manner (in Moscow). Tourist flowed to all mineral water and therapeutic resorts in a proportionate manner. Tourist trips to Georgia mainly implied having a rest and recreation on the health resorts.

The famous events of Georgia at the beginning of the 1990s and generally, instable political environment in the country have drastically reduced the number of foreign visits to Georgia. Such state of affairs led to the unfavorable surroundings for the development of the branch of tourism. The given surroundings caused drastic changes in tourist products and markets; the form and essence of domestic tourism changed, and the domestic tourism was now controlled by market principles, with two types of dominant tourist products: 1. Summer recreation at the Black Sea side or in mountain resorts (e.g. Borjomi, Bakuriani, Abastumani, Bakhmaro, etc.) and 2) winter recreation in Bakuriani or Gudauri. One more tourist product, the medical tourism lost most of its function. In this period, the principal reason for limiting the domestic tourism was the fall in the purchasing capacity of domestic consumers of tourist products and lack of social insurance state programs.

Mostly so called "adventure tours" and "cultural tours" were offered on the international tourist markets. The tours (walking tours, mountain, environmental and nature familiarization tours and special-thematic itineraries) covered most of the territory of Georgia and were mostly organized with the similar programs offered by Azerbaijan and Armenia, i.e. as group or organized tours.

The lack of competitiveness of the Georgian tourist product was the result of poor service and high prices (this trend was maintained until 2011). At present, the Georgian tourist product is being transformed what in the near future must boost its competitiveness on the tourist markets of the neighboring and foreign countries. So far, the competitiveness of Turkish and Romanian touristic products is mainly the result of relatively low prices of air tickets and high-quality service (Metreveli, 2011).

### *Developmental Trends of Tourism of Georgia*

Since 2004, the process to implement the promotional measures for Georgia, as a touristic country, and for Georgian tourist product has been activated. To date, an important obstruction for the tourist market growth has been inexpedient and inconsistent advertising strategy for tourism and measures of tourism promotion, as well as lack of identification of the country, as a tourist destination, abroad. This explains the few number of the market segments in foreign countries penetrated by Georgian tourist products before 2011.

Since 2004, due to the economic and political stabilization in Georgia, private property legalization, activation of non-governmental and public organizations, significant strengthening of the international bonds and reformative legislation the signs of revitalization of tourist and recreational infrastructure have been seen in the country.

The year of 2008 was marked with the onset of intense construction of reliable road and transport infrastructure in the country. This facilitates and reduces the journey time to the cultural, historical and ethnographic monuments of Georgia with respective reduction in tour prices.

Recently, the large-scale investments in the tourist industry have been intense, in particular the Georgian-Turkish company "TAU-URBAN-GEORGIA" invested 62 million USD to build Tbilisi Airport and 28,5 million USD for Batumi Airport. It should be noted that new Tbilisi Airport is for 2000 passengers an hour and Batumi Airport is designed for 500 passengers an hour what is a favorable indicator to meet the present demand in the country.

Israeli investment company NOVOMANAGEMENT GEORGIA invested 17 million USD to build Bazaleti complex and Youth Center in Tbilisi. The complex is designed to serve 2000 tourists at the same time. Besides, rehabilitation works were accomplished in Mtkheta and tourist infrastructure is being built in new winter resorts (in Svaneti, Ajara), etc.

From 2007 to present, major brands of the world's hotel networks operate in Ajara region. It should be noted that in 2010, Ajara region hosted 85% of the foreign tourists visiting Georgia.

As per the information of the Border Control Department, the number of visitors in Georgia in 2000 was 373 746; in 2003, 301 051 people visited Georgia and in 2004, the country had 364 512 visitors. In 2005, 559 427 people visited the country; 762 193 (in 2006), 1 05 036 (in 2007), 1 288 039 (in 2008), 1 497 415 (in 2009) and the number of tourists was 2 029 447 in 2010. The number of visits to Georgia in 2000-2010 increased by 5.4 and the share of tourism in the country GDP was 3,92% in 2006, 4,10% in 2007, 3,72% in 2008 and 4% in 2009, 2010, 2011. The number of tourists in Georgia in 2011 was 2 819 144 marked by 39% increase as compared to the previous year.



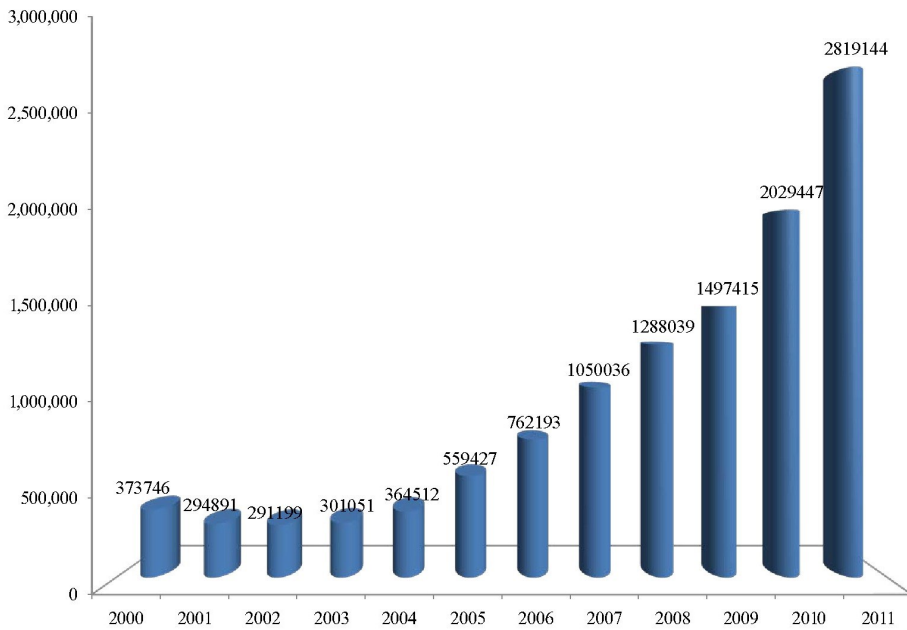


Figure 2. Number of incoming tourists in Georgia (Border Control Department of Georgia, 2011)

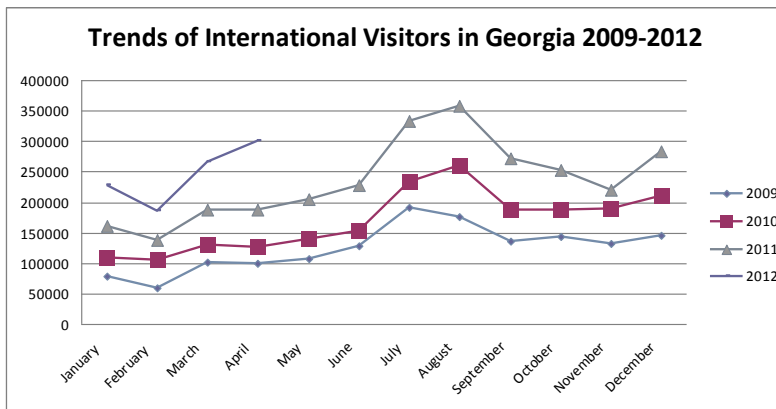


Figure 3. Trends of International Visitors in Georgia 2009-2012 (National Tourism Administration of Ministry of Economy and Sustainable Development of Georgia, 2012)

*Table 1. Arrivals of non-resident visitors at national borders of Georgia by country of citizenship (2012)  
(Information Centre, Information and Analytical Department, Ministry of Internal Affairs of Georgia)*

| Country                       | 2000   | 2005   | 2006   | 2007    | 2008    | 2009        | 2010    | 2011    | change<br>10-11 | change%<br>10-11 |
|-------------------------------|--------|--------|--------|---------|---------|-------------|---------|---------|-----------------|------------------|
| <b>Total</b>                  | 387258 | 560021 | 763231 | 1051749 | 1290108 | 150004<br>9 | 2031717 | 2822363 | 790646          | 39               |
| <b>EUROPE</b>                 | 347346 | 533127 | 726873 | 1009248 | 1243407 | 144749<br>6 | 1956128 | 2695235 | 739107          | 38               |
| <b>AMERICAS</b>               | 10789  | 14842  | 14766  | 16881   | 17552   | 19653       | 24416   | 29286   | 4870            | 20               |
| <b>EAST ASIA/<br/>PACIFIC</b> | 7145   | 3413   | 10447  | 9661    | 9733    | 11355       | 14394   | 19613   | 5219            | 36               |
| <b>MIDDLE<br/>EAST</b>        | 2152   | 973    | 1515   | 2490    | 3245    | 3298        | 3413    | 5663    | 2250            | 66               |
| <b>SOUTH ASIA</b>             | 6058   | 6641   | 8037   | 10873   | 13457   | 14572       | 27810   | 66073   | 38263           | 138              |
| <b>AFRICA</b>                 | 256    | 431    | 555    | 883     | 645     | 1041        | 2869    | 3799    | 930             | 32               |
| <b>CIS Total</b>              | 221671 | 366054 | 498795 | 655742  | 784511  | 950751      | 1286148 | 1787666 | 501518          | 39               |

|              |       |        |        |        |        |        |        |        |        |     |
|--------------|-------|--------|--------|--------|--------|--------|--------|--------|--------|-----|
| Armenia      | 72169 | 100508 | 180550 | 243133 | 281463 | 351049 | 547510 | 699382 | 151872 | 28  |
| Azerbaijan   | 55193 | 153467 | 198062 | 281629 | 344936 | 418992 | 497969 | 714418 | 216449 | 43  |
| Belarus      | 1193  | 1236   | 1278   | 1601   | 1981   | 2503   | 5016   | 5344   | 328    | 7   |
| Kazakhstan   | 1579  | 2825   | 3393   | 5098   | 4523   | 5531   | 8411   | 18565  | 10154  | 121 |
| Kyrgyzstan   | 407   | 1546   | 1328   | 736    | 787    | 1107   | 2222   | 3183   | 961    | 43  |
| Moldova      | 2905  | 1589   | 1190   | 1185   | 1261   | 1880   | 2390   | 2737   | 347    | 15  |
| Russia       | 64688 | 90277  | 88538  | 91361  | 114459 | 127937 | 170584 | 278458 | 107874 | 63  |
| Tajikistan   | 175   | 267    | 222    | 150    | 194    | 237    | 333    | 540    | 207    | 62  |
| Turkmenistan | 3901  | 729    | 774    | 451    | 468    | 375    | 1287   | 1126   | -161   | -13 |
| Ukraine      | 18098 | 12431  | 22436  | 28932  | 32988  | 39339  | 47596  | 58966  | 11370  | 24  |
| Uzbekistan   | 1363  | 1179   | 1024   | 1466   | 1451   | 1801   | 2830   | 4947   | 2117   | 75  |

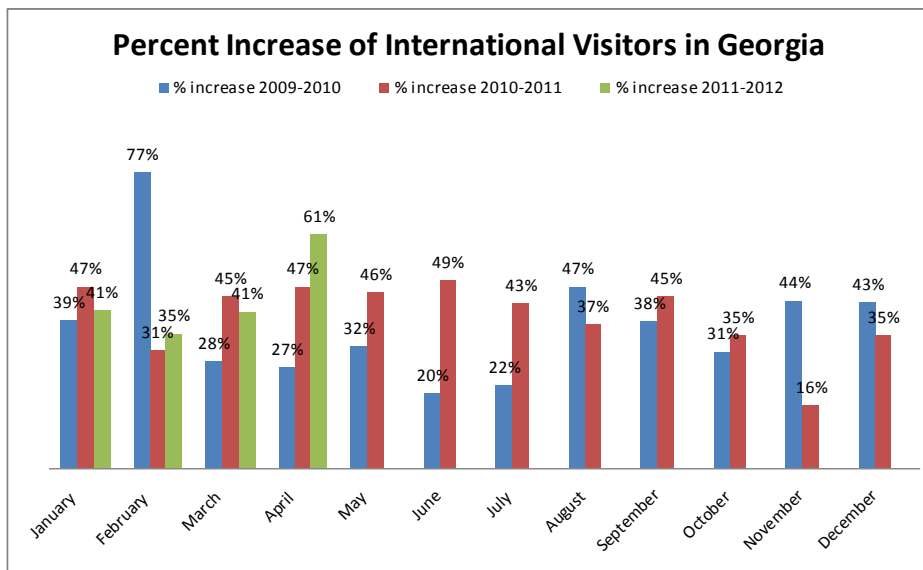


Figure 4. Percent Increase of International Visitors in Georgia (National Tourism Administration of Ministry of Economy and Sustainable Development of Georgia, 2012)

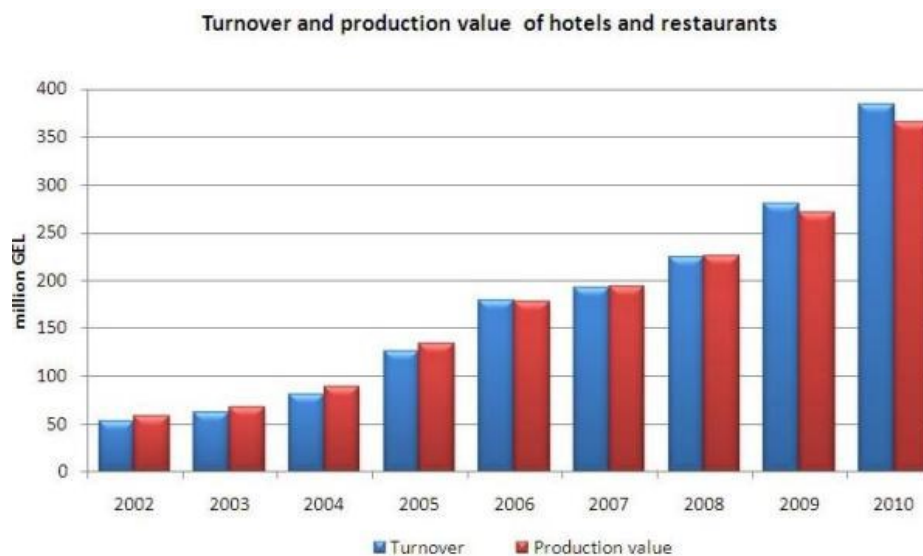


Figure 5. Turnover and Production Value of Hotels and Restaurants (www.geostat.ge)

Table 2. Number and Percent Increase of International Visitors in Georgia 2009-2012 (National Tourism Administration of Ministry of Economy and Sustainable Development of Georgia, 2012)

|                    | January | February | March  | April  | May    | June   | July   | August | Septem. | Octob. | Novem. | Decem. |
|--------------------|---------|----------|--------|--------|--------|--------|--------|--------|---------|--------|--------|--------|
| <b>2009</b>        | 78615   | 59146    | 101760 | 100343 | 106411 | 127729 | 191872 | 176495 | 136035  | 143556 | 131693 | 146394 |
| <b>2010</b>        | 109083  | 104919   | 129920 | 126978 | 140097 | 152835 | 233519 | 259836 | 188067  | 187394 | 189202 | 209867 |
| <b>2011</b>        | 160605  | 137067   | 188163 | 187122 | 204162 | 227915 | 333560 | 357187 | 272128  | 252310 | 219722 | 282422 |
| <b>2012</b>        | 227006  | 185123   | 265149 | 301243 | -      | -      | -      | -      | -       | -      | -      | -      |
| <b>% 2009-2010</b> | 39%     | 77%      | 28%    | 27%    | 32%    | 20%    | 22%    | 47%    | 38%     | 31%    | 44%    | 43%    |
| <b>% 2010-2011</b> | 47%     | 31%      | 45%    | 47%    | 46%    | 49%    | 43%    | 37%    | 45%     | 35%    | 16%    | 35%    |
| <b>% 2011-2012</b> | 41%     | 35%      | 41%    | 61%    | -      | -      | -      | -      | -       | -      | -      | -      |

The non-realistic nature of the above-listed data for many years has been a problem for the tourist executive authority of the country and is problematic when planning the branches of tourist business activity and purposeful realization of the tourist policy in the country. Aiming at solving this problem, in 2010, the National Tourism Agency of the Ministry of Economy and Sustainable Development (together with other interested organizations and experts) started its works to develop the methods to calculate the number of tourists visiting Georgia. As these methods are developed, it will be necessary to develop the methods to estimate other major indicators of the tourist market (share of tourism in the country DGP, number of the industry employees, volume of investments attracted to the branch and budgetary income gained from tourism) what is a necessary condition for specifying the role of tourism in the country economy and drafting the right policy to develop the given branch.

The Department of Business Statistics of the National Statistics Office accomplishes the study for hotels and hotel-type establishments. Following the specifics of the country, the types of accommodation should be specified and the number of visitors should be registered quarterly, as the accommodation facilities are loaded seasonally, particularly in the regions.

Besides, the income from letting hotel rooms is different in different seasons. At present, we do not have such important indicator at hand, as accommodation load index. (See figure 5 on page 132).

The competence of the National Bank of Georgia includes drafting the quarterly tax balance. This document includes the estimation of tourism export (receiving international visitors) and import (costs borne by the citizens of Georgia during their trips in foreign countries). Assessment of the tourism export is important for developing the tourism satellite accounts system. At present, a tourism article is evaluated by using "The shuttle-like study of foreign trade and foreign tourist service" of 2006. Similar studies were conducted in 2000 and 2006. Such a long interval between the studies of foreign travelers may lead to the false evaluation of the amounts spent by them. Moreover, the shuttle-like study of foreign trade and foreign tourist service of 2006 carried out along 10 borders from July to November demonstrated that the costs of foreign travelers significantly vary in different months and seasons.

The statistical study of the Revenue Service of the Ministry of Finance of Georgia is about the budgetary incomes received from tourist companies.

Through 2009, the budgetary incomes received from the tourist companies could be registered according to the types of taxes to the budget. In this way, the hotels, hotels with restaurants, tourist agencies and travel agencies were registered.

Table 3. Hotels and Restaurants ([www.geostat.ge](http://www.geostat.ge))

|   | 2004  | 2005  | 2006  | 2007  | 2008  | 2009  | 2010  | 2011  | 01. 2012 |
|---|-------|-------|-------|-------|-------|-------|-------|-------|----------|
| Turnover, mil GEL                                     | 81.3  | 126.7 | 179.0 | 192.8 | 224.6 | 280.0 | 383.9 | 406.3 | 135.7    |
| Production value, mil GEL                             | 88.3  | 134.6 | 177.4 | 193.5 | 225.7 | 271.5 | 365.6 | 387.1 | 130.5    |
| Value added, mil GEL                                  | 38.4  | 56.7  | 74.8  | 84.1  | 93.7  | 114.3 | 149.9 | ...   | ...      |
| Intermediate consumption, mil GEL                     | 49.9  | 77.9  | 102.6 | 109.4 | 132.0 | 157.2 | 215.7 | ...   | ...      |
| Fixed assets, mil GEL                                 | 232.7 | 309.6 | 222.9 | 186.0 | 379.0 | 591.3 | 646.8 | ...   | ...      |
| Number of employed persons                            | 7920  | 11437 | 11993 | 11554 | 11184 | 13540 | 16106 | 13709 | 22567    |
| Average monthly remuneration of employed persons, GEL | 155.5 | 153.1 | 196.7 | 238.5 | 333.7 | 364.9 | 377.9 | 501.0 | 391.8    |

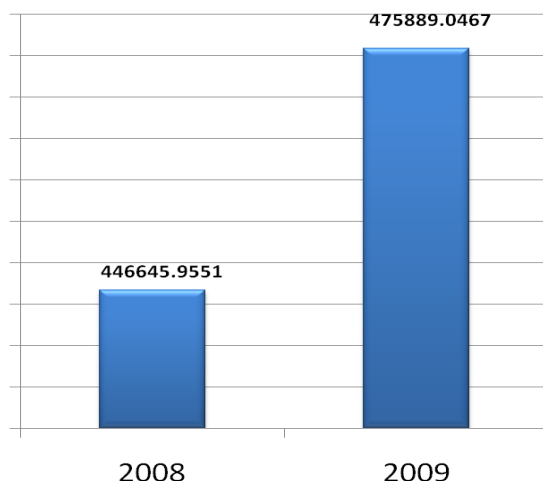


Figure 6. Tourism Share in Total Export (National Bank of Georgia, 2010)

In 2010, the clause about specifying the type of one's economic activity at registration was canceled. Accordingly, the registration of incomes gained from the newly registered companies in the aspect interesting for the branch will become impossible.

The Information-Analytical Department of the Ministry of Internal Affairs of Georgia and Border Control Policy accomplish the study of crossing the border by resident and non-resident citizens and registers the data about crossing the state border of Georgia with the following characteristics: period (year, month, citizenship), movement (entry, exit), border release point, type of transport.

The United Transport Administration of the Ministry of the Regional Development and Infrastructure of Georgia explores the statistics of air trips. It has the Civil Aviation, Road Transport and Marine Transport Departments. The statistics of conveyed passengers is to be perfected at the Road and Marine Transport Departments. In addition, the citizenship of the passengers, types of vehicles used and number of trips are to be specified.

The national museum of Georgia studies the number of the visitors (domestic and foreign) to the museums of the Georgian National Museum; however, the origination of the visitors, i.e. the country of residence is not known.

LEPL Agency of Protected Territories of the Ministry of Environmental Protection of Georgia registers the statistics of visitors to the protected territories.



*Table 4. The Number of Domestic Tourists (%) (Ministry of Economy and Sustainable Development of Georgia, The National Tourism Agency, 2011)*

| Regions  | Achara | Shida Kartli | Kakheti | Imereti | Guria | Kvemo Kartli | Samtskhe javakheti | Samgrelo | Racha | Tbilisi | Aphkhzeti | Svaneti | Pshavi | Tusheti |
|----------|--------|--------------|---------|---------|-------|--------------|--------------------|----------|-------|---------|-----------|---------|--------|---------|
| Number % | 24,3   | 23,6         | 17,7    | 17,3    | 9,5   | 8,0          | 7,7                | 7,7      | 4,4   | 3,6     | 2,2       | 0,9     | 0,6    | 0,1     |

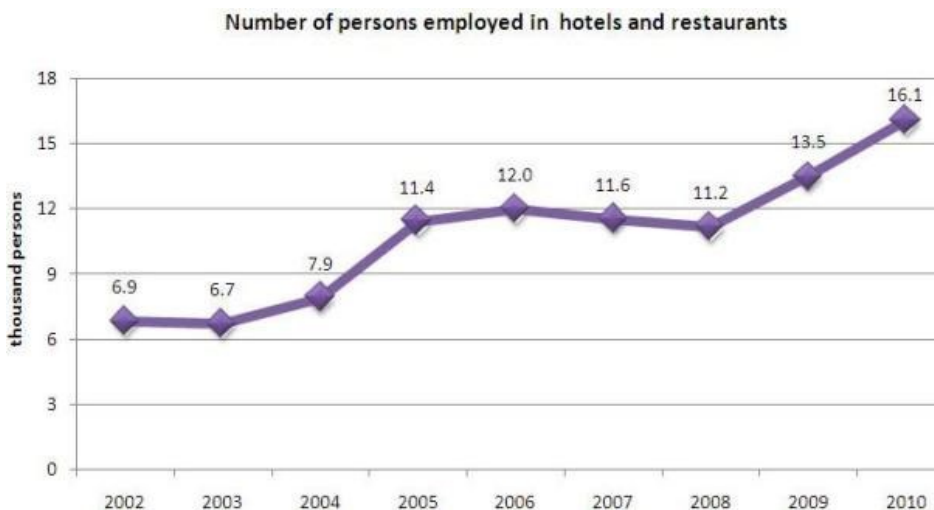
On the order of the National Tourism Agency, in 2010, a study about the problems of tourism development in the regions of the country was accomplished by BGG RESEARCH. On the order of the National Tourism

Agency of the Ministry of Economy and Sustainable Development of Georgia, the study aimed at revealing the interest of Tbilisi population (3382 respondents) in domestic trips.

For the accuracy and reliability of the above-given data, the study of the international trips is desirable to accomplish jointly by the National Tourism Agency of the Ministry of Economy and Sustainable Development of Georgia, National Statistics Office of Georgia and National Bank of Georgia. Such an initiative will abolish the doubts of whether the full influence of foreign visitors is reflected in the tax balance account and if the basic data are supplied for the development of the tourism satellite accounts. The studies about the international travelers are necessary to carry out four times a year at major border points, as the major trends of the entry of foreign visitors must be shown depending on seasonal changes.

Today the state policy of tourism development in Georgia is oriented on the maintenance of the liberal trend in the sector and supporting investments. The direct foreign investments in the branch of tourism amounted to 132 million USD in 2009. The income gained from tourism in 2004 (147 mln. USD) has almost tripled to amount to 470 mln. USD in 2009.

The tourist industry is a dynamically developing field of trading with international service. The tourist industry is able to employ human



resources in a major part of small business and develop it.

*Figure 7. Number of Persons Employed in Hotels and restaurants  
(www.geostat.ge)*

The development of tourist industry and infrastructure particularly needs the favorable investment environment in the country. The governmental document of Georgia "Principal data and trends of the Georgian government in 2011-2014" says: "Boosting the investment and touristic attractiveness of the country is an important precondition for boosting foreign investments. The measures helping the demonstration of the existing investment and touristic potential of the country on the one hand and creating the new perspectives and promoting the investment flow in different branches of the country's economy on the other hand are necessary to implement at the international level and in the country locally."

Aiming at attracting investors to Georgia and creating favorable investment surroundings in the country, a law "On supporting the development of free tourist zones" was passed. Under the given law, an investor investing 1 million USD for building a hotel on the territories of Kobuleti, Anaklia or Ganmukhuri, 140 m from the sea coastline will receive 0.2 ha of land at a symbolic price of 1 Georgian lari. In addition, such investors are allowed building design documents free of charge. The state undertakes laying the communications and necessary infrastructure to the site. An investor of the building object completed before August 1, 2011 is relieved of income and property taxes for 15 years. It should be noted that a new Anaklia-Zugdidi airport and a yacht club will be built in Anaklia-Zugdidi free tourist zone. The land on these territories given to the investors is situated along the boulevard designed by a Spanish architect.

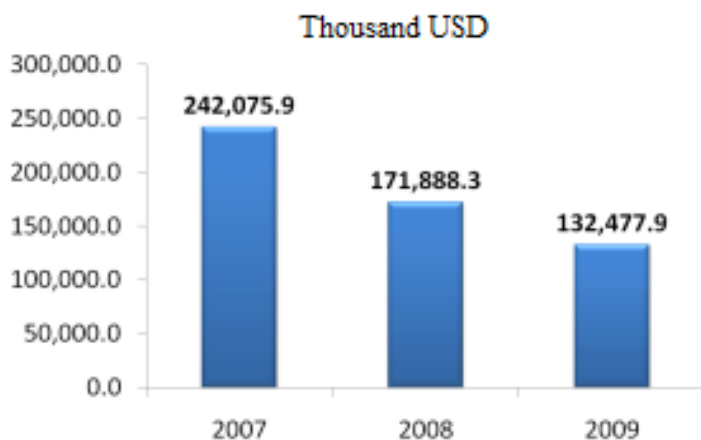
The development of high-mountainous regions in addition to the Black Sea coastline is one of the top priorities for the Georgian government. At the beginning of 2011, they started to construct a ski resort across Goderdzi Pass in Ajara, which will be completed by the end of 2012. The region of Upper Svaneti, which is an attractive site for tourists with its unique nature and ancient historical monuments, deserves a particular attention of the central and local governments.

By the decision of the government, active work is underway to attract investments to develop Mestia. This region has the characteristics typical to only several European countries. In particular, it has a summer skiing track on Ushba plateau (meeting the Olympic standards). In 5 or 6 years' time, ten super ski resorts are planned to build here.

In 2010, Mestia airdrome with interesting development perspectives was built on a magnificent location. The airport is designed for daily flights promoting Mestia and Ushguli to become important tourist centers. In addition, the airport links Svaneti with other regions of Georgia. In 2010, in Hatsvali, Mestia, a cableway was constructed and they started to build ski training school. In 2011, they started to restore an old district of Lanchvali to be finished in 2012. In 2011, the rehabilitation of motor

roads in Mestia and Lanchvali was over; a hostel “Seti” was built (in Seti square, Mestia) and they finished building the hotel “Mestia”, etc.

Before 2010, such famous brands of international hotel networks, as Radisson (4+\*), Intercontinental (5\*), Kempinski (5\*), Hayat (5\*) and Hilton (5\*), were introduced in Georgia. The investments in the hotel business development in Georgia in 2011 exceeded 300 million USD.



*Figure 8. Foreign Direct Investments in Hotel and restaurant business (www.geostat.ge)*

Generally, the tourism development policy in Georgia must be in line with the policy of the country development. The national and regional objectives should be dominant with the local and branch interests subordinate to them. At the given complex stage of development of the country's economy, the right ratio between the price and the quality of tour-products making the product competitive on the domestic market in the first instance is of great importance.

In connection to the above-mentioned, the country government, in terms of the present political and economic situation in the country, considers the development of domestic tourism, creation of such a product for the country's residents and non-residents, which is competitive on domestic and neighboring countries' tourist markets, as one of the priorities for the tourism development.

The development of domestic tourism in the regions of the country is very important to develop international tourism in the country, as the increase of the country's tourism share on the international market much depends on the increase of the local demand. Increased demand for domestic tourism creates favorable conditions to develop international

tourism, as there develop old and emerge are new tourist centers, cultural, accommodation and catering facilities, means of transportation and attractions. Thus, the countries with great demand for domestic tourism are able to meet the international demand, as well. It should be noted that domestic tourism in the developed tourist countries accounts for 80% of the total tourist flow.

In respect of the development of domestic tourism and international tourism for Georgia, stimulating the agricultural tourism, agro-tourism and wine tourism is important. In this respect, the traditional houses (private houses) of the village residents are being prepared to receive local and foreign holiday-makers, and the owners are trained to improve the service quality and skills to represent local sights. In addition, advertising and informational campaigns are realized. Aiming at developing wine tourism and agro-tourism, the network to identify farms is being developed.

Development of medical tourism at climatic health resorts and balneal resorts is one of the most important trends in Georgia in respect of development of domestic as well as international tourism. However, the scales of development of the given type of tourism due to the scarcity of the relevant tourist infrastructure are limited at present.

With the purpose of modernization and rehabilitation of resort infrastructure, they try to get local and international investors interested in the resort factors of Georgia by extensive advertising and promotion of the natural and curative resources of Georgia locally and at the international level.

Following the initial stage, when the tourist centers of the country become relatively popular, the impact of the tourism development on the environment will boost vigorously. The right strategy of tourism development in respect of the environment should ensure relatively harmless ecological environment in the regions of the country than any other branch of economy, as protection of the environment falls within the field of interests of tourism.

As we know, generally, the economics of the developed countries are based on knowledge, and the economic growth is reinforced with studies and inventions, growth of innovative activities and investments to reach the relevant level of education and improve staff qualification.

One of the factors hampering the tourism development in the cities, resorts and tourist centers of Georgia is the poor service quality of the accommodation and catering facilities demonstrated by the Georgian and foreign tourists' impressions.

The poor service quality (non-qualified service personnel, lack of proper technical appliances, failure to observe sanitary and hygienic standards in particular) of guesthouses and family guesthouses in the regions of Georgia is worth particular concern. Periodic consultations for

the hotel and family house owners are important. This would significantly improve the service quality. Another important problem is attendants' and guides' poor professionalism, and training and retraining of the guides specialized in skiing, summer mountaineering, town and other kinds of tourism is much needed.

### *Recommendations*

The Georgian Law "On tourism" should specify the state policy principles to be implemented in the branch directed towards the formation of the legal fundamentals for the single tourist market and regulation of the relations occurring in holidaymaking, traveling, and free movement of the local people, foreign nationals and stateless people and in realization of their other rights. The law should set the conditions of tourists' insurance and safe tourists' movement and rules of tourist product formation and realization, and stimulate the development of touristic companies and tourist infrastructure. Under this law, the state should recognize tourism as one of the priorities in the country's economy, support tourist business and set favorable conditions to develop tourism; specify and support tourism priorities; form the views of Georgia as those of an attractive country; support and protect tourist businesses and their associations on the territory of Georgia.

The tourism developmental strategy in Georgia should be oriented on the regulation of the tourism enlightening system and support of innovations. Creating innovative environment in the country is possible only in terms of high scientific potential and state support. It is such environment allowing us estimating short- and long-term branch developmental strategies by considering any hampering factors or expected crises.

The economic policy of tourism in Georgia should be based on the theoretical fundamentals of economics and tourism. A tourist market must be competitive, i.e. a tourist market must be as free as possible, and the legislation should be oriented on protection of a commercial market.

Development of the tourist market should mostly take place at the expense of small business development, with the monopolistic competition market at the next stage of development (meaning the competition between different brands of the same product).

Based on the right policy of tourism development, the gross demand for tour-products and tourist services should be increased in the domestic market (i.e. a competitive market is to be created) resulting in high gross demand for tour-products (improving the tour-product and tourist service quality and making it competitive in the global market). This will lay a foundation to the formation of a monopolistic competitive market in tourism.

As there is no chance to gain mass effect for a tour-product in Georgia (i.e. no mass tourism cannot be established in the global market), the state policy for tourism development should be oriented on creating competitive advantage of Georgian tourist product in the global market.

The state economic policy should render maximum help to the establishment of the tourism market as a competitive market (no state policy in a short-term perspective is meant, as in the near future, due to many reasons, large companies cannot have competitive advantage to compete successfully in the global market).

At present, the tourist market of Georgia is oligopolic, as it is controlled by 2 or 3 companies (even more so when the business of these companies is limited to inbound tourism for small foreign tourist groups, not domestic tourism) damaging the state interests. Controlling the Georgian tourist market by several companies may be justified in a long-term perspective (in 25 years' time), i.e. the interests of several companies at present are fully realized at the expense of limiting state interests, i.e. limiting the development of tourism as that of a branch.

The tourist industry of Georgia can be developed through the development of tourist product production technology (production culture: transport industry, roads, communications, service standards, distribution and diversification of accommodation facilities, wet points and pictograms along tourist itineraries, etc.).

Georgian tourist product can be introduced to the domestic and global markets through advertising and promoting the tourist products and conducting target marketing studies what will help identify the target tourist groups and potential tourist groups.

The state should extensively advertise the country's tourist capabilities resulting in the increased international and domestic tourist flows. Besides, the advertising campaign should take the world trend into account, i.e. orientation on the growth not only of the number of tourists, but also of the incomes gained from tourists. For the country with a small territory and unique natural and cultural resources, as Georgia is, an economic growth through the increase in the tourists' expenditure and not through the sharp increase in the number of tourists is the priority. This can be achieved by diversifying the tourist product, improving service quality and prolonging the seasonal period. The state investments (budgetary funds) in the promotion of tourist product and tourist infrastructure will yield the desirable result only after several-year permanent investing. The major characteristics of efficiency of the given advertising campaign are emphasis on the major target markets and volume and time of advertising investments. The advertising campaign must be focused not only on boosting tourism incomes, but also on maintaining these incomes.

The policy of tourism development should ensure the right view of the branch development, in particular of the national traditions, values and trends so that tourism, as an inter-branch complex should really become the basis for the country's development.

### *Conclusion*

While the state has declared the development of branch of tourism as one of the priorities, implementation of the tourism policy based on the existing legislative base is absolutely inadmissible, as it is not in line with the international standards chosen by the government of the country. The frame law for the branch of tourism, due to the above-sited gaps, cannot limit itself by individual changes only, but needs renovation as a whole.

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## Cultural Characteristics and Global Branding

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*Brand strategy is essential for the company; brand determines communication content. The impact of brands is now manifest in every single aspect of business. Product may be considered as brand only if it enters and covers the global market and is globally aware. For that it is important to take into account cultural characteristics. Different cultural representatives react in various manner on one and the same factor, cultural factor identification is the main keys to success. Article emphasizes the role of culture in branding illustrating various secondary and primary research data, covering issues like media characteristics, segmentation, preferences and etc. Brand strategy should be discussed in terms of globalization, it should be flexible and customized according to the relevant environment.*

*"It is better to believe than to disbelieve, in so doing you bring everything to the realm of possibility." Albert Einstein*

Branding is now of huge and growing importance in the business-to-business environment, the impact of brands is now manifest in every single aspect of business life, from the smallest decision in the corner store to the biggest decision in the largest company.

Branding is like a magical incantation and knowledge is a tool for branding that supports it overcome boundaries and extend globally. Profound knowledge of relevant markets, global, cultural peculiarities are crucial nowadays, especially considering the fact that in a rapidly changing, competitive and globalized world the lifecycle of products and services is becoming even shorter.

Managing any brand is a "big stuff", managing a global brand particularly so because of the complexities of holding together the essence of your brand and the consistency of brand experience across many diverse cultural backgrounds. Add in to that the long and often non-owned value-chain delivery mechanisms, the variability of employee commitment and understanding and the very real changes that are taking place in the way your customers, employees and partners think and behave, and very soon it becomes clear that a new approach to global branding is necessary.

As abovementioned different cultures react differently on various factors, what makes us think that the premise to brand success are existing market and cultural characteristics.

Brand strategy is aimed at influencing people's perception of a brand in such a way that they are persuaded to act in a certain manner, e.g. buy and use products and services offered by a brand, purchase these at higher price points, donate to a cause. In addition, most brand strategies aim to persuade people to buy, use, and donate again by offering them some form of gratifying experience. As branding is typically an activity that is undertaken in a competitive environment, the aim is also to persuade people to prefer the brand to competition. A global brand needs to provide relevant meaning and experience to people across multiple societies. To do so, the brand strategy needs to be devised that takes account of the brand's own capabilities and competencies, the strategies of competing brands, and the outlook of consumers (including business decision-makers) which has been largely formed by experiences in their respective societies.

There are four broad brand strategy areas that can be employed.

*(1) Brand Domain.*

Brand domain specialists are experts in one or more of the brand domain aspects (products/services, media, distribution, solutions). A brand domain specialist tries to pre-empt or even dictate particular domain developments. This requires an intimate knowledge, not only of the technologies shaping the brand domain, but also of pertinent consumer behavior and needs. The lifeblood of a brand domain specialist is innovation and creative use of its resources. A brand domain specialist is like a cheetah in the Serengeti preying on impala and gazelle. The cheetah is a specialist hunter with superior speed to chase, and the claws and teeth to kill these animals. The cheetah is also very familiar with the habits of its prey. It finds ways of approaching, singling out and capturing its prey. The cheetah is one of the most accomplished of hunters within the wild cat species; it catches up to 70% of prey that it hunts.

*(2) Brand Reputation.*

Brand reputation specialists use or develop specific traits of their brands to support their authenticity, credibility or reliability over and above competitors. A brand reputation specialist needs to have some kind of history, legacy or mythology. It also needs to be able to narrate these in a convincing manner, and be able to live up to the resulting reputation. A brand reputation specialist has to have a very good understanding of which stories will convince consumers that the brand is in some way superior. A brand reputation specialist is like a horse. It can be pure-bred, have a certain nobility and bearing, and exhibit qualities that can be traced back to these (e.g. grace, speed, temperament, looks). Like a horse, the brand reputation specialist can also thrive on association with celebrities.

*(3) Brand Affinity.*

Brand affinity specialists bond with consumers based on one or more of a range of affinity aspects. A brand affinity specialist needs to outperform competition in terms of building relationships with consumers. This means that a brand affinity specialist needs to have a distinct appeal to consumers, be able to communicate with them affectively, and provide an experience that reinforces the bonding process. A brand affinity specialist is like a pet dog. A dog is generally considered to be man's best friend, due to its affection, its obedience, its loyalty, the status and the protection it provides to its owners. Different kinds of dogs will command a different form of affection.

*(4) Brand Recognition.*

Brand recognition specialists distinguish themselves from competition by raising their profiles among consumers. The brand recognition specialist either convinces consumers that it is somehow different from competition, as is the case for niche brands, or rises above the melee by becoming more well known among consumers than competition. The latter is particularly important in categories where brands have few distinguishing features in the minds of consumers. In some cases, a brand recognition specialist needs to be able to outspend competition to gain unbeatable levels of awareness. In other cases, a brand recognition specialist needs to convince a loyal following of consumers that it is unique. A recognition specialist is like a peacock. Most of us will know little about birds, but we can recognise a peacock from a large distance. We may not know its precise qualities, but if we were to choose between birds we are more likely to plump for a peacock than for a more ordinary specimen, because of its beauty and presence.

To continue the analogy, animals that are transplanted from their original habits, face particular difficulties. Their specialist skills, particular traits or specific qualities may no longer be to their advantage and they may need to develop new ones. The cheetah may fare fine in other parts of the world where there are grassy plains with sufficient game. However, if the cheetah moves from the plains to the jungle it will need to develop an appetite for different prey (e.g. monkey), change the way it hunts (e.g. climb trees) and compete with new predators (e.g. snakes).

Although horses are widely considered noble animals, the way they are viewed does differ between societies. In some, the horse is mainly considered as a mode of transport and competes with cars and trucks. In another, the horse is mainly seen as an opportunity for gambling and there it competes with casinos and dog races. Yet in others, the horse is hardly used and seen as symbolising independence and pioneering spirit. Each of these roles requires different traits from the same animal. Simi-

larly, a dog is not considered a loveable or desirable animal in all societies. The relationship with a dog can be functional in some societies (e.g. sleigh dogs), affective in others (e.g. pet dogs), and ambitious (e.g. fighting dogs) in yet other societies. Thus, a dog may need to build a totally different kind of relationship depending on its new owner's background. A peacock may be highly recognisable all over the world, but it symbolizes something different depending on local culture. In Bengal, the peacock symbolizes prosperity, while in Bali it represents the power of knowledge, and in China it symbolises beauty and dignity.

As in the animal kingdom, there is also a place for generalists who mix and match strategies to their advantage. For instance, in some markets Heineken mainly leverages its reputation (e.g. country-of origin), while in others it applies its formidable media planning expertise to innovative use of various forms of (integrated) media; a specific form of domain specialisation. Brands also use complementary strategies. In the case of Nokia, it has been developing its brand affinity through Club Nokia and the Nokia Game.

The following section deals with factors that influence brands' strategies when operating in societies other than their original habitats (Gad, 2001).

### *The Brand Environment*

A brand operates in a space that is defined by its own company or organisation, its competitors, and the societies where it operates. There are both internal and external factors that influence how a brand is finally perceived and experienced by consumers.

#### *Internal Factors*

Factors that are internal to a brand's company or organization can be categorized as being strategy-related, performance-related and stemming from the brand's past. The strategy-related factors are those that derive from the business strategy and the marketing strategy. There is a strategy hierarchy, whereby business strategy takes the lead, guiding brand strategy. Brand strategy in its turn guides marketing strategy. The business strategy is aimed at achieving particular consumer behavior. Only if consumers actually purchase, use (more often), pay a higher price or donate (more) will objectives of a business strategy be met. These objectives may include a larger market share, increased returns, higher margins and increased shareholder value. Brands are designed to persuade consumers to exhibit the behavior that will make these objectives come true for the organization. Thus the influence of business strategy upon brand strategy is direct and compelling. The marketing strategy aims to translate the brand strategy into actual products or services, with a specific price, to be

sold at specific outlets, to be promoted through specific communications activities and channels, and to be supported by specific service. The influence of the marketing strategy is thus indirect in that the correct translation of the brand into the marketing mix determines whether consumers get the correct impression of the brand. The performance-related factors are dependent upon the marketing implementation, i.e. the actual production and delivery of the products and services, their accompanying messages to consumers, and the actual product or service experience. The implementation eventually determines whether consumers experience what the brand strategy set out to provide. The marketing implementation may make or break a brand at the moment that is of most importance to consumers: e.g. when they actually experience the brand through advertising, promotions, purchase, usage, and after-sales service. The factors that stem from the brand's past are the brand's internal legacy and its internal conventions. The brand's internal legacy is about who have developed it, who have managed it over the years, and what the role of the brand has become for the organization. This influences how management, staff, partners, distributors and shareholders view the brand and its future potential. It may prove difficult to change such perceptions once a brand has been slotted into a specific position. The internal conventions of an organization are such issues as how things are typically done, support systems, what the culture is like, who has the power to decide, who has the power to frustrate decisions, the structure of the organization, its policies, and its (other) activities.

For a global brand, such influencing factors exist at central as well as at local levels. More often than not, there are tensions between central and local as specific factors work in opposite directions, and people within the organization have different agendas for the brand (Gad, 2001).

### *External Factors*

External influences upon a brand strategy come mainly from three quarters: competition, consumers and media. These external influences will vary between the markets and societies where a brand operates. Therefore, these influences need to be determined locally. When a brand is introduced into a foreign society, it will encounter particular brand strategies that are being practiced by competitive brands. Unless competitors are very complacent, head-on confrontations with them are generally not the best way of winning the hearts and minds of consumers. It is, therefore, important to determine competitors' brand strategies and to find ways of flanking established competition by choosing an alternative strategy. Category conventions are the unwritten rules that govern the way in which products or services are designed, advertised, distributed, ser-

viced, priced, experienced, etc. Challenging such conventions may provide a brand with a competitive advantage. It is imperative that such a challenge has value to consumers and that they are willing to go along with the challenge. This is only the case if the particular convention is no longer rock solid. Such opportunities emerge when competition is complacent and underestimates the effects of the challenge. An example is the advent of on-line share trading, which became possible due to the combined development of the Internet and the popularization of shareholding. Established stockbrokers failed to respond adequately to the challenge to their conventional mode of operations and thus lost a lot of their business to Charles Swab cum suis.

Cultural conventions determine how people in a society interact, what they believe, how they make decisions and what meanings they attach to certain representations. Cultures are not static, but develop through intergenerational and interpersonal learning and experience. A cultural convention can be challenged if it is already losing its value to consumers and is ready to be replaced by something new.

Therefore, one needs to be on the lookout for such cultural shifts. Once identified, it becomes a matter of deciding whether the challenge will be of perceived value to consumers and will provide competitive advantage. Needs conventions determine the forms in which consumers' needs are manifested.

Human needs are not universal and neither is the importance placed upon each need. However, the major differences lie in the manner in which a need is articulated or the form of a solution that is provided to a need. For example, although there is a general need for nutrition, there are considerable differences between societies with regard to which foodstuffs are acceptable for specific meals. Not to mention foods that are totally unacceptable to specific societies, as witnessed by the controversy over the consumption of dog meat during the upcoming world cup soccer finals in Korea (Gad, 2001).

The media can seriously affect a brand strategy in a positive or a negative manner. In some developing countries foreign brands are promoted by the media as examples of modernity, while in others these same brands may be portrayed as the vanguards of a foreign domination. Particularly, bad news about brands can spread like wild fire across borders, as Coke found out in Belgium, where the outsides of some bottles were contaminated with a fungicide, causing a health scare.

The factors discussed above should be considered and their specific impact should be reflected on the general brand strategies (Keller, 2000).

To better illustrate the theoretical underpinnings let's discuss the real-life examples.

If we discuss briefly China market characteristics according to Millward Brown's The Global brand and primary research provided below we will obviously see how seriously cultures matter.

In terms of land area, China is as big as Europe; in terms of population, it is much bigger. However, as Nigel Hollis states in Chapter 6 of "The Global Brand," the Chinese market is not a single homogenous market. Rather, it consists of many distinct regions that differ in terms of language, geography, and levels of market development. Currently the most common way of segmenting the Chinese market is according to the size of the population centers and their rough level of economic development. This segmentation results in markets known as Tier 1, Tier 2, Tier 3, and Tier 4.

Tier 1 markets are big cities, such as Beijing and Shanghai, with populations close to or exceeding 10 million and city consumption power over 200 billion Renminbi (RMB).

Tier 2 markets are smaller cities with populations between 2 million and 10 million and city consumption between 20 billion and 200 billion RMB.

Tier 3 markets are less developed cities with populations ranging from 100,000 to 2 million and consumption capacity ranging from hundreds of millions up to 20 billion.

Tier 4 markets, where over half of the Chinese population lives, are the rural areas.

In 1978, China's leader Deng Xiaoping launched a series of reform measures that allowed peasants in rural areas to buy and sell their products freely in small open markets. As China's leadership saw the incomes of rural citizens improve with no deleterious effect on the social order, they began to unleash similar reforms in Special Economic Zones, Shenzhen being the best known of these. After this action was also successful, restrictions on commerce were lifted in most eastern seaboard cities, which, because of their location, were well placed to trade with the outside world. Over the years, reforms gradually moved westward into the cities of China's less developed interior.

Most consumer categories penetrated Tier 1 markets first and then moved to lower-tier markets. For example, Tier 1 cities have become important markets for automobiles, LCD TVs, and other luxury goods, while penetration rates for these products are still low in Tier 3 and Tier 4. In general, there is more emphasis on price in Tier 3 and Tier 4 markets; consumers in these markets are more frugal, and take notice of even small price differences.

Distribution channels are at different stages of development across the various market tiers. In Tiers 1 and 2, the major distribution channels are big supermarket chains and home appliance stores. However, in Tiers



3 and 4, traditional distribution channels such as wholesalers, small independent supermarkets, and mom-and-pop grocery stores predominate. Indeed, the management of traditional distribution channels presents a significant challenge to marketing and sales managers of MNCs.

Local brands enjoy a number of advantages in Tier 3 and 4 markets, including their familiarity with the established distribution channels and their understanding of what's important to local consumers. But increasingly, MNCs are focusing on these markets. As early as 1996, P&G embarked on road shows through tens of thousands of villages and towns. They offered personal care products such as soap, shampoo, and toothpaste, with packaging and prices appropriate for rural areas.

In 2003, P&G mounted a campaign in rural markets introducing a new package of the shampoo Rejoice that would be available only in rural areas for a price of RMB 9.90 (US\$ 1.50). Having established a beachhead in distribution channels as well as production lines in the less developed tiers, P&G continues to focus on rural areas and has highlighted this as a strategic priority in China. (Hollis, 2008)

Consumer shopping habits vary with the retail environment. In Tier 1 cities, consumers tend to shop once a week in the hypermarket, but in Tier 3 cities, where hypermarkets are less common, consumers tend to shop more often in small- to middle-sized supermarkets.

The geography of China is vast and varied, and as a result consumer needs vary according to geographical factors. For example, dry weather in the north makes fabric softeners more popular there than in other areas. Therefore, in northern cities, manufacturers emphasize the role of fabric softener in preventing static electricity, while in the warm and humid regions in the east and south (where deodorant products enjoy a bigger market share than they do in the north), they communicate the benefit of keeping clothes smelling fresh. (Hollis, 2008)

The vastness of China also makes media buying a challenge. Forty-seven satellite TV channels cover the entire country, while there are as many as 2,000 TV stations at province, city, and county levels sending out more than 6,000 TV channels in all. On average, each family receives 60 channels. While the national channel, CCTV, has relatively high penetration, its ratings vary by region. CCTV gets high ratings in northern cities, mid-level ratings in the east (where local and provincial channels do better), and low ratings in southern cities, where it competes not only with local channels but also those from Hong Kong. Marketing managers need to adapt their media buying to this fragmented media market to achieve optimal results. (Hollis, 2008)

Consumers' understanding and acceptance of advertising also varies across the different tiers of cities. People in Tier 3 and Tier 4 cities tend to value advertising for the information it offers about products, while people in Tier 1 cities tend to expect more entertainment from advertising.

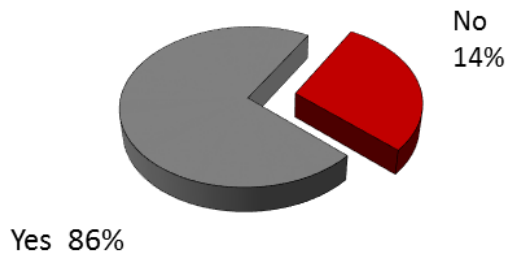
Consumers in Tier 1 and Tier 2 markets are more sophisticated and critical; they rate ads lower than people in Tiers 3 and 4. Within a given tier, feedback in northern cities is slightly more positive than that in southern cities. All of this variation in response underlines the diversity that exists within China.

One very distinct aspect of Chinese culture is the written language consisting of Chinese characters. The selection of a Chinese name can have a major impact on the success of an international brand in China. A brand name can be simply transliterated — that is, represented by Chinese characters that reflect the phonetics of the pronunciation of the brand's name in its original language — or it can be translated — that is, represented by characters that convey the meaning of the brand name in addition to keeping the pronunciation similar. Well-known examples of translated names include: BMW (宝马, “precious horse”), Mercedes-Benz (奔驰, “running”), Johnson & Johnson (强生, “strong life”), and IKEA (宜家, “suitable for home”). (Hollis, 2008)

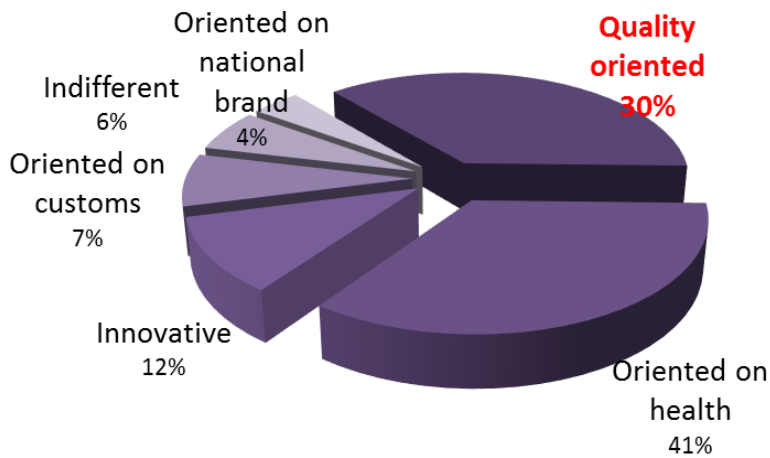
An analysis of BrandZ™ data shows that in developed markets, such as Hong Kong, Japan, Korea, the United States, and Europe, the top driver of consumer bonding with a brand is emotional affinity, followed by popularity. In China, however, the order is reversed. Furthermore, when we drill down into the components of emotional affinity for China, the statement “I want to be seen using this brand” ranks much higher than “appeals to me more than others,” suggesting that consumers expect to gain face through their brand choices. In part this may be a reflection of the current stage of consumer-brand relationships in China (where, in early stages, consumers appreciate brands for the status they convey), but the importance of face in China makes the respect and the opinions of other people at least as important to a brand user as his or her own feelings. In promoting brands in China, marketers must be attentive to face. In particular, when communicating with consumers, brands cannot make other people lose face. One important implication of this rule is that jokes that might be effective in advertising in many countries will not work in China. When humor comes at the expense of another person, it causes that person to lose face; therefore it is unacceptable in China.

In order to make some cultural comparison with Georgia and once more highlight that culture really matters, quantitative research was also conducted, besides the secondary research and case analysis. In Georgia not several products can be named brands. One of these products that one might dare to call a brand is still and sparkling water companies. According to the interviews with Georgian bottled water companies one of the major target market for global branding among neighbor countries is Russia. Because of that a certain market overview was conducted that

once more emphasized the necessity of devising flexible approaches during branding across cultures and societies. (Hollis, 2008)

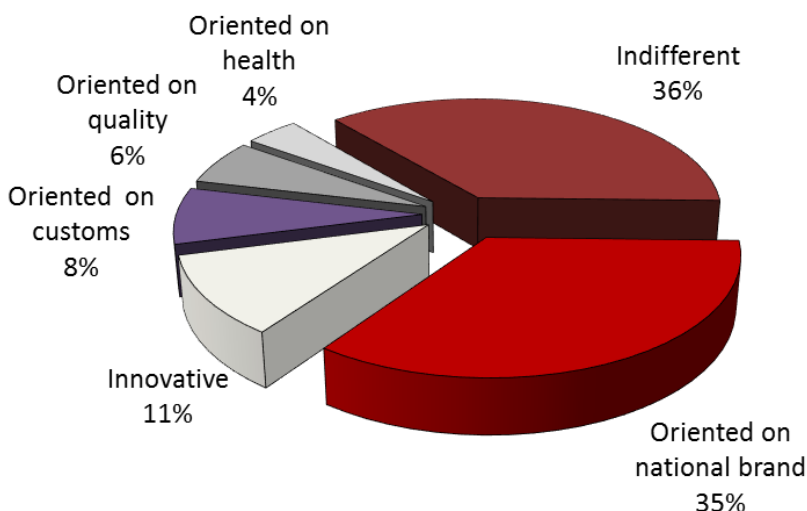


Quantitative research was conducted to identify the market characteristics leading to brand success in Moscow and some key findings were summarized.



*Differences in behavior*

Bottled water is one of the demanding products in the region, while in Georgia most usually the primary competitor “brand” is tank water. In Moscow the vast majority drinks bottled water.



Bottled Water Drinking

*Differences in motivation*

During communication and branding process business representatives should consider that cultures differ according to their motivation during purchase, in Moscow, for example the segmentation can be divided according to following percentage:

Segmentation Categories

In Tbilisi the segmentation is presented according to following picture:

Segmentation Categories

One of the main cultural differences is revealed in this case, too. The picture above emphasizes how brand should be communicated in various cultures, in one case in Moscow, the major emphasize should be put on

quality of the product and health, while in Tbilisi one of the major concern during brand purchase is orientation on Georgian products.

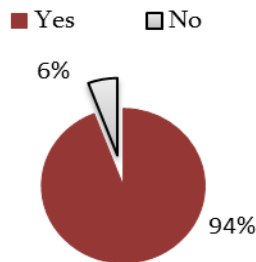
In cultural sense, we can see how trends change overtime, because several years ago, in 2008 for example, in Georgia National brand was not a priority, instead Georgian production was in association with something harmful. This data indicates a certain growth and steps forward on Georgian markets.

The above mentioned information serves as a good indication to plan relevant communication strategy and choose relevant segments accordingly.

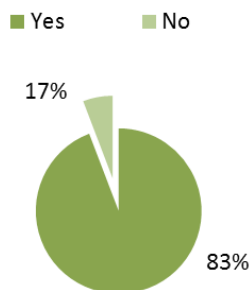
*Differences in media consumption characteristics and differences in communication.*

Quite interesting data were obtained in this direction too, as it appears Television and Internet stay as the most powerful tool for communication disregard the culture, but one of the most important cultural characteristic that was revealed here is that radio is one of the most preferred communication means in Moscow, while in Georgia it has the least importance. Russians are actively involved in several radio programmes, interact, mostly listen to radio during walking and during the day, while Georgians prefer to listen to playlists recoded by themselves.

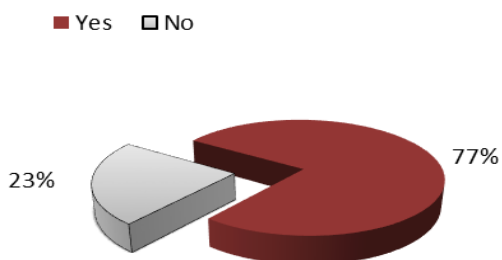
**TV, Tbilisi, TV Consumption**



**Moscow, TV Consumption**



### Internet Tbilisi, Internet Consumption

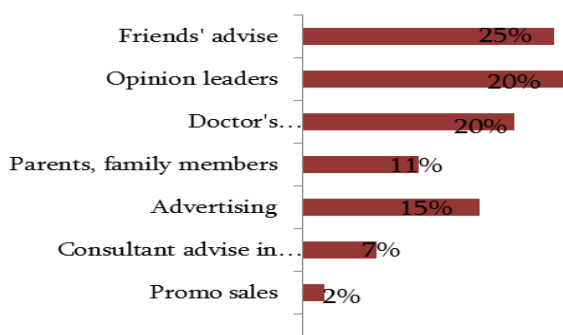


### Moscow, Internet Consumption

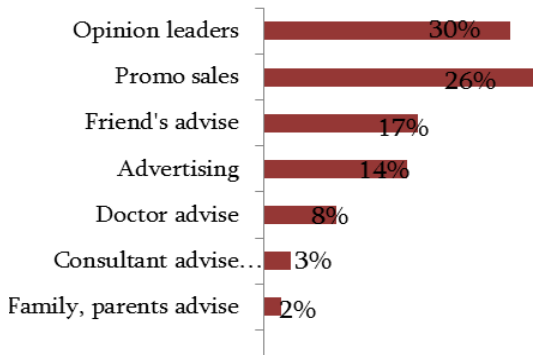


### *Differences in information sources*

#### Moscow, Decision Making Process



### Tbilisi, Decision-making process



As it is obvious the most important information sources influencing purchase decision are different in different cultures, opinion leaders play essential role during decision making process and it's worth mentioning that Georgian customers are quite sensitive towards promotional activities, while Russians pay the least attention to it. Georgians are much more "experiencers", they want to buy what is tangible

### *Differences in message strategies*

Main message strategy for Russians is emphasis on health, as revealed according to the research, while in Tbilisi the major concern is emotional; Georgians prefer messages related to energy, refreshment, rather than health or quality. As a consequence in one case message strategies should be based on functional dimension of the brand while, on the other hand

Even the most primitive quantitative research reveals the factors to consider during global branding, most important is to acknowledge the role of correct brand strategies across cultures in terms of globalization. How best to manage a brand internationally largely depends on the factors discussed in this paper. Brand strategy is not a given and needs to be constantly reassessed. Brand managers must decide what is the best course of action for their brands in particular markets, based on an analysis of the relevant internal and external influences on the brands.

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