YEAR: 01 NUMBER: 01 • ISSN:2149-5769

FLORYA CHRONICLES OF POLITICAL ECONOMY

FACULTY OF ECONOMICS & ADMINISTRATIVE SCIENCES

Florya Chronicles of Political Economy

ISTANBUL AYDIN UNIVERSITY
Journal of Faculty of Economics and Administrative Sciences

Year: 1 Number: 1 - 2015

Florya Chronicles of Political Economy

ISSN : 2149-5750

Language
English

Publication Period
Published twice a year
October and April

Academic Studies Coordination Office (ASCO)

Administrative Coordinator
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Year: 1 Number: 1 - 2015

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Printed by
Matsis Matbaacılık
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Scientific Board

Journal of Economic, Administrative and Political Studies is a double-blind peer-reviewed journal which provides a platform for publication of original scientific research and applied practice studies. Positioned as a vehicle for academics and practitioners to share field research, the journal aims to appeal to both researchers and academicians.

ABOUT THE JOURNAL

The Florya Chronicles Journal is the scholarly publication of the İstanbul Aydın University, Faculty of Economics and Administrative Sciences. The Journal is distributed on a twice a year basis. The Florya Chronicles Journal is a peer-reviewed in the area of economics, international relations, management and political studies and is published in both Turkish and English languages. Language support for Turkish translation is given to those manuscripts received in English and accepted for publication. The content of the Journal covers all aspects of economics and social sciences including but not limited to mainstream to heterodox approaches. The Journal aims to meet the needs of the public and private sector employees, specialists, academics, and research scholars of economics and social sciences as well as undergraduate and postgraduate level students. The Florya Chronicles offers a wide spectrum of publication including

- *Research Articles*
- *Case Reports that adds value to empirical and policy oriented techniques, and topics on management*
- *Opinions on areas of relevance*
- *Reviews that comprehensively and systematically covers a specific aspect of economics and social sciences.*

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From the Editor

The need to publish cutting edge inter-disciplinary research in social sciences instigated us to put together a journal at the Faculty of Economics and Administrative Sciences of İstanbul Aydın University. The name of the journal comes from the area where university campus is located. This is a historical part at the outskirts of the majestic city of Istanbul. The journal is open to articles, reviews, discussion papers and conference proceedings in both languages, English and Turkish.

We feel gratified with the support we receive from the university, from top down, starting with the President of the Board of Directors, Dr. Mustafa Aydın. University's commitment to have a peer reviewed, internationally renowned journal encourages us a great deal. We believe gathering together research papers and scholarly articles by top academics in social sciences around the globe and publishing them at the Florya Chronicles will provide invaluable contribution to our understanding of how societies evolve.

In this issue we present four original articles all in English. The very first article is written by Turan Subaşat, Professor of Economics at Muğla Sıtkı Koçman University, Department of Economics. He questions the merits of the concept of "globalization" by using a political economy framework. The second article is a research paper on Azerbaijan by three authors. This article focuses on the challenges faced by the Azerbaijani economy in the wake of inflowing large sums of funds generated by oil exports. The third article is reporting on the interesting findings of an econometric study based on the recent crisis in the euro-zone. The kind of technique used by Lawrence Maishu in that article can be extended to the research on other currency unions, particularly the one in Western Africa. The final article in this volume is by Dr. Sinitta Mara-Işık and focuses specifically on rewarding schemes in IT Departments of corporations.

In this first issue we have managed to put together a Chronicle with substantial international contributions. This is important for keeping up the momentum for the coming issues as we also aim to have international audience for our journal. It is important to note that the entire staff at the

Faculty of Economics and Administrative Sciences (FEAS) was mobilized with great energy to bring this issue to fruition. Altogether, including the Dean Prof. Dr. Celal Nazım İrem we managed to meet our deadlines and feel a sense of achievement through team work.

Finally, we would like to invite contributions for the coming issues and we will need volunteers to help with the review of articles. Please contact us if you want to contribute or you can help with refreeing.

Prof. Dr. Sedat AYBAR
Professor of Economics and Finance
Editor

What is Globalisation and What Is Not?: A Historical Perspective[1]

Turan SUBAŞAT[2]

Abstract

Despite the widespread use of the concept there is neither a consistent theoretical construction nor a clear definition of globalisation. Although the debate between pro and anti globalisation scholars and activists is interesting, it largely fails to address globalisation as a fundamental structural transformation of modern capitalism from a historical perspective and tends to reduce it to a re-articulation of the old debate on states versus markets. The first aim of this paper is to provide a clearer definition of globalisation, which will be helpful in assessing the validity of various arguments surrounding the concept of globalisation, including whether such a process exists. Then an alternative interpretation of globalisation viewed from a historical materialist perspective will be introduced. It will be argued that internationalisation in the form of increased trade and foreign direct investment is the nature of capitalist accumulation process, thus, cannot be impeded. This accumulation process necessarily creates its own ideological climate to facilitate acceptance of the doctrine and to justify the economic and social problems it creates. Finally it will argue that there is a globalisation tendency since increased internationalisation inevitably weakens the role of nation states by transferring some of their functions to newly created supranational states that are created by the dynamics of this internationalisation process.

Keywords: *Globalization, Internationalisation, Historical Materialist Perspective*

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[1] This paper draws heavily on Subaşat, T. (2008), What is Globalisation and What is Not?: A Political Economy Perspective, Working Paper #08/01, Izmir University of Economics.

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1. Introduction

Globalisation, as a concept, means different things to different people. Despite the widespread use of the concept, apart from a common agreement on the tendency of economic activity to expand beyond national borders, there is to date neither a consistent theoretical construction nor a clear definition of globalisation. There is a very interesting debate between pro and anti globalisation scholars and activists. Although this debate is interesting, it largely fails due to a terminological confusion over the closely connected but distinctive concepts of globalisation, internationalisation and liberalisation, which are often used interchangeably and hastily. The confusion results from the lack of a precise definition. One can read through this vast literature and often remain disorientated. The debate largely fails to address globalisation as a fundamental structural transformation of modern capitalism from a historical perspective and tends to reduce it to a re-articulation of the old debate on states versus markets.

An illustrative example comes from Singaporean Prime Minister Goh Chok Tong who said ‘September 11 [...] marks the conflict between globalisation and isolationism, between free trade and protectionism’ (BBC, 2001). In his view, it is implied that if one is against globalisation one must be favouring isolationism. Moreover globalisation is inaccurately associated with free trade and isolationism with protectionism. Such an unsophisticated approach to these concepts compels one to fall for such simplistic dichotomies that even the critics of globalisation willingly accept. In this confusion it is not uncommon for people to reject globalisation as a myth but characterize themselves as ‘anti-globalisation’ without realising the contradiction.

Moreover most of the arguments are rather descriptive, ‘portraying what is going on rather than a conceptual or theoretical attempt to explain why all these things are happening now and what to make out of all these changes’ (Khondker, 1994: 5). Globalisation is often seen as the totality of recent trends and events such as American hegemony, distance reducing technological changes, economic liberalisation and internationalisation.
In the absence of an accurate and commonly accepted definition, arguments for and against globalisation become obscure as writers define globalisation according to their ideological inspirations and what they intend to prove.

In this sense globalisation is an ideological term and like all ideological terms it is the subject of great controversy. The ever-increasing literature on globalisation proves that, in the absence of a clear definition, we will never know whether globalisation is a 'myth' or a 'fact' as there is no agreement on what processes constitute globalisation. Thus globalisation will always be seen either as an 'incontestable fact' or as a 'myth.'

The first aim of this paper, therefore, is to clarify the distinction between the concepts of internationalisation, liberalisation and globalisation. Globalisation will be defined as 'a *relative* decline in the nation state's role/power to implement *independent* domestic policies as a result of increased internationalisation'. This definition will be helpful in assessing the validity of various arguments surrounding the concept of globalisation, including whether such a process exists.

Later an alternative interpretation of globalisation viewed from a historical perspective will be introduced. It will be argued that internationalisation in the form of increased trade and foreign direct investment (FDI) is the nature of capitalist accumulation process, thus, cannot be impeded or reversed unless extraordinary events such as world wars or severe global recessions occur. This accumulation process necessarily creates its own ideological climate to facilitate acceptance of the doctrine and to justify the economic and social problems it creates. The over emphasis of the benefits of free trade arising from this ideological base, and the recent unprecedented domination of the neoclassical theory (despite all of its theoretical and empirical failures) can be better understood from this perspective. This paper rejects the ideas that draw parallel lines between globalisation and liberalisation. It will however argue that there is a globalisation tendency since increased internationalisation inevitably weakens the role of nation states by transferring some of their functions to newly created supranational states that are created by the dynamics of this internationalisation process. Moreover the ever increasing power of multinational companies (MNCs) means that nation states increasingly need to take their influence into account. In other words, international actors increasingly influence the policies of the nation state, and in this sense contemporary capitalism is experiencing an important structural change.

It should be made clear from the outset that defining globalisation accurately is not just a matter of academic curiosity; it also informs the direction of political action. An accurate definition of globalisation will determine its perception, therefore the nature of political action to endorse or confront it. The current confusion leads either to unqualified support or unqualified rejection of globalisation. The importance of defining globalisation accurately cannot be over-emphasised as it signifies the nature of contemporary capitalism.

2. Definitions Of Globalisation

Globalisation has been defined in a number of alternative ways but there are two commonly used broad based approaches. The initial approach perceived globalisation as the spread of market relations in terms of increased trade and FDI. A broader definition of globalisation is 'the integration of production, distribution, and use of goods and services among the economies of the world' (Otsubo, 1996: 1). In this sense globalisation is synonymous with internationalisation. Why are there two terms existing to describe the same phenomenon? Two reasons emerge. First, 'this sort of definition [...] proposes an 'original condition', a starting-point for the process' where a structural change, a radical increase in internationalisation is thought to occur (Radice, 1998: 3).[1] Second, globalisation is perceived as a 'deepening' of international economic relations as opposed to widening them in terms of the range of countries and other agents involved (Thompson, 1995: 199).

Furthermore, globalisation is usually associated with liberalisation firstly because pressures of capital mobility, technical change and increased market competition are assumed to have significantly reduced the role of the nation state; and secondly, liberalisation is seen as the most effective way to bring about globalisation. From this point of view 'a truly global economy is one dominated by trans-national firms and financial institutions, operating in world markets independently of national boundaries, national political objectives and domestic economic constraints' (Bairock & Wright, 1996: 3).

[1] *This is what Weeks (1999) empirically tested and found no evidence. Thus 'the new era' thesis is rejected.*

While this definition is broadly accepted by the 'hyper-globalists' (mostly neoclassical economists), and 'sceptics' (mostly structuralist economists), they disagree on the nature of globalisation and whether such a process is actually taking place. The hyper-globalists believe that capital is free from all constraints and has enough power to penalize countries that attempt to limit this freedom. In this view, globalised markets are very difficult to regulate, and governments are therefore at the mercy of unruly global market forces. Countries that pursue interventionist policies will pay a heavy penalty. Internationally mobile capital will fly away from countries that restrict their freedom and in doing so will disadvantage their economies. These developments are not only very well advanced and unstoppable, but also desirable. By reducing the seemingly arbitrary interventions of governments, globalisation will allow market forces to increase efficiency and productivity through competition, and better resource reallocation. This integration is seen as of particular benefit to LDCs as the result of the movement of capital is to facilitate the more even distribution of capital worldwide. Globalisation will lead to the elimination of all national differences. We are witnessing the end of the Third World.

This interpretation of globalisation has been criticized and challenged by the sceptics. None of these writers deny the importance of increased international trade and FDI. They, however, challenge the implications of this trend. They argue that there is no clear evidence of globalisation and therefore it is a myth since: 1. The existence of highly internationalised economies is not unprecedented (which implies that it should be unprecedented). 2. Genuine trans-national companies (TNCs) appear to be relatively rare (which implies that they should be more common) 3. Foreign direct investment is highly concentrated among the advanced industrial economies (which implies that it should be more evenly distributed and include LDCs). 4. Trade, investment and financial flows are concentrated in the Triad of Europe, Japan and North America (which implies regionalisation but not globalisation). 5. Major economic powers have the capacity to exert powerful governance pressures over financial markets and other economic trends (which implies that global markets are not beyond regulation and control) (Hirst & Thompson, 1996: 2).[2]

[2] *Weiss (1997: 7) also makes similar points and argues that '[i]f such a [globalisation] tendency existed, one would expect to find evidence indicating that the changes in question conformed to at least three criteria: novelty, magnitude and distribution.'*

The sceptics rightly point out that we are living in a very disorderly and fractured world where the rule is uneven development. The liberal idea of integration with harmony and prosperity is untenable. All major indicators show that the income gap between rich and poor countries has never been so wide. There is no evidence of convergence and regional inequalities persist. The nation state is still the most important actor in international markets and will continue to be so for the foreseeable future.

This earlier debate lacked depth as it stemmed from the simplistic presumptions of the hyper-globalists. The sceptics rightly reacted to the inaccuracies of the hyper-globalists' interpretation but failed to engage in a deeper analysis of the structural changes in international capitalism. Therefore the debate remained fairly shallow. Hirst and Thompson (1996), for example, openly admit that they are dealing with the 'most extreme' or 'strong' version of the globalisation thesis and do not deny that there is a weak globalisation tendency which constraints certain types of national economic strategy.

In another article (Subaşat, 2005) we have argued that although valuable as a counter-position against hyper-globalism, the sceptics' arguments are essentially irrelevant to the globalisation debate and in some cases inaccurate. It is fairly easy to refute the hyper-globalists' thesis as their arguments reflect their ideology rather than the reality. However, the obvious naivety of such interpretations does not lend credence to their critiques. It is easy to compare the hypothetical expectations of their thesis with reality and argue that globalisation is a myth. Instead of an integration with harmony and prosperity for everyone, as hyper-globalists propose, another form of integration with greater inequality might be taking place, where the nation state might surrender some of its power to the new forms of supranational state structures created by the dynamics of this integration process.

An important problem in this debate derives from the fact that many researchers describe the characteristics of globalisation rather than define it. For example the above definition is, in effect, not a definition but a description, and is consequently rather tautological. If one defines globalisation as the spread of market relations in terms of increased trade and FDI coupled with liberalisation, this is a description of what has happened during the last 20-30 years, which is not refuted. Increasing international trade and international flows of capital are not *per se* evidence of globalisation. These are characteristics of internationalisation, and globalisation must refer to something different to have any analytical meaning. In other words, globalisation should refer to a new economic structure and not just to a greater intensification of internationalisation within the current international economic system. In the absence of an accurate definition and a clear separation of globalisation from internationalisation, the terms remain interchangeable even in the hands of the researchers who emphasise such differences in the first place. Moreover, due to its haziness, such a definition also fails to comprehend the permanent and transitory characteristics of the evolving world economy. Although, as will be argued, internationalisation in the form of the expansion of trade and FDI can be seen as the essence of capitalism and of capital accumulation, the future of liberalisation policies will be determined politically. In other words, liberalisation is not the only available policy framework for a more global world.

Based on the failures of this earlier debate, more sophisticated alternative approaches to defining globalisation have been developed, mainly by sociologists and international relations scholars. The 'trans-formationalists' have defined globalisation as the 'intensification of worldwide social relations' (Giddens, 1990: 64), the 'widening, deepening and spreading of global interconnectedness' and 'accelerating interdependence' (Held, McGrew, Goldblatt & Perraton, 2002).

Although more accurate compared to the earlier approach, defining globalisation in such ways is also problematical for a number of reasons. First of all, such definitions are rather vague and the authors often struggle to qualify their definitions by producing pages of explanations that only complicate the picture even further, and render them useless for policymaking and political struggle.

Secondly, interconnectedness and interdependence have been growing since the beginning of humankind and mapping the progress of globalisation since the time of Adam and Eve is not constructive as it does not help us in our endeavour to understand the current structural transformation that the World economy is going through.[3] Qualifying such definitions by 'intensification', 'widening', 'deepening', 'spreading' or 'accelerating' is not useful as this is not the first time that social relations have intensified, widened, deepened or accelerated. The domestication of the horse, the invention of the wheel or the steam engine must have contributed more to the intensification of social relations than recent developments. Thirdly, like the first definition, such definitions give a sense of naturalness and inevitability to these changes and fail to understand the permanent and transitory features of them. Finally, such definitions fail to comprehend the structural transformation the world economy is going through as they reduce changes to quantitative accelerations rather than qualitative transformations.

Scholte (2002) produces a slightly more sophisticated version of the transformationalists arguments and defines globalisation as deterritorialisation, or as the spread of transplanetary and, in recent times more particularly, supraterritorial connections between people. 'From this perspective, globalisation involves reductions in barriers to transworld contacts. People become more able […] to engage with each other in 'one world'' (Scholte, 2002: 14). He argues that transplanetary relations refer to social links between people located at points anywhere on earth, within a whole-world context and supraterritorial relations are social connections that transcend territorial geography.

In the context of transplanetary relations, the world is seen as a single social space. Supraterritoriality, however, implies that territorial distance is covered in no time, and territorial boundaries present no particular impediment. 'Distancelessness' and the abolition of every possibility of 'remoteness' are the main characteristics of supraterritoriality. Scholte claims that although transplanetary connectivity has figured in human history for centuries, supraterritoriality is relatively new and the rise of supraterritoriality marks a striking break with the territorialist geography that came before. Contemporary transplanetary links are also much denser and involve the volume of transworld communications, diseases, finance, investment, travel and trade. Scholte gives a number of examples to qualify

[3] *The 'novelty' aspect of globalisation has been questioned by many 'sceptics'. See Weiss (1998) and Hirst & Thompson (2003).*

globality-as-supraterritoriality:

[J]et airplanes transport passengers and cargo across any distance on the planet within twenty-four hours. Telephone and computer networks effect instantaneous interpersonal communication between points all over the earth […]. The global mass media spread messages simultaneously to transworld audiences. The US dollar and the euro are examples of money that has instantaneous transplanetary circulation, particularly when in digital form. In global finance, various types of savings and investment […] flow instantaneously in world-scale spaces. In the field of organizations, several thousand firms, voluntary associations and regulatory agencies coordinate their respective activities across transworld domains. A global conference of the United Nations (UN) involves delegates from all over the planet at the same time. Ecologically, developments such as climate change (so-called 'global warming'), stratospheric ozone depletion, certain epidemics, and losses of biological diversity unfold simultaneously on a world scale […] (Scholte, 2002: 18)

Given the above examples, the distinction between transplanetary and supraterritorial is blurred and puzzling. If we focus on supraterritoriality which, in his view, signifies 'current' globalisation, we can identify some weaknesses.

With the exception of computer networks, which increase not only interpersonal communication but also facilitate the 'international' circulation of finance, the above examples are to a large extent misleading. The world is not a contiguous terrain and territorial distance is far from 'covered in no time', and territorial boundaries do present impediment. If supraterritoriality as 'distancelessness' signifies globalisation, apart from telegraphs, telephones and computer networks, it does not and probably will not exist. Supraterritoriality in the form of telegraph and telephones have been around since the middle of nineteenth century and airplanes since the early twentieth century and, although international travel has expanded to unprecedented levels, this does not prove supraterritoriality. A truly global money existed in the form of the gold standard which collapsed during World War One. Since the advent of nuclear technology the possibility of a global ecological disaster has existed and the possible impacts of global warming are far from uniform and free from territorial geographical boundaries. Widespread epidemics that transcend national borders have existed for centuries.[4] Even within computer networks where 'distancelessness' is a reality and supraterritoriality is evident, the importance of geographical divisions remain as most people, particularly in the third world, do not have access to such technology.

Scholte recognises these facts but claims that most manifestations of supraterritorial connectivity have reached unprecedented levels during the past half-century. There is no doubt that technological changes have reduced the distance factor considerably and increased social links between people. It is also true that contemporary 'transplanetary links' are denser than those of any previous epoch. Hirst and Thompson (2003: 17), however, claim that it is untrue that the spread of transplanetary and supraterritoriality has been faster than ever before.

The 50 years between 1950-2000 are not remarkable when compared with the period 1850-1914 – in that period flows of merchandise trade, capital investment and labour migration were all comparable to or greater than those of today. Technological change in the form of international telegraph cables unified markets and led to price and interest rate convergence of a kind that has never been equalled since. Financial integration was far greater, and levels of capital export from the major lender countries unprecedented. (Hirst and Thompson, 2003: 17)

Whoever is right about the speed of change, the fact remains that Scholte reduces globalisation to a decline in distance factor and in consequence to the technological changes that facilitate it. By doing so he simply restates the obvious. Such technological factors certainly play a part in 'globalisation' but globalisation cannot be reduced to distance reducing technological factors alone. Once Scholte's approach is accepted, globalisation must be happening by definition, as it is difficult to refute the distance reducing technological changes. Such a definition of globalisation effectively removes politics from the debate and, in this view anti-globalisation has no real meaning. As such, although it may have a political impact, the concept is fairly apolitical. The definition implies a sense of technological evolution that is politically neutral.

[4] *One can only remind the outbreak of the plague in Europe between 1347 and 1353 that killed 25 million people, approximately one-third of the population.*

Finally, with the exception of internet technology, there is very little supraterritoriality in the process of technological change and even if the speed of technological change is faster, it is a continuation of on-going changes rather than a qualitative breakthrough. Scholte (2002: 17) states that '[u]nlike earlier times, *contemporary globalization*[5] has been marked by a large-scale spread of supraterritorialism' which implies that in his view globalisation is not a new process but the continuation of an old process.

3. How Can Globalisation Be Accurately Defined?

One obvious way is to define globalisation as a process that propels an international economy towards a truly global economy. It is then possible to deduce a definition of globalisation by identifying the most fundamental characteristics of a truly global economy. A truly global economy, as apposed to an international economy, would equate the world economy with that of a single country. Although one can stretch the limits of imagination, the following would be some of the most important characteristics:

There would be no national borders and people and capital would be free to move wherever they want and settle down, work and invest. There would be a single global state and global laws that all people would obey. The nation states would either disappear or diminish to the level of local authorities. Nationalism as the ideology of the nation state would disappear. Although differences would exist, there would be a cultural convergence, including perhaps a common global language. Politics would be organised globally. There would be global elections and political parties. Some non-governmental organisations would also organise globally.

The existence of supranational states, and the disappearance or a radical transformation of the nation state, describe and distinguish a global world from a non-global (international) world. From this narrative it is possible to deduce a definition of globalisation as 'a *relative* decline in the nation state's role/power to implement *independent* domestic policies as a result of increased internationalisation'. According to this definition, globalisation is a political process driven by economic incidents. A relative weakening and transformation of the nation state, combined with the emergence of transnational states defines globalisation.

[5] *My emphasis.*

It is important to emphasize the word 'relative' since the weakening of the nation state is not a uniform process and there will always be some states more powerful than the others in terms of their ability to implement *independent* policies, and the part they play in the globalisation process. As will be explained later on, countries experience globalisation according to their own specific circumstances. A reduction in the role of the nation state may or may not mean a reduction in the 'power' of the nation state. The nation state may be coerced into reducing its role or voluntarily surrender some of its power to other international institutions or perhaps initiate this process. In this sense the nation state is an integral part of this process. There are significant differences between developed and developing countries facing globalisation as well as within these broad categories. Developed countries tend to lead the globalisation process while developing countries respond more passively to the changing environment. It is also important to note that a *relative* decline of the 'nation state' does not mean, as liberals often believe, the decline and disappearance of the 'state', or 'statelessness' which is inconceivable. Although the 'state' has existed for thousands of years in many different forms, the 'nation state' as a specific state form is relatively new and linked to the emergence of industrial society and capitalism. As the importance of the nation state declines, transnational states undertake some of their functions.

Moreover, the 'independence' of the nation state to implement domestic policies refers to its independence from outside influences, such as international capital and supranational states. Nation states are not 'independent' institutions and their policies are determined by complex social interactions. Even though Murray (1971) accepted that internationalisation tends to reduce the power of nation states in general, Poulantzas (1975) argued that nation states had no power of their own, but instead expressed and crystallized class powers. Both arguments are consistent with our definition. Nation states increasingly need to respond to the demands of international capital as well as newly created supranational states. The relative autonomy of the nation state from classes is a very controversial issue that will not be analysed here. See Fine & Harris (1979: 158) for the details of this particular discussion.

In this definition the core difference between globalisation and internationalisation lies in the role of the nation state. 'A truly global economy is one [...] in which distinct national economies and, therefore, domestic strategies of national economic management are increasingly irrelevant' (Hirst & Thompson, 1996: 1). In its extreme form, a truly global world is one where the nation state has no decisive role or power.[6] Globalisation, then, must be defined as a process (not an event) where the nation state's role/power relatively declines in the implementation of national policies. In this sense, globalisation does not require a complete disintegration of the nation state. Rather it requires a reconstruction of the nation state as an empowering instrument of international capital.

This definition will clarify a number of confusions in the characteristics of globalisation. First of all, to argue that the nation state loses power as a result of globalisation is contradictory since globalisation is now defined as the loss of the nation state's power.

Secondly, an increase in international trade or FDI does not automatically imply globalisation (it implies internationalisation) unless it also reduces the nation state's power. It can be argued that internationalisation may contribute to globalisation since, for example, an autarkic economy is by definition easier to manage within the boundaries of a nation state. From this perspective, however, the correlation between globalisation and internationalisation is weaker. As Weiss (1997: 20) persuasively argues, strong states may well be facilitators of internationalisation rather than 'victims' of it. Trade and FDI are usually promoted by strong states as in the case of the so-called East Asian Miracle countries.

Thirdly, globalisation does not necessarily imply liberalisation. Liberalisation, by definition, refers to a reduction in the nation state's intervention and in this sense (hypothetically speaking) a truly liberalised world would also be a truly globalised world. A non-liberal (or interventionist) form of globalisation, however, is possible as long as the

[6] When the nation state does not have any power, it may cease to exist or reduced to the level of local authori ties. In this case, a truly globalised world is where there are no nation states and no national borders. A truly global economy cannot be created as long as the nations state exists. As long as the nation state exists it will have some power/function. Globalisation is in this sense 'does not mean that national boundaries are disappearing. Far from it. There are more nation-states in the world today than any other time previously' (Drache, 1996: 31).

role of the nation state is replaced by the supranational states, which may implement interventionist policies. The binding rules of various forms of international institutions and regional integration activities do reduce the sovereignty and role/power of the nation states to implement independent national policies. As will be elaborated on in section three, the creation of strong (stronger) supranational states to absorb and reduce the power of the nation states should be seen as a sign of globalisation. Such state structures, however, can implement interventionist policies.

Fourthly, the decline of the nation state can take seemingly contradictory forms: centralisation and decentralisation, integration and disintegration, internationalisation and localisation. These are in fact complementary processes. In other words, the creation of the supranational states does not reduce the importance of the local. Even in a truly globalised word, local differences will exist. In the USA, for example, the federal states have substantial powers over economic and social policies such as taxation, employment, economic development, transport, education, policing, justice and health. The nation state may give way to both supranational and subnational institutions, which involves the distribution of power from central to local levels. Most countries are both integrated into the world economy and devolve power to local governments and communities.

Fifthly, although imperialism can be defined in a number of alternative ways, whichever definition is adopted, there is little doubt that globalisation is an imperialistic process. This article will not explore the imperialistic nature of globalisation as many radical writers have already done this. However it is important to separate these two concepts, as globalisation is not a euphemism for imperialism. Imperialism has a long history whereas globalisation is relatively new. Although imperialistic trends may take new forms in the globalisation process, it is a mistake to equate them.

Finally, unlike the mainstream definitions, this definition does not presume globalisation and allows room for caution. Although the creation and increasing power of the supranational states indicates a tendency to globalisation by reducing the role/power of the nation states, this may not be a permanent feature of the contemporary capitalist world economy and may be reversible. Indeed, many writers, while recognising the structural changes in the world economy, have argued that nation states are capable of finding ways to adjust to and deal with the challenges that the new conditions bring about. Therefore, they argue there is evidence of adaptability, but no real weakening in the capacity of nation states to manage their own affairs.

Moreover, even if globalisation is taking place, it may be a reversible process. As will be argued in the next section, one important objective behind the formation of the supranational states (that in our view identifies globalisation) is to moderate international rivalries that are provoked by increased internationalisation and competition between international bourgeoisies (as well as establishing stronger domination over the working classes). The inner-rivalries of the international capital that the supranational states are supposed to moderate may however easily spiral out of control and damage the system itself. The unilateralist US policies followed by George W Bush, for example, are reflections of increased international conflict that may damage globalisation as a process. As Engler argues,

Particularly since September 11, 2001, Bush's globalization policy has been quite different from what characterized the Clinton years. As in its military actions, the current administration has shown a penchant for go-it-alone nationalism in its economic negotiations. This has led to a type of bare-knuckles promotion of U.S. interests distinct from the multilateralist model of global capitalism advanced in the 1990s. As a result of this shift, as well as a concurrent global economic downturn, trade talks in recent years have been combative, tense, and often unproductive (Engler, 2004).

Unilateralist US policies may legitimise and encourage similar policies worldwide and damage EU-US relations. The recent US steel tariff dispute and the deadlock in Cancun due to a lack of willingness by the US to open up its markets are two important examples. Such policies are clearly in conflict with globalisation and reflect its reversibility. However, once we accept that globalisation is an uneven and unlinear process, it becomes evident that more time is needed to reach such a conclusion.

4. A Political Economy Interpretation Of Globalisation

In response to the weakness of the hyper-globalists' and sceptics' arguments, an alternative literature has burgeoned based on the idea that 'the nation-state is neither retaining its primacy nor disappearing, but becoming transformed and absorbed' into a larger transnational state system (Robinson, 1998; Radice, 1998). In other words, globalisation denotes a transition process from the nation state phase of capitalism to a qualitatively new transnational state phase where the nation state is transferring some of its power to those newly formed transnational states.

Internationalisation in the form of trade and FDI is the nature of capital accumulation. The rapid quantitative increase in internationalisation, particularly in the form of FDI, at this particular juncture in capitalist history requires a qualitative structural change and necessarily creates transnational states to regulate this process. These transnational states remove part of the nation state's functions and create globalisation trends. The increase in the number and role of these new state structures are directly linked to increased internationalisation in a dialectical process. In other words, although the speed of these changes may or may not be greater compared to previous epochs in the history of capitalism, the spread of internationalisation has reached a point that requires qualitative structural changes to manage this process. In this sense globalisation can also be defined as 'a process of transition from the nation state phase of capitalism to a qualitatively new supranational state phase where the nation states are transformed and absorbed into a larger supranational state system'.

Capital accumulation necessitates the expansion of capital beyond national borders and produces the process of internationalisation. Marx argued that the centralization of capital is the nature of capital accumulation.[7] When possibilities for expansion in the domestic markets are exhausted, capital quickly expands beyond national boundaries to seek new market opportunities. As Marx and Engels wrote in the Communist Manifesto, capitalism is a very expansionary and aggressive system. In one of their most widely quoted lines, they said 'the need of a constantly expanding

[7] *Centralization means monopolization of huge mass of means of production in the hands of smaller number of capitalists. Marx explains the logic of concentration in Capital as follows: 'The battle of competition is fought by cheapening of commodities. The cheapness of commodities demands, caeteris paribus, on the productiveness of labour, and this again on the scale of production. Therefore, the larger capitals beat the smaller.'(Marx, 1990: 777)*

market for its products chases the bourgeoisie over the whole surface of the globe. It must nestle everywhere, settle everywhere, establish connections everywhere' (Marx and Engels, 1977: 83). Internationalisation in this sense is rooted deep in the nature of the capital accumulation process. Through internationalisation, domestic economies of nation states integrate into the world economy. The more a country integrates into the world economy, the more it influences and is influenced by it.

The internationalisation of capital takes three different forms: that of commodity, money and production. Commodity capital was the main form of internationalisation in the 19th century. Financial capital also internationalised by the end of the 19th century with the development of the credit system. Although it existed to a limited extent earlier, the real expansion of productive capital came after the Second World War with the birth of the MNCs, and significantly intensified during the 1980s and 1990s.

The sequence of internationalisation of these three forms of capital is determined predominantly by developments in the forces of production and a number of political changes. International mobility of capital is a technical issue as well as political one. Recent developments for example, should be seen in the light of a number of technological and political changes. New production techniques and rapid developments in the electronic and telecommunication sectors, as well as a dramatic fall in transport costs, played an important role in this process. They enhanced the ability of productive capital to move and organize itself internationally without the need to consider the distance between different production units. In addition the end of the Cold War, the failure of the Keynesian policies to manage the international economic crisis of the 1970s and 1980s, and a general fall in the political power of workers and their organizations have facilitated this process.

The sceptics often argue that the contemporary internationalisation process is not unprecedented and trade and capital flows before 1913 were not dissimilar in size to flows in the post-war period (Weiss, 1997). They claim that for a number of industrialised nations trade intensity is only marginally greater in 1991 than in 1913. Hirst and Thompson (1996: 2) claims that '[i]n some respects, the current international economy is less open and integrated than the regime that prevailed from 1870 to 1914'. This is an important argument, which, if true, could negate our arguments. In other words, if the nature of the current internationalisation process is not fundamentally different from the old one, one would not expect any significant structural changes in the management of this new process. The nation state would remain as the prime actor, there would be no need for transnational state structures and therefore no case for globalisation as we have defined it. These arguments, however, are mistaken and can be criticized from a number of perspectives.

Firstly, the level and speed of trade integration mainly depends on whether the figures are calculated using constant or current prices. The above arguments are based on a calculation of trade intensity using current price export and GDP. van Bergeijk & Mensink (1997), in contrast, argue that any historical comparison should be based on constant prices since service dominated GDP price index tends to increase much faster than the manufacture dominated exports price index. This means that 'a historical comparison of a nation's trade ratio that is based on nominal values suffers from the fact that the price increase for services persistently exceeds the price increase for manufactures' (van Bergeijk & Mensink, 1997: 164). They show that when calculated with constant prices, the world trade ratio in 1996 (13.5%) is much higher than the 1820s (5%). Kitson and Michie (1995) also calculated the trade ratio using constant prices and found not only that trade openness today is much higher than during the pre-war period, but that it increased dramatically after the 1950s. Maddison (2000: 363) produced more significant results. The world trade ratio increased from 4.6 percent in 1870 to 17.2 percent in 1998. The same figures are 4.9 percent to 28.7 percent for France, 9.5 percent to 38.9 percent for Germany, 0.2 percent to 13.4 percent for Japan, 12.2 percent to 25.0 percent for the UK, 2.5 percent to 10.1 percent for the USA. Whichever measure is used, trade integration is continuing and there is no sign of a slow down.

Secondly, trade integration can only expand until all tradable commodities are traded. This implies a structural limit to internationalisation through trade integration. Therefore the increase in trade intensity is expected to slow down and even stop once the peak has been reached. Moreover, it is often argued that a gradual decline in the share of manufacturing (and agriculture) in total GDP may mean less trade integration as the share of 'less trade-intensive' services rises.[8] International trade, however, is only one of many different forms of internationalisation and there is a complex and dynamic relationship between them.[9]

Capital market integration is another major form of internationalisation. During the last few decades, the international flows of financial capital has increased so dramatically that globalization is often characterised by this massive transfer of money. Every day trillions of dollars are traded on foreign exchange markets which amount to many times more than the total value of world trade and GDP. Whether the phenomenal internationalization of capital markets signifies a permanent or transitory feature of internationalisation process is not clear,[10] its impacts on national economies are obvious. As Stiglitz (2000) argues '[o]ver the last 20 years, financial crises have become more frequent and more costly'. As the recent crises in Mexico (1994), Asia (1997), Argentina (2001) and Turkey (2000 and 2001) indicate, the internationalization of financial capital makes national economies more vulnerable to short term capital and money movements.

A further form of internationalisation is the 'non-equity forms of cooperation' which is less visible but still very considerable.[11] Moreover,

[8] *Figures suggest that the share of services in total trade is substantial and has been increasing. World Bank data suggests that world service exports to merchandise export ratio was 18% in 1980 and increased to 22% in 1995. Not only financial capital but also many business services have become internationally tradable as transaction and communication costs fall (Nunnenkamp & Gundlach, 1995:2). Services can also be exported indirectly without being registered to the official export figures when people are mobile. This means that services are no longer isolated from the international markets. Tourism is one of the very well known cases of indirect export of services. Services such as health and education can also be exported indirectly. The biggest barrier restraining people's mobility is the transport cost that has been declining substantially. People are indeed more mobile domestically as well as internationally.*

[9] *For example an increase in FDI may have a negative or positive impact on exports depending on whether FDI and exports are substitutes or complementaries.Trade policy itself may have impacts on FDI in different ways. For example the threat of protection had a substantial impact on Japanese FDI in the US in 1980s. For more detail see Nunnenkamp & Gundlach (1995) and WTO (1996). The International Chamber of Commerce (ICC) however suggests that '[t]he conventional distinction between trade and investment no longer reflects business realities; presence in a local market is now frequently vital to be able to compete. Companies trade to invest and they invest to trade' (ICC, 1997).*

[10] *The growth of international financial flows was largely triggered by the deregulation of financial markets and the abandonment of capital controls, which are reversible policies. See Pettit for (2003) for further details.*

[11] *'NEC covers a broad and heterogeneous range of cross-border activities of companies. They include in particular: R&D cooperation; joint ventures with minor foreign equity stakes; the supply of technology or trademarks through licensing agreements; production sharing arrangements, international subcontracting that involves firms with a local majority stake; as well as contracts on franchising and turnkey projects'. (Nunnenkamp & Gundlach, 1995: 4)*

non-tradable commodities are integrated into the internationalisation process through FDI which involves not only the tradable commodities but also non-tradable. Although there might be structural constraints on trade, there are no such limits on FDI, which can expand absolutely and relatively without any boundaries.

The predominant form of the current internationalisation process, however, is FDI. A very strong upward trend in FDI is observed in almost all relative and absolute indicators of international production, and this now exceeds trade as the other major form of internationalisation. The internationalisation of productive capital and the formation of extremely large MNCs are relatively new phenomena which have been so profound that some have suggested that globalisation, as opposed to internationalisation, should be identified by the rise of MNCs and FDI.[12] MNCs are immensely powerful institutions and their production capacity now has reached record levels. The following facts, produced by the World Investment Report (2000 and 2003), will be helpful in assessing the importance of MNCs and FDI in this new internationalisation process.

FDI inflows have increased steadily throughout the post-war period and more rapidly during the 1980s. Since 1980 FDI has grown many times faster than world trade and output. The annual global inflows increased dramatically from $55 billion in 1980 to $1393 billion in 2000, and declined to $824 billion in 2001 and $651 billion in 2002 due to slow economic growth in most parts of the world (WIR, 2003). The ratio of world FDI inflows to global gross fixed capital formation increased from 2.3 percent in 1980 to 20.8 percent in 2000, and declined to 12.8 percent in 2001 and 12.2 percent in 2002. The inward stock of FDI continuously rose from $699 billion in 1980 to $7123 billion in 2002. Its share in world GDP increased from 6.7 percent to 22.3 percent. In developing countries the same figure was nearly 33 percent in 2001. There are now some 64,000 transnational parent firms (about 7,000 at the end of the 1960s) with around

[12] *For example Costello et al (1989: 39) argues that 'globalisation trend which is clearly new, post-war phenomenon is the growth of transnational corporations which organize a growing division of production between plants in different countries.' Kozul-Wright (1995: 135) also argues that '[t]his rise of the TNC, on many accounts, mark a transition from the Golden Age to a 'globalising age'. In these accounts, the role of TNCs as long-standing organizers of a broad range of cross-border economic assets and activities has been transformed by new technologies and the relaxation of regulatory controls; free from their national setting and with a fully internalised governance structure these firms can now pursue global strategies of production, marketing, and profit seeking.'*

870,000 foreign affiliates. FDI is more important than trade in delivering goods and services internationally. In 2002, global sales by TNCs reached \$18 trillion, which is significantly higher than world exports of \$8 trillion. The sales figures for foreign affiliates worldwide increased from \$3 trillion in 1980 to \$14 trillion in 1999. This figure would be significantly higher if subcontracting, franchising and licensing were to be included. The gross product associated with international production increased from about 5 percent of global GDP in 1982 to 10 percent in 1999. On the technology side an estimated 70 per cent of the global payments of royalties and fees constitute transactions between parent firms and their affiliates. Two-thirds of world trade is controlled by MNCs through intra-firm trade among MNCs and MNC exports to non-affiliates.

The above figures are impressive but they may not reflect the real significance of internationalisation in the form of FDI since they record only the initial entry of a firm into a foreign location and subsequent expansions by affiliates often involve little or no FDI. MNCs advance capital from different sources such as commercial banks, local and international equity markets, public organizations and their own corporate systems in the form of internally generated profits for reinvestment. When these different sources are considered, investment into foreign affiliates are estimated to be four times bigger than FDI flows (WIR, 1997: 5). Even this figure does not capture additional investment controlled by TNCs via various non-equity measures, including corporate alliances.

Therefore, even if trade flows before 1913 were not dissimilar in size to flows in the post-war period, there are events that are substantially different that are relevant to and important for the globalisation debate. These are the creation of massive MNCs, which control not only FDI but also two third of world trade, and the formation of supranational organizations.[13] By controlling international trade, MNCs may be able to impose substantial constraints on nation states. The creation of supranational organizations such as the UN, IMF, WB, WTO, EU, and NAFTA is also relatively new and very relevant to the debates on globalisation.[14]

[13] *'The intra-firm trade among MNCs accounts for about one third of world trade, and that MNC exports to non-affiliates account for another third of world trade, with the remaining one third accounting for by trade among national (non-MNC) firms.' (WTO, Annual Report, 1996: 44)*

[14] *UN and its sub-agencies such as UNDP, UN Commission for Human Rights, UN Environment Programme, UNESCO, Save the Children, FAO, ILO, WHO; and other NGO's such as Green Peace, Friends of the Earth, Amnesty International, Oxfam, Christian Aid, Red Cross, etc.*

There are several technological factors driving this process. 1. The centralization process is intensified by the growing economies of scale and scope, particularly the initial fixed cost of research and development. 2. '[T]he flexibility that comes from reprogrammable capital equipment means that these large units can serve smaller, specialized niche markets' (Costello et al, 1989: 39). 3. Standardization of production and production techniques has made it possible to expand production beyond national borders. 4. The introduction of new technologies which make productive capital more light and mobile, and developments in telecommunication technology which reduced the importance of the 'distance' factor. 5. A substantial fall in transport costs. 6. International advertising and marketing strategies that helps consumption patterns to converge. Because of these technological developments it is now easier to locate production in different parts of the world. The requirement of supervision and enforcement of standards previously required the production process to be carried out within a single production unit. Today the manufacture of components in the production process can be dispersed across the globe or sub-contracted to other firms, prior to assembly.

The large MNCs are the driving force and the biggest beneficiaries of this new economic order. As MNCs grow in size, they increase their relative economic and political power, and their strategic influence, which helps them to gain concessions and better deals in the bargaining process with workers and nation states. There are two ways through which MNCs can exert influence on state policies.

Firstly, as a result of increased flexibility MNCs '[c]an relocate production internationally, wielding immense power over trade unions and national governments' (Costello et al, 1989: 39). In this case MNCs can passively respond to the policies of the nation state simply by not investing. Such a threat may be significant enough to persuade governments to pursue more pro-FDI policies and give significant concessions. However, as many researches have shown, the determinants of FDI are complex and multidimensional which allows the nation state a great deal of flexibility to negotiate the conditions of FDI with MNCs. Although MNCs may benefit from lower levels of labour costs, taxation, regulation, unionisation and a flexible work environment, they also require access to large domestic markets (both total and per capita GDP), political stability, good infrastructure, a skilled work force and membership of an economic and political grouping within which to function. Therefore there is a trade off between the functional requirements of the MNCs and the operating environment that the nation state can offer.

A number of countries, such as China, have been able to exert robust conditions on FDI.[15] Moreover, FDI is not a pre-condition for economic development and countries may prefer not having FDI rather than having to comply with their demands. Many countries, such as Japan and South Korea, have successfully developed despite having very rigid policies that limit FDI inflows. The positive and negative impacts of FDI are also far from being uncontroversial. Therefore, although a significant tool in the armoury of the MNCs, withdrawing investment or declining to invest is not the most effective way in which MNCs can exercise influence over nation states. If it were, the sceptics would have been more accurate in their arguments. MNCs, however, are much more aggressive in their pursuit to control world markets. They do not passively respond to government policies, they aim at shaping them. Therefore, the second way through which MNCs can exert influence on the state policies is more important and relevant to our debate. Although there is a clear tendency to exaggerate the power of MNCs and the powerlessness of nation states in the relevant literature, it is obvious that big businesses have increasingly stronger influence on governments through lobbying activities domestically, as well as through international organizations.

At international level, MNE representatives are active in lobbying the World Trade Organization, the European Commission, the International Standards Organization, the UN Commission on Sustainable Development and many other bodies concerned with regulatory matters and corporate behaviour. [...] The US has been particularly effective at this, using the threat of trade sanctions to pry open new markets for American business in films and TV, motor vehicles, tobacco, agricultural products, pharmaceuticals, etc. (Understanding the Global Issues, 1997: 1)

[15] Needless to say the ability of the nation states to negotiate with MNCs are country specific and not all countries can be as successful as China.

MNCs actively lobby international organisations such as the WTO for investment agreements focused on investors' rights through their representatives such as the International Chamber of Commerce (ICC), the Business and Industry Advisory Committee to the OECD (BIAC), the European Round Table of Industrials, the European American Business Council, the United States Council for International Business, the Fédération Bancaire de l'Union Européenne, European Union's Foreign Trade Association, the European Services Forum, the Union of Industrial and Employers' Confederations of Europe (UNICE), the International Organisation of Employers, and the World Business Council for Sustainable Development

As MNCs control two-thirds of international trade, they are the major beneficiaries of WTO rules. Encouraged by MNCs, the WTO, however, is not limited to international trade and increasingly covers international investment rules.

The ICC foresees a growing agenda for the WTO since it is no longer sufficient to focus on barriers to "trade", in its traditional sense, as the primary impediments to doing business across frontiers. The emphasis today must be on a wider conception of market access - on the international rules for doing business on a global scale. […] The ICC urged the first Ministerial Conference of the WTO to aim to build a solid consensus for work to begin within the WTO to establish a truly global framework of rules and disciplines to govern cross-border direct investment. (ICC, 1997)

The WTO agreements which were established during the Uruguay Round of (GATT) trade negotiations (1986-1993) such as Trade-Related Investment Measures (TRIMs), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and The General Agreement on Trade and Services (GATS) are powerful instruments to promote MNCs' interests and limit the ability of nation states to manage their economies.
In 1997, OECD governments negotiated a Multilateral Agreement on Investment (MAI), which aimed at removing the remaining restrictions on foreign investment. The MAI was an attempt to establish the absolute domination of MNCs over states, which was defeated in 1998 as a result of worldwide mass protests. Renato Ruggiero, the Director-General of the WTO, in an October 1996 speech presented to the United Nations

Committee on Trade and Development said '[w]e are no longer writing the rules of interaction among separate national economies. We are writing the constitution of a single global economy' (UNCTAD, 1996).

The MAI included not only FDI but also intellectual property and portfolio investment. The agreement would have given MNCs' extraordinary rights over governments including protection against social unrest and the ability to take states to an international court. Clearly, MAI represented an attempt to create a world governed by, and for, MNCs. MNCs and their representatives were obviously behind the proposal. The ICC for example stated that,

The ICC calls upon the G7 governments to take the lead to ensure that the MAI negotiations are concluded as soon as possible and to reject pressures to link the Agreement with environmental and labour standards. […] Most of the problems addressed under the agreement occur outside the OECD membership. It is thus crucial that as many non-OECD countries as possible accede to the agreement. (ICC, 1997)

Although the MAI was defeated in 1998, it would be too naïve to assume that what MAI intended to achieve is off the agenda. Many writers believe that developments included in existing agreements, particularly TRIMS, are attempts to resurrect MAI. There is little doubt that MNCs will keep on working until they achieve the complete liberalisation of world markets which will allow them to expand their business. The WTO rules go far beyond mere liberalisation. They aim to restructure the whole world economy in line with the demands of MNCs.

The 'tendency of concentration and centralisation of capital' argument employed by Marx implies that one can only expect a few large MNCs to increase their domination over world markets. As the size and power of MNCs increase, their ability to influence policies at national and international levels also increase. Economic power always brings some degree of political power. Through lobbying or other practices, governments have to take big business into account when they produce their economic policies. It is not a secret that in many countries, large companies make substantial donations to political parties and often use illegitimate strategies such as bribery, and support for oppressive regimes.

The above arguments may explain the nature of globalisation as a contemporary phenomenon. The difference between the old internationalisation process, which was mainly based on international trade, and the new current internationalisation, which is based on FDI, is substantial. Although internationalisation through trade integration can be managed by the nation states, internationalisation through FDI requires supranational states. Earlier internationalisation required larger markets, which could be achieved through colonisation. Production was done locally and goods were traded internationally. The new process of internationalisation, however, requires world markets to be integrated into larger entities. This is achieved by creating supranational states, particularly through regional integration activities.

The concept of the state is at the heart of the globalisation debate. The role of the state can be approached from two broad perspectives. One is concerned with the effectiveness and the power of the nation state in the management of economy. The discussions between neoclassicals and structuralists have traditionally been based on this criterion. Many hyper-globalists insist that the power of global capital undermines monetary and fiscal policies and forces all governments to adopt similar neoliberal policies. With national economies more open than ever, governments seem to have lost control over their economies and have less ability to pursue independent economic policies. The sceptics contested these ideas by arguing that

'[t]he problem with 'powerlessness' argument is not that it is wrong about the new constraints on government capacity to make and implement policy. Rather, it is the assumption that such constraints are absolute rather than relative [...] rather than an evolving history of state adaptation to both external and internal challenges' (Weiss, 1997: 13).

The trouble with this debate is that it isolates the nation state from its social and historical context, and relies on purely technical arguments. In this sense the logic of both positions are very similar. Both views are based on the state versus market dichotomy and both views see the relationship between the market and the state as a power struggle to dominate each other. Thus, a weakening role for the nation state represents a defeat on the part of state in its struggle against market forces. The core of this debate is, then, whether the nation state is actually losing this struggle.

The alternative political economy approach claims that the 'state versus market' debate is irrelevant to globalisation and economists on both sides display an inaccurate understanding of the concept of state. In this view the functions of the capitalist state are determined by the need to accumulate capital and to control the pursuant class struggle that represents the conflict between capital and labour, and to regulate the competing interests of capital. 'The primary function of the state-in-general is to guarantee the reproduction of capitalist social relations - relations which pertain to the existence of capital-in-general' (Fine and Harris, 1979: 146). This view of the state provides a powerful device to the understanding of the structural changes the world economy is going through, and the new forms of state structures that are associated with it.

It is clear that at certain junctures in history one can identify different types of state and different degrees of state intervention, which are determined by a complex set of influences. For example, while the period after the WW2 can be characterized by the increasing internationalisation of productive capital; strengthening of the labour movements and the increased role of the nation state in economic management, the 1980s and 1990s are characterized by an erosion in the role of the national state; dis-empowerment of the labour movements and a drastic increase in the internationalisation of productive and financial capital. In the words of Hirst and Thompson

'[t]he relative internationalisation of economic relations since the 1970s has appeared to strengthen the economic liberals' case, giving rise to the widespread belief that global markets are ungovernable. [...] [T]his is far from being the case, and, even in a period of economic liberal ideological dominance, structures of market regulation have been built up or maintained at the international level.' (Hirst & Thompson, 1996: 123)

The idea behind this argument is the possibility of transferring part of the nation state's functions to other supranational state bodies. In other words, although the nation states may be declining in their power/role in managing their domestic economies, new types of supranational states are being created by the dynamics of this new capital accumulation process.

Hirst & Thompson (1996) identify five levels of economic governance in the international economy: 1. Governance through agreement between the major nation states, particularly the G3 (Europe, Japan and North America); 2. Governance through a substantial number of states creating international regulatory agencies for some specific dimension of economic activity, such as the WTO[16] to police the GATT settlement; 3. Governance of large economic areas by trade and investment blocs such as the EU or NAFTA[17]; 4. Governance through national-level policies that balance cooperation and competition between firms and the major social interests; 5. Governance through regional-level policies.

The debate on the possibility that internationalisation may weaken the nation state as an institution is not new. A number of writers have analysed this issue from a political economy point of view.[18] Although there are important theoretical differences between them regarding the nature and functions of the state (and nation state), there is a broad consensus that the nation state may lose/transfer some of its functions to other forms of supranational states and thus there might be a reduction in its power/role to implement independent national policies. As it was noted in section three, the nations states, particularly in developed countries, are an integral part of this process. They are the facilitators, rather than the victims. They do respond to the needs of the capital accumulation process and do what is required to guarantee the reproduction of capitalist social relations in a changing environment by creating supranational states and transferring significant powers. Therefore this approach radically differs from both hyper-globalists and sceptics.

There are two important objectives behind the formation of these supranational state apparatuses. One is political and the other is more technical. The political one is related to the national class structure, which is also carried through to an international domain by the internationalisation of capital, which reflects the struggle between workers and international capital, and the struggle between different segments of capital. Given that the nation state fulfils the fundamental role of guaranteeing social reproduction, an international state system may also perform a similar

[16] *And perhaps the WB and IMF*
[17] *And many others such as Afta, Efta, Andean Pact, UEMOA, SADC, SAARC, Apec, Mercosur.*
[18] *Murray (1971), Warren (1971), Rowthorn (1971), Poulantzas (1975), Fine & Harris (1979). See Fine & Harris (1979) for a comprehensive exposition and critique of this debate.*

function for the resolution of international rivalries by organizing cooperation to moderate the effects of the increased competition provoked by internationalisation. 'In addition the working classes of all national states can be disciplined and moderated in class struggle by the economic control exercised by those bodies, a control that is remote from the struggles at the point of production' (Fine and Harris, 1979: 153). There is, then, an important incentive for international capital to create these supranational states, in as much as their inner-rivalries allow.

The technical objective is related but separate to the political one. As the International Chamber of Commerce (ICC) states,

[...] governments and business must work more closely together, at national and international level, to design the multilateral rules for the worldwide marketplace which will be increasingly necessary for the smooth functioning and good management of globalization. Globalization is a business-driven phenomenon, and business has now become a natural partner of governments to help them in this task. (ICC, 1997)

Whether it takes the form of trade or FDI, international economic integration is not as a result of individual actions of firms and firms neither individually nor collectively can manage all the consequences of this dynamic process (Kozul-Wright, 1995: 138). Since not all parties benefit equally, the integration process has always been a matter of rivalry that seeks a resolution through negotiation, consensus building, co-operation, compliance and intimidation in varying degrees. Internationalisation has always been a regulated process. '[M]arket economies need to be appropriately governed if they are to perform effectively in meeting the substantive expectations of a wide range of economic actors' (Hirst & Thompson, 1996). Thus, appropriate rules and regulations must be established to manage this complicated process. '[S]upervisory authorities [should be] created to ensure the process of international integration is managed effectively. [...] Ideally, the spread of TNCs needs to be matted by transnational state structures' (Kozul-Wright, 1995: 138). The creation of such institutions is also necessary to reduce transaction costs and to coordinate cross-border activity.

As noted earlier neither internationalisation nor globalisation need to be liberal processes. Many writers have rightly argued that the internationalisation of capital does not necessarily require an association with liberalisation (Weiss (1997 and 1998), Hirst & Thompson (1996), Evans (1997), Bairock & Wright (1996)). Liberalisation of trade, for example, may in fact stall the internationalisation process by creating economic, political and social crisis. On the other hand, as some of the East Asian countries have undeniably demonstrated, it is possible to stimulate exports through state intervention. Bairock & Wright (1996) argued that before WW1, trade liberalisation was not a major factor in the internationalisation process. In fact, 'rapid export growth in this period occurred against a tide of rising protection Bairock & Wright (1996: 20).' Furthermore Cameron (1978) and Rodrik (1996) affirm a positive correlation between the trade ratio and the size of government in economic activity. Evans (1997: 67) concludes that 'a look at the nations that have been most economically successful over the last thirty years suggests that high stateness may even be a competitive advantage in a globalised economy.'

The same logic is applicable to globalisation. For example, if one takes the EU as a 'miniature' form of globalisation, it is obvious that the nation states in the EU have lost/transferred considerable power as a result of the integration process. Particularly in the wake of monetary unification, the nation state's power to implement independent monetary and fiscal policies has been reduced substantially. This reduction of power, however, does not necessarily imply liberalisation. As the role of the nation state declines in the EU, another super state is being created. It is obvious that the EU does not inevitably require liberalisation and it can implement interventionist, or even socialist economic and social policies. Thus, as long as the relevant international state structures are created, globalisation does not necessarily require liberalisation. The reason why liberalisation is perceived in association with internationalisation is the fact that the best established effective argument for governed and socially embedded markets, the theory of the 'mixed economy', was developed for national-level economic management. We need a new equivalent type of theory which recognizes that many aspects of economic activity are no longer under direct national control and that a changed international environment needs new strategies and institutions. (Hirst & Thompson, 1996: 123)

The liberal ideology plays an important role in this process. There is an obvious relationship between the structural changes in the world economy, domestic and international class relationships and the dominant ideologies that were produced to support them. From this angle the recent rise of the anti-state ideology should be put in perspective. Economic theories are ideological constructions and their popularity is determined by the dominant processes of capital accumulation. The debates over the role of state, and namely if the state (or how much state) is required to facilitate economic development, cannot be reduced to a technical issue. Thus, the recent popularity of neoclassical economics should be approached from the viewpoint of its ideological base, rather than its intellectual superiority over the alternative structuralist and political economy perspectives.

Globalisation should be seen as an uneven process through time and space. Through time, as a complex process, globalisation will be unlikely to make continuous progress but will experience many upswings and setbacks. It is obvious that the creation of supranational states is not a simple matter since 'international capital' is not a homogenous category and the divergent interests and power structures that characterize the international economy are absorbed into the political struggle in the process of constructing such institutions. However, the destructive nature of this struggle itself necessitates and facilitates this process. For example recent US policies, although damaging to globalisation process, may be seen as temporary setbacks.

In the same manner globalisation is an uneven process through space as not all countries influence or are influenced by the globalisation process uniformly. Nation states represent different segments of international capital as a truly transnational capital yet does not exist. Therefore countries continuously reposition themselves and revise their policies in the light of internal and external circumstances. The discrepancy between developed and developing countries is particularly worth emphasising. Developed country states, which account for most international capital, are active and leading participants in this process, whereas the states of developing countries, perhaps with the exception of large and powerful countries such as China, India and Russia, are integrated into a process over which they have very little control. Most developing countries are marginalized and disadvantaged in this process as they have lost considerable power over their own economies. For example, the rules of WTO and policies of the Bretton Woods institutions prevent them from implementing the industrial policies that all today's developed countries employed in their earlier development processes.

5. Conclusion

Arguably the internationalisation of capital is predominantly a technical process whereas liberalization is predominantly a political one. As we argued earlier, a separation of these two developments is essential to understanding the nature of globalisation process, particularly what is permanent and what is temporary. The internationalisation of capital is a permanent feature of capitalism and expected to continue, unless there are extraordinary events like world wars and/or severe international crises. As Robinson (1998) argues such processes cannot be reverted as such, as they are not projects conceived, planned and implemented at the level of intentionality, but they can be influenced, redirected, and transcended.

The big international capital 'insists on being free to operate on a world stage' (Radice, 1998: 19) and prefers a liberal globalisation process. Through a liberal globalisation process, international capital increases its bargaining power over popular classes worldwide. The future of the liberalisation process, however, will be determined politically by the ability of its opponents to take up this new challenge and organise themselves nationally as well as internationally. It has long been argued that the policies of the nation state are in general determined by 'the internal forces generated by class struggle and external forces imposed by international capital and class antagonism on a world scale' (Fine & Harris, 1979: 153). What is new in this process, however, is that as its volume and mobility grows, capital increasingly engages in production on an international scale and enjoys an unprecedented structural power, while labour stays predominantly within national borders. The marginalisation of the working classes and their political organisations can partially be explained by this phenomenon.

There is no doubt that the creation of supranational states has been initiated by, and serves the interest of international capital. The same supranational states, however, create opportunities for the poor and oppressed people of the world to engage in the political process more effectively. There is a need for progressive forces to try to influence the policies of supranational states. Such strategies could take many different forms. Although some 'anti-globalisation' movements have already emerged, the labour movement has been slow in taking up this new challenge. Nevertheless there are encouraging signs. For example the collapse of TWO talks in Cancun due to resistance by developing countries, could be considered as symbolic and an important victory for them. Civil initiatives such as the World Social Forum are promising developments in the opposition to neoliberalism and the domination of the world by powerful companies. As John Weeks (1996) argues, regional integration could potentially be a way to regain policy autonomy for developing countries from multilateral organisations. The same logic can be extended and interpreted more widely for developed countries as well. Through regional integration or by the formation of other supranational states, populations in DCs can also regain policy autonomy from international capital through working class struggle. Initiatives like the UN's Global Compact, although it has failed to become a code of conduct, could be a useful device to control and limit the damaging impact of MNCs. Increased international cooperation and even the unification of trade unions, for example throughout the EU, could potentially provide an important power base to counter the influence of MNCs. In other words, the ability of the labour movement to influence supranational state policies will be determined by its ability to organise itself internationally.

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Economic Diversification and Policy in Azerbaijan

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Abstract
The purpose of this paper is to develop an analysis of economic diversification of Azerbaijan and suggest some policy options for further diversification. More specifically, this paper aims to assess export diversification in Azerbaijan by analyzing diversification performances of two petroleum exporting countries namely Indonesia and Nigeria. The paper first discusses the merits of diversification by referring to existing literature on this topic then moves onto present an analyses of current economic situation and export potential of Azerbaijan. The paper also presents an econometric model in which measurement of diversification is proposed. Calculating diversification based on a model proceeded by using standard macro-economic ratios appears to develop our understanding of the level of diversification of the economy of Azerbaijan. In the final section concluding remarks and policy suggestions to achieve a more diversified economy is presented.

Keywords: *Economy of Azerbaijan, Petroleum Exporting Countries, Sectoral Diversification, Dutch Disease*

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1. Introduction

The purpose of this paper is to develop an analysis of economic diversification efforts of the Azerbaijani economy. These efforts, as it will be argued further down, can only become meaningful when diversification of the economy is derived from foreign trade and particularly from its exports. Studying export based economic diversification needs to focus on international experience. Nevertheless, drawing a solid policy recommendation for implementation needs to reconcile the current economic situation and the potential of the country.

Diversification of production is a simultaneous development. A variety of products produced in one enterprise occurs simultaneously. The firm expands and varies its production base to increase its competitiveness. Diversification is also desired to increase the effectiveness of production, to increase profitability and to prevent bankruptcy.

There exists arguments on pros and cons of diversification and these are referred to in this study. Especially the experience of Indonesia and Nigeria are highlighted. The article after giving a brief explanation on the merits of diversity continue with an overview of the current situation of Azerbaijani economy and her potentials. Then in the following section a calculation of the economic diversity is done by using a diversification index based on a variety of individual country experiences such as Nigeria and Indonesia and some of the measures required for industrial development through export diversification is presented. Finally article concludes with some policy suggestions for the purpose of further industrial development and to achieve export diversification.

2. Arguments On Pros And Cons Of Diversifications

An economy with economic diversity has more advantages than an economy without.

First of all let's treat this matter from the export viewpoint. As it is well known part of the commodities produced in one country is exported and ratio of total foreign trade to GDP may be considered as an indicator of openness of economy. In countries with low openness indicator, the matter of export diversification may not act as important problem, irrespective of presence of risks that may lead to a reduction of prices for exported commodities in foreign markets. Even when such cases occur the economy of these countries may not be affected.

This problem is an essential one for Azerbaijan. She is in the process of openning up to the world particularly in the recent years, a process that accompanies the modern occurrence of globalization. In addition Azerbaijan is seeking membership with to the World Trade Organization (WTO). This would strengthen the trend of more integration to the global economy.

It is also a well known fact that its oil resources which is playing an important role for the country's economy will be exhausted one day. The total weight of this sector in 2011 with huge export incomes makes up 52.4% of the GDP and its share in exports is 94.4% (Ministry of Economic Development of Azerbaijan Republic and the National Bank) This is a clear indication that Azerbaijan depends heavily on "one commodity". It is not difficult to imagine what would happen if there was no oil. Export revenues would be very low which would have negative impact on the growth of the economy. The aim of this paper therefore is to create a theoretical framework regarding what will happen to the economy in case of a sharp decrease of oil and gas production and export.

Since no new oil and gas fields are found, it is estimated that oil and gas exports will be exhausted by the near future. Therefore Azerbaijan needs to set her policy priorities according to this reality. However up until the day of exhaustion of oil the economic conditions in Azerbaijan will be known as the period of oil boom. The main challenge that remains is development of the non-oil sectors, particularly trade sectors which would in turn avoid balance of payments crisis and any other disturbance that might occur as a result of a budget deficit. This would also develop Azerbaijan's international competitiveness. Development of the non-oil sectors would prevent Azerbaijan from facing some of the most severe economic complexities.

It must be noted that during this period the government is committed to a "no debt" policy. Otherwise all the above mentioned problems will happen as soon as the oil reserves are exhausted. If Azerbaijan waits until the final hour, the non-tradable sectors will be negatively affected which would lead to "Dutch Disease". The tradable sectors that are most likely to be affected by atrophy would still lead to a crisis and the solution to these problems will not be a case for economists. Major problems start when export revenues earned from a single commodity comes to a halt after the exhaustion of that commodity. This would lead to a severe balance of payments deficit. Other problems would follow suit. In the case of Azerbaijan funds at the State Oil Fund of Republic of Azerbaijan (SOFAR) will be drawn and eventually will be exhausted. Because the government now will be unable to reduce its expenses with the same proportion and will be unable to reduce budget deficit situation will become even more severe.

Azerbaijan is waiting for current inflow of petro-dollars for the last fifteen years. It is almost impossible not to get into euphoria as huge amounts of petrodollars finally began flowing into the country as a result of recent oil and gas extraction projects. The challenge here lies with how to use this money. The task is on the government which should make efforts to avoid longevity of the current indeterminate situation about where to invest and how to spend oil and gas generated funds. SOFAR is established to deal with such issues relating to spending and it acts according to the Regulations and economic logic of "Long-term strategy on management of oil and gas incomes".

The other risk the economy is facing with a single commodity generated incomes is the dependence on the price fluctuations of this product in the global markets. If our imagination is forced to reveal what would happen to say automobiles manufacturing as a result of an oil saving innovation the result would be a sharp decline of oil prices and oil revenues, besides other impacts. This would result in a contraction of the economy, a rise in bankruptcies and unemployment.

Another risk to the economy with no diversification would come from a rise in the global prices of imported and interim goods that are required for exports. If we continue with the previous example it would be easy to highlight the situation with rising prices of imported good that are used to produce export items. For instance, if the cost of imported steel used in car manufacturing is increased up to the level whereby manufacturing and exporting of cars are now unprofitable this would still trigger crisis dynamics in the economy.

We should also note that Azerbaijan is currently going through a war period. The country is managed under the war conditions. If military engagement with Armenia is resumed, oil revenues might be put under risk. If that happens the oil sector will be useful only inside the country, losing its international markets as a result of possible embargoes. If the war situation resumes even when Azerbaijan is not subjected oil exports embargo, some hostile countries may impose restrictions on some of the Azerbaijani goods and if these goods are of strategic importance then the defence capability of the country.

In the same time, if we look at this matter from employment point of view, we will see that it would be very difficult to direct the labour force at one field. Particularly, when capabilities of the labour force vary. We have to note that in Azerbaijan oil and gas sector occupies more than half of GDP, but very small part of the labour force is engaged in this field. So, economic diversity would be more desirable if problems relating to employment needs to be prevented from turning into a crisis.

Some argument against the diversification may be also cited. The government targets to base country's economic specialization in one field and using Dynamic Theory of Comparative Costs[19].

From the other end of the spectrum it is not desirable to diversify the economy in Azerbaijan at present conditions at the cost of oil and gas sector (i.e. to withdraw capital, labour force and technology from this sector and to direct them to other fields), as this sector functions effectively and there is no such effective and profitable sphere in the country other than oil and gas.

[19] Dynamic Theory of Comparative Costs is not static compared to models of Ricardo and Hecksher-Ohlin, and it takes into account factors changing by time. This theory takes as basis comparative costs structure of plans in future. Developing country today may possess comparative advantage in labor-intensive fields, but may get comparative advantage in capital intensive fields at result of implemented economic policy [3].

3. Experiences Of Oil Exporting Countries

Oil rich countries in Persian Gulf and Latin America consider oil as a mean to settle their development problems. In fact, despite positive interrelations between increases of oil exports and a rise of living standards in some of these countries, for the majority of them these relations are not set at the desired levels. Therefore a deeper study of the experience of these countries is very important for Azerbaijan. This would help avoiding some of the mistakes. The oil is to be accepted in Azerbaijan as a mean for creation of competitive production fields. In this study we will analyze the experiences of Indonesia and Nigeria and we will refer to the other experiences of some of the other countries, as similar cases are in abundance across the globe.

3.1. Indonesia

In Indonesia rapid increase of foreign currency reserves, along with high domestic expenses had led to sharp increase of real currency exchange rates. This has reflected at the difficulties of some of the non-oil sectors such as the rubber production and processing. Under the unstable oil prices the government decided that the growth dependence on oil incomes was dangerous and future economic growth was based on producing labour-intensive exported goods. In 1978 the government had decided that devaluation of local currency would facilitate revival of economy, decrease dependence on oil and it would be support producers and exporters of non-oil goods. The currency was devalued 50% in 1979 which was accompanied with 22% inflation rate (Hobdari, at all., 2004).

In general, the impact of devaluation was estimated to be positive. Thus during 1978-79 exports of manufactured goods was doubled and foreign trade balance of non-oil goods has increased. As foreign currency reserves was enough for 4 months of imports, the devaluation was actually not aimed for settling some of the problems of balance of payments. The aim was to assist to relatively more labour-intensive non-oil commercial sectors.

During a second oil boom the government had decided to make second devaluation to stop outflow of capital from private sectors for a short term and develop foreign trade balance of non-oil goods sectors. In 1983 local currency was devalued 50% and for a second time during 5 years price ratio of trade and non-trade goods was sharply changed. Fiscal policy was toughened and devaluation was supported. By mid of 1983 capital-intensive state project with 10 billion dollars (GDP in 12% ratio) was cancelled or postponed. This sharp reduction in state expenses allowed a government to transfer expenses from industrial field to infrastructure and social sectors.

In 1984 the government had changed a tax code and simplified form of simplified value added which allowed smooth management and monitoring of non-oil sector. Immediately after devaluation the government liberalized the fiscal system to increase competition, mobilize local collection on high level, and creation of incentives for loans. This devaluation was successful. During 1983-1985 exports of non-oil and manufacturing goods industry had increased, import of non-oil goods was reduced, foreign currency reserves got stronger and shoe-string-budget matched with balance.

While focusing on the use of large oil incomes, compared to other oil exporting countries Indonesian experience has been successful. There are three main factors for this success:

- oil was not a single source of export incomes and exports of other goods were also used to generate significant incomes;

- the government has not relied only on oil incomes and tried to diversify the economy: the country was a big exporter of non-oil goods during the oil boom;

- Indonesian government had applied macroeconomic policies to alter the negative impact of the changes in the foreign economic environment.

3.2. Nigeria

Before oil boom Nigeria had dominant agriculture sector in its economy, and country was the main producer of cacao and palm items. When 1st oil boom occurred the government faced a problem like how to use unplanned huge amount of oil incomes. Responsible and competent persons for fiscal policy did not pay any attention on possibility of turning current positive conditions to be worse and decided to spend this money for large scale local investment projects. The state had increased basic expenses, incomes earned during 1970-1976 were mainly utilized, and at result a big budget deficit was formed. This deficit was covered thanks to funds accumulated during 1973-1974 period and monetary expansion. It led to inflation: prices went up 22% and in fact stable exchange rate and real exchange rate regimes were grown in value.

The government was not successful in diversifying the economy and such policies weakened the only strong agricultural sector. During 1964-1978 export of agricultural products was reduced twice and in 1975 Nigeria turned to be a net importer of agricultural products.

The second oil boom detained a government from taking unpopular steps. But as no lessons were learned from first oil boom and expenses for completion of incomplete buildings and construction of new ones were sharply increased.

As a result, all of the above was repeated and import limitations were applied, so manufacturing industry suffered from it, and government addressed to foreign creditors with request to prolong repayment time and even asked for new credits too.

Nigeria could not succeed to use its oil riches for the sake of poverty reduction. As there were some restrictions in application, so large scale investment projects were failed. Investments in industry were ineffective too. Ineffective tax, customs and currency policies had negative effects in 1980-ies and in 1990-ies on macroeconomic conditions of country (Hobdari, at all., 2004).

4. Current Economic Situation In Azerbaijan And Export Potential

Azerbaijan's dependence on oil revenues has grown dramatically in the recent years. Based on the data from 2006 it can be said without any exaggeration that Azerbaijan is now an oil revenue dependent country. If we look at the parameters such as the share of oil sector in the GDP, the share of oil revenues in total exports and of the share of oil incomes in state budget which was 73.8% in 2011, then we will be able to establish solidly the oil dependence state of the Azerbaijani economy.

The question then is what will happen after end of oil boom, how the government views current economic situation and what steps are taken towards diversifying of the economy. As it was mentioned in section 2, a policy of "long term strategy on management of oil and gas incomes" was adopted in Azerbaijan. But it would be hard to say that the fiscal policy currently is carried out is in conformity with the general principles of a stable and realistic expenses policy. For this purpose an annual expenditure calculation mechanism should be applied on institutional levels. But still no such mechanism is available and no real restriction is imposed against the ineffective use of means.

During past years a lot investments were made in Azerbaijani economy and the country began to spend part of its oil incomes. As a result the economy got intensified and it caused inflation, and from other side the national currency got overvalued. We think that these two issues are the main problems that the Azerbaijani economy faces. If these leads to a lower investment spree in the factors of production, the weight of non-oil tradable sectors will be also reduced in proportion to the GDP.

At the same time it is important to note that Azerbaijan cannot compete just by exporting its natural resources and raw materials. Global practices show that countries developing by using their raw material resources, cheap labour and geopolitical advantages, ends up with larger income distribution gap.

Azerbaijan has great agricultural resources, fertile lands, facilities to grow various kinds of fruits and vegetables. There is a potential to increase activity in fruit and vegetable processing for export, especially for Russian markets. Further non-organized and long-term export opportunities are connected with expanding international markets which have great demand in "green" products that were grown without using chemical fertilizers, harmful preparations against plants and parasites. As majority of agricultural lands of Azerbaijan remains useless or at least not a single chemical preparation was applied there for the last ten years, crops grown at these lands are classified as "green" products (Centre of Economic

Reforms, 2004). Presently local and foreign manufacturing companies operate to provide local and foreign markets with various kinds of (juices, dry fruits, wine, jams, etc.) products.

But some factors exist and negatively affect the utilization of this potential. It includes weak usage of modern marketing and advertisement methods in promoting new products in local and foreign markets; reluctant implementation of flexible policy tools in competitive pricing with foreigners who produce similar goods as well as other factors that originate from non-perfect local business environment, including problems in supplying raw materials and infrastructural restrictions.

It should be noted with certainty that local consumers still prefer to purchase imported goods. In fact this trend should be a warning sign for the producers in Azerbaijan and they should be more careful in designing their products. Furthermore shortages related to networks for harvesting crops, planting after harvest, ceras, inspection devices, lack of irrigation infrastructure; unfavourable micro-business climate – execution mechanism of contracts, fees on packing materials, robbing business practises, etc. have negative effect on the utilization of current potential.

A number of research findings concluded that, being an agricultural country, to a certain degree Azerbaijan has relative advantages in the fields like growing of tobacco, apple, nuts, sub tropic fruits, other fruits and berries, green tea, vegetables, natural honey, oil seeds, raw cotton, wool, leather, raw silk, medical herbs like liquorice and etc. Moreover there are haw, medlar, hips bushes, chestnut forests. Annually, Zagatala region produces about 40 thousand tons of dates, 11 thousand tons of cucumber, 40 thousand tons of maize seeds. There is a need to prepare a list for medical herb production in the territories and the definition of natural habitat of each medical herb. Azerbaijan has huge reserves of construction materials like sand and crushed stones.

Processing industries based on local agricultural products and raw materials have developed at a certain level. For instance, enterprises in Zagatala, inherited from the Soviet Union era has nut processing capability and these are presently privatized. More recently these companies assumed the nature of a joint-stock companies (OJSC). Basic activities of these enterprises are production of fruit and vegetable cans and juices, processing of hazelnuts. These enterprises previously had a production capacity of 14-15 million conventional cans, 1000-1200 tons of hazelnut, at present can use only a part of their capacity because of lack of funds. Capital inadequacies, absence of sufficiently modern management practices etc., prevent these firms to adjust their business operations to the market conditions. Particularly the quality of technological equipment these enterprises utilize are outdated when compared to modern international standards. These companies are also subjected to moral and physical wearing-off. These conditions do not allow those enterprises to produce good quality and competitive products.

Few years ago some foodstuffs and cloths produced or packed in Azerbaijan were marketed locally. This problem is now partly eliminated. For the last few years due to the new investments by local and foreign investors, many enterprises are reconstructed. Application of modern technologies or inserting new ones using modern technologies are established. For example, vegetable oils, fruit and vegetable juice, beer, wine, tea, meat and dairy products, shoes and textiles are the case in point.

In the former Soviet Union Azerbaijani was very popular. This area had competitiveness with the similar products of the other Soviet republics. This opportunity may be gained again and we have to note that sufficient works were done in this direction recently. It is observed that more attention is paid on this field in the regions with favourable climatic conditions. According to the estimations of experts it is possible to get back expenses made in one hectare of vineyard just after five years in one season.

Based on the results from seveal research, we can safely assert that Azerbaijan export commodities and services rely on export revenues of fuel and mineral exports, and importing of capital and labour intensive commodities and services (machineries and equipment, mechanisms) (Centre of Economic Reforms, 2006). At the same time we can also assert that Azerbaijan's manufacturing is labour intensive. This is due to:

1) the presence of unqualified and cheap labour, and;

2) excessive reliance on qualified and expensive foreign labour.

Absence of detailed indicators on fields of “Cost-Pass” in Azerbaijani statistics on professions and managerial positions is a main factor that hinders preferring any of these hypotheses.

The results of present study indicates that in Azerbaijan dominance of natural resources (fuel and minerals) and labour intensity in production is inevitably leads to a search for economic policies that would reduce oil export revenues and provide diversification of the economy. Moreover, this research clearly indicates that the services sectors particularly banking and finance has great potential to develop as these sectors already enjoy using available good quality infrastructure in Azerbaijan. Besides that forestry and fisheries are important natural resources and can help developing middle level productive sectors in the country. But level of supply of equipment, machinery and other mechanisms, which are urgently required for capital accumulation as the main production factors in the modern world, are not adequately available. Obviously it is a serious signal and is to be taken into account in defining of development strategy. Finally, economic progress can not be assured without a regulatory role given to the public sector.

5. Evaluating Diversification in an Economy

Diversification of exports is the increase in number of goods of exported goods and services. As a result of diversification of exported goods, the conditions are created for manoeuvre of economy, opportunities for elimination of negative effects of undesired economic conjectures on the economy. These also include elimination of bad “commercial condition”. At the modern stage of diversification of exports, it is connected with rapid renewal of assortment of exported goods under influence of scientific–technical progress. Diversification of production is the shifting of production from one commodity to production with multi profiled, expanded nomenclature. Diversification of products is one of the forms of competition conditions of the modern market economy and expresses rise of products in significant numbers.

Diversification index is used to define diversity of economy or conditions of field structure (State Statistics Committee of Azerbaijan Republic, 2006).

$$D = \frac{C^2}{C_1^2 + C_2^2 + \cdots + C_H^2}, \quad 1 \leq D \leq H$$

here, D – diversification index of economy, S – volume of products created in all fields of economy.

$$S = S_1 + S_2 + ... + S_n$$

S_i ($u = \overline{1, H}$) – accordingly shows volume of value added of i – field.

D – index can vary between 1 and n (n – is a number of fields). Closeness of D *to 1* is undesired and closeness to n is desirable. D = 1 means that economy consists of just one field and product of that field comprises 100% of GDP. If $D = n$, it means equal volume of products are produced in all fields (in n quantity fields) of economy. Naturally, for all countries diversification index varies from 1 and n.

At classification of GDP structure of Azerbaijan, 15 fields diversification index for years 1995-2005 was calculated (Table on volume of value added set on activity kinds of economy was given in Supplements) (State Statistics Committee of Azerbaijan Republic, 2006). As it can be seen from picture 1, best position of GDP structure in Azerbaijan was observed in 1998. Amount of diversification index had been rising regularly during 1995-1998. It means diversity of economy, i.e. field structure has improved. Diversification index began to go down since 1998, despite remaining relatively unchanged for a few years. In 2005, this index was 4.44 which mean that if it is not prevented, the economy would depend just on one area of production. As we have noted above, it is proved with clarity that the oil sector had 54.4% in a specific weight of GDP for 2006.

Decline in the diversification index in 2007 is linked with increase of value added in "mining industry and quarrying" field in specific weight of GDP from 10.7% in 1998 up to 39.4% in 2007. We have to note that 99.8% from 4682.5 million AZN value added created in 2010 in this field comes from the share of oil and gas production. From the other side despite of slight increase of dynamic of volume of values added in majority of non-oil sectors the specific weight of these fields in GDP went down (e.g. “agriculture, hunting and forestry” – went down from 18% in 1998 to 9,1% in 2010, “construction” – from 13% to 7.5%, “transport, stores and communication – from 12% to 7.9%, “education” – from 6,9% to 3.3%, “other utilities, social and personal services” – from 7,8% to 1,1%). But, if we look carefully, we will see that a difference among percentages in fields with prevailing specific weight in value added is smaller in 1998 than 2010.

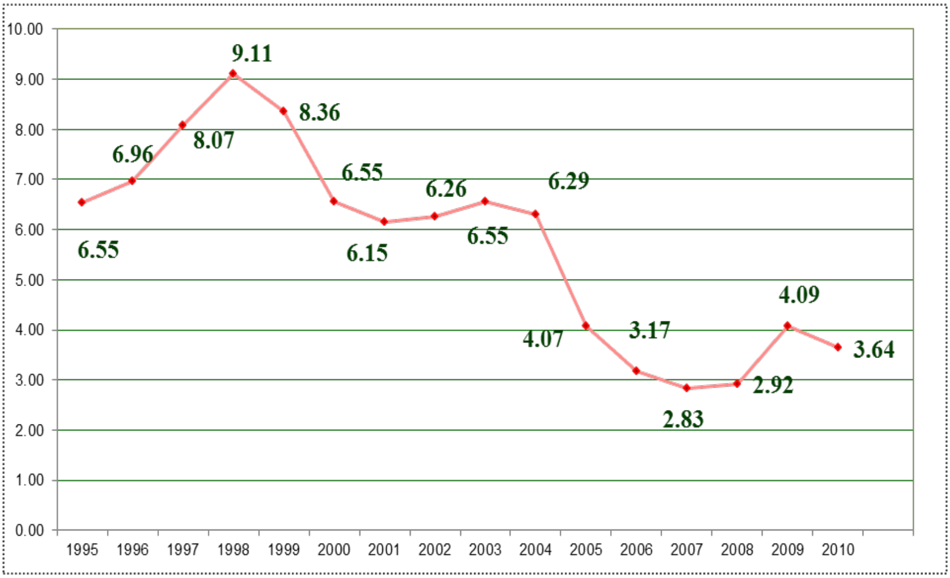

Figure 1. *Dynamics of diversification index.*

We think that for effective integration of Azerbaijani economy into global economic system Azerbaijan possesses real opportunities and using these opportunities logically will play important role in solving very urgent social and economic problems that challenge the country. This might also provide a perspective to achieve a place among developed countries of the world for Azerbaijan.

This study shows that once a scientifically grounded industrial policy is developed and implemented this would strengthen international specialization of the economy and provides a promotion for national products produced by using high technologies in new markets. This would lead to export diversification based on traditional export. This would further modernize the economy in accordance with the economic potential of the country, its domestic demand and its advantages in the world division of labour.

To our mind at modern era industrial policy of a country should be developed by taking in view settlement of following issues:

1) *Segmentation of industry and global strategy*

Azerbaijan has capable but at the same time cheap labour force. Wide transport networks create grounds for Azerbaijan to develop its economic ties with foreign countries. Azerbaijan possesses a potential to develop oil refinery, oil chemistry, chemistry, electro-mechanics, machinery, ferrous and non-ferrous metallurgy, manufacture of construction materials, light and food industries.

2) *Strengthening of specialized fields*

The export similarity of Azerbaijan with 84 countries of the world was calculated using Finger and Krein index (Centre of Economic Reform, 2004) to define the products that may be exported compared with the other countries. According to results of this work, finding similarities in exports of Azerbaijan with export structure of any other country is possible by making an assumption about similarity of goods produced and exported from Azerbaijan. Here basic support comes from the similarity of production factors, technology, productivity and production.

Some countries that have similar export structures with Azerbaijan exist. These countries export oil products too, but they do not export crude oil but oil refinery products (engine oils, white oil, primary refined benzene, gasoil, lubricants etc.). Study of export structure of such countries and definition of exportable goods from Azerbaijan are useful for our purpose.

Researching into similar countries and providing detailed list of goods that are not exported by Azerbaijan should be available. It would be better for Azerbaijan to export to the global markets end products by developing oil industry, instead of merely exporting crude oil. At the same time oil chemistry should be developed based on development of oil industry and Azerbaijan can turn into a big exporter of products like lactam, laccin, tyres for trucks and buses, polyvinyl chloride and etc.

Almost all similar countries are exporters of liquefied propane. In future this field has to be developed in view of gas resources of Azerbaijan.

The research shows that similar countries have dominating position in products of chemical industry. Production of sulfur (except purified), nitrogen fertilizers (there is a great need in country in this product) etc may be developed in Azerbaijan in the near future. Azerbaijan has great opportunities to develop these fields.

Detailed analysis of export structure of similar countries shows that Azerbaijan in future can export flour made of oily seeds, oats, fine animal hair, salted, frozen, canned and dried fish liver, fresh Crustaceas, flour of cereals (except grain), foods and breakfasts made of cereals, juices, sugar, grain grass, flour from grain grass, natural honey, combed and cleaned wool. Azerbaijan exports agricultural products, though in small amount.

3) *Import substitution (possibility to replace imports in certain areas that has much suffered from balance of payments deficit);*

It would be easy enough to demonstrate the areas and products that have suffered from trade deficit. But some failures of import substituting policies in developing countries show how selection of sectors need government help to deal with problems. We think that three main criteria should be taken into account at such selection:

- Influence on the country’s economy;
- Potential competition position of Azerbaijan in this sector;
- Possibility of fast realization of relevant measures within framework of industrial policy;

Influence on the country's economy: first of all influence of import substitution may be estimated on the volume of trade deficit. This is the mostclear criteria. In fact, support for building of broad economy and reduction of risks related to shortages of de-centralization efforts of production should be directed to expanded fields in significantly restricted number and fields corresponding to this aim are those which have big trade deficit. But Azerbaijan has to face significant changes in its market structure for being a transit country. All current trends of this market is to be analysed. For example, let's imagine that it was decided to restore or reconstruct some fields in Azerbaijan, which suffered in during 1990s from shortages of investments, e.g. in heating system. Therefore it is expected that import of such equipment in the future will grow.

Current or future account deficits, their volume and scope, relations with the relevant areas of the economy should be studied. For example, import of polymer plastic may not be important entirely but its influence on competitiveness of fields is certain. Therefore choice among import components having significant share in value of commodities or its local production will be more dependable on availability of cheapest local producers (as transportation expenses are high). In such a case state support on construction of enterprises in country will be important. Hence while private investors estimate ratio of risk and profitability, will not take at all into account how this enterprise is valuable for whole fields.

Potential competitiveness: The second criterion is competitiveness of Azerbaijan. At the first stage, potential competitiveness may be divided into following elements after elimination of main obstacles for its achievement:

- Cost factors;
- Economy with wide coverage;
- Technical know-how;
- Experience in organizational and marketing fields.

Fast execution and expressing monitoring practices: This practice shows that correct selection of fields and regulation methods are not important to get success of state interference, skill of definition of mistakes and correcting them are sufficient grounds. Therefore effectiveness of industrial policy direct at development of import substituting, most likely would be high, if results would be obtained sooner and estimated then. As result of it would be better to give priority on short term investments fields but not on excessive capital intensive ones.

4) New export destinations;

From short-term to long-term: We think that industrial policy directed at achieving new and high diversified exports is to be defined with three term categories:

- <u>short-term:</u> the aim should be giving a push to already available production fields (Today there are many Azerbaijani goods which can not find itself export markets due to various reasons);
- <u>mid-term:</u> the aim is to assist to the areas, which have its markets but requires investment for development in creation of production;
- <u>long-term:</u> the aim is to achieve effective utilization of potentials of Azerbaijan in technologies and markets with high development perspectives, which are absent now;

We think that basing on above-said, working out and implementation of scientifically grounded industrial policy by taking into view potentials of country at modern period will help in development of non-oil sector and manufacturing industry, including obtaining of diversification of economy, in other words increase of diversification index.

6. Conclusion and Suggestions

International experience, current economic situation of country and export potential were studied in research work and some conclusions were made in this regard.

From macroeconomic point of view as it was mentioned above there are two main problems: inflation and growth of real currency rate. We think that the second problem is more serious as at result of continuation of such tendency non-oil trade sectors may collapse entirely and it would be more difficult to revive these fields after cease of oil export. In long-term a growth of real currency rate should be slowed as much as possible.

If government would accept control of non-oil deficit as a base of long term fiscal policy, we believe that steady development of Azerbaijani economy will be provided. According to various estimations ratio of non-oil fiscal deficit to non-oil economy had grown from 16-19% in 2002 to 60-66% in 2011. And this growth fluctuates.

Ratio of non-oil deficit to non-oil GDP will have to be reduced up to such level by 2025 that since that time this deficit might be financed on account of incomes that will be received from management of funds accumulated in SOFAR (Sabiroglu at all., 2011). At the same time from one side all infrastructural projects that would develop non-oil economy should be completed by 2015, and from other side fiscal burden of non-oil economy should be lessened. During this period non-oil economy may get stronger due to infrastructural provision and low rated tax policy and may step to qualitatively new development stage.

Between 2016-2025 years the shoestring-budget expenses of state and non-oil deficit should be reduced thanks to reduction of state investment expenses, fiscal burden of non-oil economy is to be optimized gradually. That is large scale oil incomes provides us unprecedented chance to reduce fiscal burden of non-oil economy thanks to non-oil deficit. We should certainly avail this opportunity effectively.

As it was noted very scanty investments are directed at non-oil trade sectors. Preference is to be given to these fields in respect of sector-wise policy. As it is known agricultural sector is exempted from profit tax for the period of 5 years. Continuation of this policy is not sufficient, as agriculture and rural infrastructure is to be seriously developed. Agriculture is to be set a priority in economic policy of country and support on this field should be of total an expansionist nature so to change the situation in deep. Granting of credits, especially investment credits is to be increased as a part of implemented measures.

The second priority is to be a processing industry of agricultural products so to increase a demand in farmers' products. As third priority field we suggest other processing industries. This prioritization should be reflected in tax and credit policy in addition to state investment policy. Differentiation is to be applied regarding taxes, and as far as credit concerned a preference of credit taking person is to be defined according to this prioritization in credits granted by state.

Another priority field is an expansion of transit facilities of Azerbaijan Republic, creation of competitive transport-transit system meeting international standards and at the same time conduction of works in direction of maximum effective use of current potential.

Conclusions of performed research show that Azerbaijan first of all has abundance of factors in agricultural production and low skilled labour. Thus we face shortage of mid and high qualified labour. From other side according to results of performed research Azerbaijan has not comparative dominance in fields using mid and high qualified agriculture labour. State policy is to be directed mainly on support of development of fields which uses this kind of labour and that would be competitive in future.

At classification of GDP structure of Azerbaijan on 15 fields, diversification index for years 1995-2010 was calculated. In 2010 this index was 3.64, which means that if it is not prevented, the country economy would depend just on one field.. All it means that in modern period scientifically grounded industrial policy should be developed and realized for achieving strengthening of international specialization of country economy and provision of promotion of national products produced using high technologies in new markets basing on traditional export positions, in accordance with economic potential of country, local demand and domination position in international labour distribution.

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Exchange Rate Volatility and Trade Flows in The Euro Area

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Abstract
This paper examines the euro area as an optimum currency area alongside the current financial crisis. In evaluating the effectiveness of the Eurozone's currency club, this research measured the effects of 2008 financial crisis in the Eurozone by considering exchange rate volatility on trade flows between the United States and the Eurozone. The study employed a conditional autoregressive distributed lag model or bound testing as its empirical methodology, which verifies co-integration between variables and further differentiates the short and long run impacts. The selection of the appropriate model or the lag length is based on Schwarz Information Criterion and Akaike Information Criterion. The data is a quarterly time series data from 1999 to 2014, which provides enough observations for the time-series econometric model. The empirical findings revealed exports were more sensitive than imports to exchange rate volatility. The short run causality effects were generally minimal and the speed of recovery back to the macroeconomic equilibrium was higher in exports than imports. In definitive, the euro area is not a perfect example of a currency club as pointed out by the transfer of asymmetric shocks to members. However, this study recommends that future studies on exchange rate risk vis-à-vis trade be broken down at the level of trade flows into various economic activities or sectors. Testing for imports and exports as a whole, seems too vast to better appreciate and interpret results correctly.

Keywords: *Exchange rate, exchange rate volatility, trade flows, euro, ARDL*

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1. Introduction

Central African Economic and Monetary Community (CEMAC), Economic Community of Central African States (ECCAS), Euro Area (E.A), the United States currency area, Canadian currency area are just few example of recent tendency on use of common currency all over the World. Since the Euro area has some special properties like too many countries, language and cultural diversity, significant number of members, we are therefore going to concentrate studies principally on the E.A as optimum currency area.

After the 2008 global financial crisis, devastating consequences spread to Europe. The fiscal problems or financial crisis that resulted from the global crises has affected the present day European Union (E.U.) thereby compromising the future of the Euro area (E.A). Since 2008, the European Central Bank (ECB) has adopted strategies aimed at stabilizing and closing macroeconomic disequilibrium in the euro club. The sovereign debt crisis in euro area has raised doubts about the viability of European Economic and Monetary Union (EMU) and the future of the euro and its monetary system.

By mid 2000s, Federal Reserve increased interest rates on subprime loans by 4% and since the United States household largely depended on mortgage, which is also referred to as subprime loans --- loans granted without much collateral security to households. When these rates increased, ability to repay became difficult, thus the beginning of collapse. These housing bubbles via various securitization channels affected financial markets of major advanced economies. These shocks were directly transmitted to banks because they were heavily involved in real estate, consequently banks started witnessing defaults. The climax of this default was the bankruptcy or collapse of the U.S Lehman Brothers around September 2008. The shocks rapidly spread to Europe and hit the entire euro area but the difficulties were so conspicuous in the economies of Portugal, Ireland, Italy, Greece and Spain because they used advantage of cheap credits to borrow and finance their economies. Consequently, these difficulties translated a significant downturn in the Euro Area.

According to the European Central Bank, by the end of 2008, the Euro area had registered the worst ever growth rate of -2.1%, less than 8% unemployment rates, increased price levels, huge government debts and negative current account balances. The period of 2008/2009 saw a deterioration of balance of payment position, exchange rate volatility or variation between the euro area and its partner, the United States in the last quarter of 2008 and first quarter of 2009, heightened, with a rate of approximately 1.6% with respect to the United States dollars. Exports and imports especially in the last quarter of 2008 and first quarter of 2009 registered a decline. These macroeconomic indicators registered disequilibrium in the euro area in a general but in an asymmetric manner. This asymmetry of shocks pushed researchers to ask questions if truly the euro zone is optimal. This paper is therefore interested to investigate the optimality in the euro area currency zone within a monetary union.

2. Purpose Of The Article

Euro zone being a key player in global economy (especially as there are arguments suggesting Greece might leave the euro area with adverse consequences) will be the area under consideration. Trade flows with the United States and the Euro Area partner will be studied to see how changes in exchange rate affected trade through imports and exports. Studies have demonstrated that the 2008 economic crisis transmitted asymmetric shocks to the various sovereign Euro Area states via various channels. One of the transmission mechanisms was via trade flows. Existing empirical write-ups have largely pointed out a significant relationship between exchange rate and other variables like imports and exports. Very limited has been done when it comes to evaluating the gap existing between exchange rates variations or changes and its measured impacts on trade flows in the euro area.

3. Methodology Of The Study

This research is going to use conditional autoregressive distributed lag (ARDL) or bound test approach to cointegration, which checks cointegration of variables, that is, investigating the relationship amongst variables in the long run based on standard F-test, (Pesaran et al, 2001). At first, two main approaches existed to check cointegration;

- The two-step residuals based procedures for testing the null of no-cointegration, (Engel & Granger, 1987)

— The system-based reduced rank regression approach, (Johansen, 1995)

The two old models of testing for cointegration amongst variables suggested that variables are integrated in the I(1).

Pesaran et al, (2001), adopts a new approach to check relationship amongst variables-they suggest variables could be stationary I(0), integrated of first order I(1) or mutually cointegrated. The advantage of an Autoregressive distributed lag model is that it does not require a pre-unit-root testing of variables. Secondly, it measures the long run and short run effects of exchange rate volatility on trade flows. In conformity to (Bahmani-Oskooee & Mitra, 2008), this methodology explains better the research as exchange rate volatility could be stationary where as other variables are non-stationary. Again, the estimates from the long run model generally indicate unbiased results of the long run t-statistics. The technical part of this work will seek to evaluate the euro area in the recent financial shock; exchange rate volatility or risk between the euro area and the United States and the impacts of this volatility on trade flows.

3.1. Data and Sources

The dependent variables are imports and exports; imports from the United States and exports to the United States from the euro area. The independent variables or explanatory variables are Exchange rate values between the Euro and dollars, the Gross Domestic Product (GDP) was used as a proxy for income since it measures the growth rates, exchange rate Volatility was considered as the standard deviation of exchange rates. Exchange rate data were retrieved from ECB statistical warehouse, GDP rates were retrieved from Organization for Economic Co-operation and Development (OECD) and imports and exports values were retrieved from the United States census Bureau. The period under consideration is 01/01/1999 to 31/12/2014; the data is expressed on quarterly basis with total observations of 64. This large study period permits the estimations of exchange rate changes on trade flows over a long period.

4. Theoretical Background

It’s been almost half a century since the classical authors propounded literature on Optimum Currency Area (OCA). The selected review of the literature is going to answer the research questions and also state major conclusions of the theories. The groundwork will be used to search for characteristics that will be used to define OCA.

The first person to have coined and designed the phrase ''Optimum Currency Area'' was the Canadian Economist Robert Mundell in 1961 in his seminal paper entitled ''A Theory of Optimum Currency Areas'' Mundell defined optimum currency area as a geographical unit closely integrated through international trade and factor movements such as labor and capital. The theory stated that fixed exchange rate systems are most appropriate for these areas. Mundell (1961) identified the effects of adopting a currency in an area and advocated the formation of a common and harmonized fiscal authority to ease the transfer of resources amongst members of that OCA facing asymmetric shocks when mechanisms such as wage and price flexibility or labor mobility fail to achieve the desired goals. One of the main failures of the euro zone and that has plunged the area to macroeconomic instability at this point is the inability to create an institution that will discipline fiscal policies within members of the currency region (Alojzy & Yochanan, 2012).

McKinnon (1963) drew inspiration from the drawbacks of Mundell (1961), theory. McKinnon centralized his studies on factor immobility between regions. According to him, each area within the currency area has its own specificity and specialized industries. This makes it difficult to differentiate immobility emanating from geographical perspective with that arising from inter-industrial (McKinnon, 1963). The theories of Mundell (1961), and that of McKinnon (1963), conclude in affirming that factor mobility is a vital parameter in constructing an Optimum Currency Area.

The criterion of factor mobility earlier discussed was expanded via product diversification of Kenen (1969). He suggested that if labor is mobile, and production also diversified, there would be an optimal functioning of the region. The definition of a region should not be based on geographical or political motive but rather on the activities. Kenen (1969) went further to explain that perfect inter-regional labor mobility requires perfect occupational mobility. This is realized when the nature of job (labor) is a similar skilled labor. Furthermore, the analysis of Horvath, (2003) in the light of Kenen's work, Horvath demonstrates that, a well-diversified economy also has a diversified export sector. Kenen (1969) maintains that product diversification reduces the probabilities of asymmetric shocks and equally reduces their negative effects; hence fixed rates are acceptable to a well-diversified economy.

Corden (1972) sees single currency regions as just an exchange rate region. Adhering to a currency union means total loss of control over monetary and exchange policies. He however concludes that wages and price flexibility should be central in forming a common currency area while considering inflation differentials as costly and dangerous in such an endeavor (Corden, 1972).

Ishiyama (1975) cautions that prospective single currency union members should make a cost-to-benefit analysis before adhering to such a union. Ishiyama (1975), raises some other criteria to be preconditions for joining such as inflation differences, wage packages and even social preferences. Just as indicated earlier by Corden (1972).

This theory went to slumber but however re-surfaced in the 1990s following the birth of a European Monetary Union, Central African Monetary Union just to name a few, when more and more researchers took keen interest again in the theory. As there was significant improvement and development on the international monetary scene, Tavlas (1993), introduced another important factor in the revival of interest in the OCA theory. De Grauwe (1992) termed these theoretical developments the "new" theory of optimum currency areas.

Significant contemporary contribution to OCA vis-à-vis the euro area was the report of European Communities in 1990, which outlined the advantages of a single or one-currency area. That is "One Market, One Money" in which authors raised difficulties likely to erupt from such a union, but did not hesitate to recommend further integration via monetary unification. There are many issues that the new approach of OCA takes keen interest in such as: Monetary Policy effectiveness; Endogeneity of OCA criteria; correlation and variations of shocks; Effectiveness of exchange rate adjustments; synchronization of business cycles and political influences

To some, there are no veritable write-ups on an appropriate and resounding pathway to adopting a common currency. The analysis of Bayoumi and Eichengreen (1992) shows signals of high symmetry of shocks in the heart of the euro area.

Larosière (2012) outlines the current crisis facing the Euro Area as a great differences that arise from the heavy exporting countries like Germany, Austria, Netherlands and heavy importing countries like Greece, Portugal. This Export led vs Import led economies makes us ask the evidences of endogeneity in the Euro Area.

Thanks to such thoughts of Mundell that we have a euro zone, or CEMAC zone. In definitive, this research work found out that joining and adhering to a currency area, is not a linear route since the challenges and pressure emanating from political ideas and socio-cultural differences can't be underestimated.

5. Is The Euro Area An Optimal Currency Area

In line with European project of greater economic integration, a monetary union (EMU) was put in place, and in accordance with the membership of EMU, was the Maastricht convergence criteria. These criteria were a set of economic variables linked to macroeconomic stability that were supposed to act as fulfilment criteria for joining and adhering to the EMU. These convergence criteria slightly weakened the simple criteria laid down by the classical authors of Optimum Currency Area (OCA) theory. The classical framework laid the criteria to which a member (or region) has the right economic situations for joining a currency area with less emphasis on stability per se and with more focus on flexibility and real economic convergence.

Most of the empirical studies investigating Euro area reach a conclusion that at the core of Euro Area, some members like Germany and its neighbours, seem to be in an advanced or developed section of the EMU, and two periphery groups, that is, the Southern and Northern Europe respectively whose conditions for being in the EMU are less optimistic. The architects of the Maastricht Treaty, as a great step towards fuller economic integration and the single market recognized using a single currency.

The simple sharing of the euro amongst its members did not translate an automatic economic performance (economic symmetry) and integration (political unity). We are going to verify if the Euro Area is optimal by reviewing the various criteria.

- Members of the currency area trade extensively with each other,
- The economic cycles in the different regions are in phases (i.e., the regions face symmetric shocks)
- Labor markets are integrated and there is high mobility of labor.
- There are automatic mechanisms (fiscal Equalization) to transfer funds to regions suffering from asymmetric shocks.

Despite the high rate in economic integration, there are still economic and political risks both in southern and some northern euro countries. The southern European countries are attacked by multiple recessions, their economic decrease are deeper and longer than in the rest of regions in the EMU. These uncertainty or risks are from the recent recessions, which are translated and explained by so many factors like;

- Weaknesses in competition between members, for example, Greece imports a good quantity of manufactured goods and other finished goods. This consequently explains the reasons for her slow and weak economic recovery.
- The 2008 debts/financial/sovereign crisis; the crisis has further complicated the smooth functioning of economies and left huge macroeconomic deviations amongst members.
- The sharp fall in real estate especially in Europe especially Greece and Spain

The Euro Area satisfies some of these criteria as seen above; likewise, some are fulfilled as the union progresses as discussed by Jurgen (2009) in the endogeneity evidence. Furthermore, the presence of the 2009 financial crisis in the euro zone is also a soft warning for the criteria of OCA to be re-examined.

This critical analysis shows euro area is an OCA but not a perfect example of an OCA. According to Business Insider of 29 June 2015, the 2004 financial audit report shows that Greece did not qualify to belong to the euro-club because her government budget deficit was above the 3% limit for admittance. This accounts for the non-fulfilment of the Maastricht convergence conditions.

Since the conception of the Euro zone, it has been highly debated if truly the euro area will succeed in its efforts of total economic integration or it would break-up and return to national currencies? The recent crisis has further worsened the situation and with some countries like Greece yet to recover. The question posed here is to investigate if countries like Greece would be better off if they leave the euro area. Also, it's interesting to find out why despite the crisis in the euro area, there is rather an enlargement of the region instead of a brake-up. The baseline of this argument however revolves around the advantages and disadvantages of leaving the euro area with respect to the current economic crisis.

6. Impacts Of Exchange Rate Volatility On Trade Flows Between The Euro Area And The United States

In this part, an econometric analysis is applied to measure the effects of exchange rate volatility on trade flows. The aim of this analysis is out to find out if exchange rate or exchange rate volatility is important factors in explaining the international trade flows especially in the 2008 financial crisis.

The analysis of currency volatility theory is inspired by the J-curve consequences and the Marshall-Lerner condition. The Marshall Lerner conditions explains how a country's currency depreciation can be corrected using a current account deficit. Price elasticity of demand (PED) for exports plus the price elasticity of demand for import should be greater than one, that is, ($PED_x + PED_m > 1$). In other words, if the home currency devalues or depreciates, that is the prices of international goods increases in relation to the prices of local goods, the balance of trade will be affected positively because home consumers will buy fewer imports and foreign consumers will purchase more of exports (Welfens, 2009).

The J-curve shows deterioration in a country's balance of payment position when there is a devaluation / depreciation. The J-shape indicates the time series trend. The effect is a phenomenon in which a period of weak or negative output or returns is followed by a slow or weak recovery that stabilizes at a higher level than before the decline. The situation appears as a 'J' shape on a time series.

The trade balance of a country faces the J-curve effect if devaluation of its currency occurs. At first, the total value of imports exceeds its total value of exports resulting in a trade deficit. But eventually, the currency devaluation reduces the price of its exports. Consequently, the country's level of exports gradually recovers, and the country moves back to a trade surplus (Bremmer, 2007).

This technical part tests the impact of exchange rates and their volatility on trade flows in the Euro Area and the USA. The same test has previously been studied by Huchet-Bourdon and Korinek (2011) for the trade between China, Euro and the United States. A conditional autoregressive-distributed lag (ARDL) is used to measure and model the effects of exchange rate and exchange rate fluctuations on trade flows. The estimations of imports and exports are done in two separate equations; exchange rate and exchange rate volatility, and also, determinants proxy for income (GDP) is also included in these equations. The method was chosen for various reasons; it takes into account the mathematical properties of the time series by verifying stationary or non-stationary of our variables. Cointegration is applied to check the long run as well as short run effects with the associated risk. Since in the ARDL there is no pre-unit test, and there is the measurement of short and long run, it makes it more suitable than the other techniques of cointegration test like that of Johansen, Augmented Dickey-fuller, (ADF), and Watson.

$$M_{,t} = b + b2\, Y_{E.A,t} + b3\, ER_t + b4\, Vol_t + \boldsymbol{\mu_t} \quad (1)$$

$$X_{,t} = b5 + b6 Y_{U.S,t} + b7\, ER_t + b8\, Vol_t + \varepsilon_t \quad (2)$$

Equation (1) is a reduced form of the equation, derived from demand and supply model in which *M* is the measure of trade in time period *t* defined as a ratio of imports of the E.A from the U.S. $Y_{E.A}$ is the measure of production (proxy for income here is GDP), ER is the exchange rate parity of the euro and the dollar (nominal), Vol is the represents exchange rate volatility (risk). The second equation (2) is also a reduced form equation, derived from demand and supply model where *X* measures the value of exports from E.A to the U.S, $Y_{U.S}$ represents income and ER is the nominal exchange rate.

6.1. Econometric Methodology

The econometric model is formulated in two separate equations of exports and imports with respect to the euro area vis-à-vis her partner. The trade flows equations are modeled as a conditional ARDL-correction model for the E.A and the U.S. The equations incorporate a linear combination of the lagged level of all variables, which represent the error correction term (ECT, second line of each equation). With these specifications, we detect the effects in the short run and long run.

$$\Delta M_t = c_0 + \sum_{k=1}^{n1} c_{1K}\, \Delta M_{,t-k} + \sum_{k=0}^{n2} c_{2k}\, \Delta Y_{EA,t-k} + \sum_{k=0}^{n3} c_{3k}\, \Delta ER_{t-k} + \sum_{k=0}^{n4} c_{4k}\, \Delta Vol_{t-k}$$
$$+\delta_0 M_{t-1} + \delta_1\, Y_{EA,t-1} + \delta_2 ER_{t-1} + \delta_3 Vol_{t-1} + \mu_1$$

$$\Delta X_t = d_0 + \sum_{k=1}^{n1} d_{1k}\, \Delta X_{t-k} + \sum_{k=0}^{n2} d_{2k}\, \Delta Y_{US,t-k} + \sum_{k=0}^{n3} d_{3k}\, \Delta \mathrm{ER}_{t-k} + \sum_{k=0}^{n4} d_{4k}\, \Delta\, Vol_{t-k}$$

$$+\lambda_0\, X_{i,t-1} + \lambda_1 Y_{US,t-1} + \lambda_2 ER_{t-1} + \lambda_3 Vol_{t-1} + \xi t$$

The following steps will guide the analysis

6.2. The Process of Cointegrations

To check for cointegration or significance of the lagged variables, we refer results to the standard F-test, which is the first step in estimating the error correction. In this stage, Pesaran et al, (2001) propose a fixed number of lags to be added to the differenced variable. The estimations are by Ordinary Least Square and the different models of ARDL for all lags with a maximum of 12 lags. To select the best model of the lags for this analysis, the Akaike's information criterion (AIC) and Schwartz Bayesian Criterion (SBC) also known as Schwartz information criteria (SIC) are applied to select the best lags for the model. The model with the smallest value is selected.

Cointegration is then tested using OLS estimations by restricting all estimated coefficients of lagged level variables equal to zero (**$\lambda_0 = \lambda_1 = \lambda_2 = \lambda_3 = 0$**) the null hypothesis is then tested against alternative for cointegration using the F-test with an asymptotic non-standard distribution. When the F-statistics is above the upper band, the null is rejected, hence justifying the presence of cointegration. If this value thus fall below the band, the null can't be rejected, thus a situation of no cointegration indicative of such a result. When the F-statistics fall within the band, the results are difficult to interpret. That is why it is referred to as a bound test, because it falls between the bounds because the two sets of critical values indicate possibilities of the regressors into purely I(0), I(1) or mutually integrated After the confirmation of the existence of long-term relationship between the variables, the long run and short run model is thus derived. The error correction term is then formed from these estimates λ_0-λ_3 as $ECT_{t-1.}$

The ECT_{t-1} is then introduced and it replaces the linear combination of the lagged variables and re-estimated by using the same lag as before. The velocity of recovery back to the long run equilibrium is then measured by the coefficient obtained from this ECT_{t-1}. A negative coefficient that is also significant indicates the speed of adjustment back to the equilibrium and also justifies the presence of cointegration amongst the variables (Bahmani & Ardalani, 2006). The greater the coefficient, the more rapid the economy is to return back to equilibrium.

In the concluding part, a cumulative sum (CUSUM) and cumulative sum of square test (CUSUMQ) test for stability are tested for long rum and short run stability test of Brown et al, (1975). Serial correlation is checked using the specifications of LM-test of non-autocorrelation of residuals and Ramsey Reset specification test.

$$W_r = \frac{1}{\hat{\sigma}_{ols}} \sum_{j=k+1}^{r} v_j \, , r = k+1, k+2, .., n$$

The tests (CUSUM and CUSUMQ) are based on a recursive residual that rely on the first j observations. Also the tests are demonstrated on a graph with assumption of a 5 % significance level where W and a pair of straight lines for values of r= k+1, k+2, n.

Since there is no pre-unit-testing test here, we proceed by differencing the variables and after which we select suitable lags in the guidelines of AIC and SIC. In this research, testing and selection started with 12 lags to see the model that aptly satisfies the SIC and AIC criteria. In this case, the export and import equations were introduced 3-lags which had the lowest values of SIC and AIC criteria. Thus, the formulation of the distributed lag model was as follows,

The Normal Model:

$$M=b_1+b_{2*}GDP_{E.A}+b_{3*}ER+b_{4*}Vol$$
$$X=b_5+b_{6*}GDP_{U.S}+b7_*ER+b_{8\,*}Vol$$

M=imports, X=Exports, GDP= Gross domestic product, ER=Exchange rates, Vol=ER Volatility

The model used 3-lags; The software used for the analysis is Eviews (IHS Global Inc.) version 8.

6.3. Procedures to Test Long-Term Relationship (Cointegration)

After selecting the perfect model, the following are tested;

1. Stability Diagnostics via recursive estimate (Ordinary Least Square), that is, CASUM and CASUMQ by plotting W and a pair of straight lines for values of r=k+1, k+2, n. assuming a 5% significance level for CASUM and CASUMQ
2. Serial correlation; LM test verifying the R^2 & P values. If >5% we Accept the Null Hypothesis and attesting no serial correlation
3. Bound testing; Bound testing via coefficient diagnostic using WALD test compared with the Pesaran Critical values at 5% significance. The F-statisitics is then compared within the bounds. If F-stat > upper limit, we confirm cointegration (reject the null) if below, no cointergration, within, inconclusive.
4. The next is to develop the SR & LR model by establishing the error correction term d(m) c d(m(-1)) d(m(-2)) d(m(-3)) d(gu(-1)) d(gu(-2)) d(gu(-3)) d(e(-1)) d(e(-2)) d(e(-3)) d(v(-1)) d(v(-2)) d(v(-3)) ECT(-1)
5. After correcting the model, the ECT coefficient is obtained. A negative and significant coefficient is desirable because it indicates the speed of recovery back to the equilibrium.

6. The model is then tested for -Serial correlation and stability diagnostic as specified above.
7. The last step is to restrict the independent variables and check the short run causality amongst the lagged variables to see the short run impacts
8. Where null hypothesis is rejected in case the probability is not equal to zero

7. Results

The econometric model reveals that the effect of exchange rate variations in the recent crisis affects exports more than imports. The ECT is both significant and negative, which confirms the presence of cointegration between variables (Bahmani-Oskooe & Ardalani, 2006). In testing for a long-run relationship between variables, the study found out that there was the existence of cointegration amongst variables both at the level of exports and imports. The study was able to distinguish the long run impacts as well as short run impacts using the Walt test to diagnose the coefficients.

The results demonstrated that long run equilibrium could be re-gained at the speed of 14.9% and 15.32% and for imports and exports respectively. The short-run causality/ effects were generally minimal as regards exchange rate in this study.

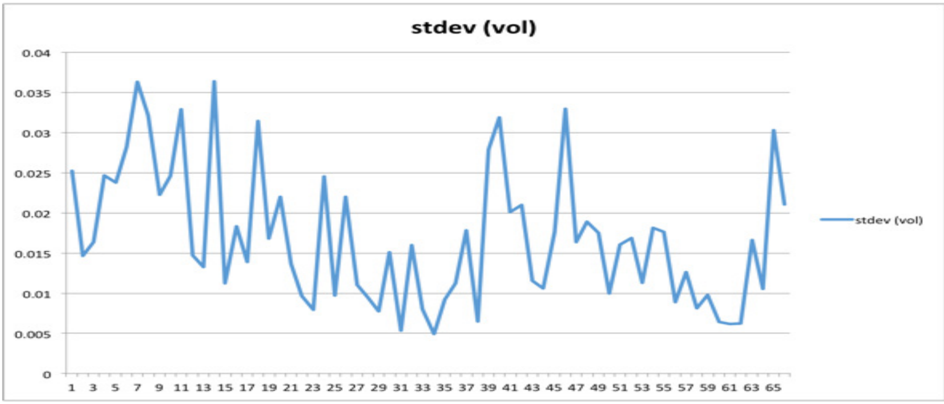

Figure 1: *Exchange rate volatility calculated as standard deviation of exchange rate*

The above figure shows how volatile exchange rate in the euro area has been since 1999. The figure further shows that in the early years when the euro was launched, the exchange rate was volatile and around 2008 it went again very high. The volatility calculations are based on standard deviation. The data is daily movement of exchange rate fluctuations, which is later converted to a quarterly time series data.

Table 2. *Summary of empirical results or findings*

Description	Export Model/Equation	Import Model/Equation
Number of Lags used and their SIC &AIC values	3-lags; AIC=-1.976868 and SIC= -1.383471	3 lags; AIC= -2.318051 and SIC= -1.724654
Stability diagnostics via recursive estimate; CASUM & CASUMQ	Stable at 5% significance level	Stable at 5% significance level
Serial Correlation; LM test via R^2 and Probability values	Acceptance of null hypothesis thus attesting no serial correlation at 5% significance.	Acceptance of null hypothesis thus attesting no serial correlation at 5% significance.
Coefficients diagnostics using WALD test and the Pesaran Critical values (Bound Testing)	Confirmation of cointegration because the F-statistics > upper limit of the Pesaran critical value at 5 % significance, thus, we reject the null for the alternative hypothesis for all the coefficients variables tested.	Confirmation of cointegration because the F-statistics > upper limit of the Pesaran critical value at 5 % significance, thus, we reject the null for the alternative hypothesis for all the coefficients of the variables tested.
Error Correction Term (Speed of recovery back to the long run equilibrium	-15.32%; in absolute values. A negative and larger coefficient is desirable as it indicates the velocity to re-adjust back to the long run macroeconomic equilibrium.	-14.9%; %; in absolute values. A negative and larger coefficient is desirable as it indicates the velocity to re-adjust back to the long run equilibrium.

8. Conclusion

The aim of this study was to find out if the present Euro club is an Optimal Currency Area and also to measure the impacts of the recent financial crisis in the said region. The study was able to trace divergence in the economies of Euro area member states characterized by the transmission of asymmetric shocks leading to macroeconomic disequilibrium. This paper was equally interested in tracing the origin of the financial crisis in Europe. The study suggests Greece situation reflects the weakness that had culminated in the euro zone.

This study also joined other studies to confirm that some OCA criteria are fulfilled ex-post that were not satisfied ex-ante.

As a further recommendation would be suggestion of a political union for the Euro area in order to cope with the management of both fiscal and monetary policies, a political union is highly solicited to wave the pain arising from cultural, political and linguistic barriers. The political willingness of states to function and regard each other as one is very necessary in an Optimum Currency Area-if there were no such barriers, the recent shock would not only concentrate in the Greek economy.

In this technical analysis, the study, traced weak short run effects on imports and exports and relatively significant impacts in the long run. It's confirmed in this work that exchange rate variations affects exports more than imports and their ability to recover back to the equilibrium was possible in the long run.

The study found out that exchange rates are not the only drivers of trade flows, because trade imbalances may be provoked by differentials in international market process, which hampers trade balances. Exchange rate affects the current account via competiveness. In this study, an autoregressive distributed lag model was used, the results showed that in the short run, there is no short-run causality running from lag 1 to 2 and to 3, thereby contrasting the null hypothesis in favor of the alternative hypothesis as indicated by their probabilities. For the long run, an estimation of the error correction term coefficients pointed out the effects and possibility of recovery in the long run.

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Employee Benefits and Motivation: How it-Experts are Motivated and Prefer to be Rewarded

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Abstract
This paper identifies the role of rewarding and recognition in employees' motivation and work commitment in a bank's IT-department. The IT-department is located in Istanbul, Turkey with total almost 400 employees and it is part of a greater organization which's main branch is financial services and banking and it operates internationally in more than 40 countries. To identify the role of rewarding and recognition in employees' motivation this survey was conducted in the IT-department and it was sent to 80 employees. The study intends to increase the understanding of the relationship between motivation and rewarding, especially in such business environment as information technology is. The findings show that though there is a relationship between motivation and rewarding, the relationship is not apparent and the effect is hard to be observed when measuring individual rewarding methods. Therefore this study concentrates more on general opinions about rewarding system used in the organization and how, according to employees' prospects, it could be improved.

Keywords: *Motivation, IT-departments, Management*

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Introduction

The business world has been in change for a while and traditional values such as continuous employment, guaranteed wage base, secured incentive plans and definite workplace loyalty do not quite describe today's work environment. Employers cannot anymore ensure workplace for next year but also employees are free to go and change their jobs according to their interest and current market situation. Management have new role in business life and managers are not anymore only straight commanding their employees but identifying, measuring and developing their performances by individual and team level and aligning the performance with strategic goals of the organization. All these changes are part of everyday work life and they have great role in rewarding and motivation since the changes have changed their origin too. (Aguinis, 2009) Rewarding is not just a monetary way to give feedback from employee's work performance and motivation is not only related to employee's capability to do their job. However it is assumed that these two themes are related to each other and this research aims to find out how they are depended and how effective is the relation.

Motivation and rewarding have a proven relation but literature argues if it is measurable by individual rewarding methods or not. For example Kressler (2003) claims that motivation is combination of different desires that direct and have an influence on employee's behavior and action but rewarding methods such as bonuses are too specific and their impact on behavior is only short term, thereby they cannot largely increase or decrease motivation. Human motivation is too complex and personal concept that organizations could create guaranteed rewarding system which motivates their employees entirely. This however does not mean that organizations should not reward their employees and as Kouzes & Posner (2003) assert, employees who are not being rewarded and motivated properly will cause more harm to the organization than the cost of total rewarding itself. Literature commonly agrees that money is not a good motivator since it has only short term effect on human behavior and it is costly for the organization. Instead of increasing monetary rewards it is recommended to apply rewarding methods such as feedback, praises, events or educations to enhance performance and eventually motivation. Managers however should know their employees first and reward them in appropriate ways whenever it is needed and as personally as possible if they want to foster job performance.

In order to fill the research gaps the study was implemented in Turkey, Istanbul in March 2015 just before the annual bonus announcements at the chosen organization. The research was carried out before the bonus announcements so they will not have positive or negative effect on research outcomes. The organization which was chosen to this research is an IT-department of a top ten international financial institution in Turkey and the department has 400 employees in Istanbul. The organization wishes to stay anonymous because of the sensitivity of the research topic. For the same reason the research itself was carried out anonymously and the results were demonstrated only in common level so no individual responses were able to be tracked. Because of the timing and anonymity the responses from the research were expected to be truthful and sincere.

The contribution of this research is manifold. First it helps to increase the understanding of the relation between rewarding and motivation and more importantly how strong impact individual rewards have on employee's performance. It also tests how effective the current rewarding and recognizing methods are in the examined company. Third it also attempts to uncover more effective practices to reward and recognize employees while increasing motivation. Finding new ways to reward employees is crucial in order to keep the employees motivated and maintain their performance level especially in such organizations where over hours and intense pace of work is common.

Theoretical Background

1. Rewarding

Rewarding includes all the methods that intend positively affect worker's attitude, productivity and organizational competitiveness. It also aims to attract and retain valued employees in the organization. (Bowen, 2000) Rewarding is according to Amstrong & Stephens (2005) divided to transactional and relational rewards which sometimes are also called tangible and intangible rewarding methods. Transactional or tangible rewards are: base pay, shares, holidays, health care and other perks.

Transactional rewards are mostly mandatory and they constitute the foundation of total rewarding. Every employee receives at least in certain degree these rewards unlike relational rewards which are more personal. Relational rewards cover learning and development and work environment hence they do not have clear visibility and pure money exchange features. However Epstein & Manzoni (2008) intensify that even though relational rewards are personal, they are not independent and they require influence and existence of a manager. Sometimes it designates that employees who enjoy higher quality relationship with their managers are more likely to receive more rewards such as challenging task assignments, more resources to do their job, wider training opportunities and more support and information from their managers. This highlights the importance of social skills and reputation within the organization since it might be crucial when talking about rewarding and recognition.

Kouzes & Posner (2003) suggest visible recognition as the most efficient rewarding method. Public recognition builds recipient's self-esteem and increases sense of community and belonging of working together to achieve shared goals and victories. Public recognition is according to Parker & McAdams & Zielinski (2000) spontaneous and unplanned activities such as celebrations, team lunches or meetings where manager shares accomplishments and challenges which have been achieved by individual worker, specific team or even whole organization. Recognition requires strong involvement from talented manager but it is an inexpensive and powerful way to reward and motivate employees since recognition enhances the awareness of good work and it can increase good competition among employees. Deeprose (2006) amplifies that also employee empowerment is an effective way to recognize and reward since employees' innovative ideas, important contribution to the organization and talents and skills will not only help make employees feel important but also help managers to improve their job performances and foster employee-manager relationship. This also gains employee motivation since employees will feel more valuable and important to the organization and their thoughts and opinions are being listened.

Cameron & Pierce (2002) capsulize the concept of effective rewarding system as a scheme that requires experimental attitude, continual finetuning, input from everyone within the system including employees and ongoing evaluation of the effectiveness of the system. However the exact rewarding methods that should be used in each organization depends on the field and culture that dominates in the company. The aim of effective rewarding system should in any case increase employee satisfaction and productivity, attain high standards, lead to personal and social goals and increase the feeling of competence and freedom among employees. Proper rewarding methods can be unraveled by fundamental rewarding strategy planning and later by following the practices that are functional within the organization. In any case it is important to understand that all successful rewarding plans are tailor made, literature or other resources cannot present absolute practices how to reward and motivate employees.

2. Motivation

Kressler (2003) defines motivation as a rationale behind human behavior; anyone who has motives is motivated and has reasons and causes for their actions and inactions. Rationale to work is generally a combination of necessity to work, satisfy individual needs and avoid frustration. However motivation is highly personal and people react differently to motivational factors. Armstrong (2006) continues that motivation has three dimensions; direction that tells what person is trying to do, effort which explains how hard persons is trying and persistence that clarifies how long person keeps on trying. Motivation is shortly a goal-directed behavior where actions lead to valued reward and as Pinder (2008) defines: "Work motivation is a set of energetic forces that originate both within as well as beyond individual's being to initiate work-related behavior, and to determine its form, direction, intensity and duration" (p.11).

McCoy (1992) explained work motivation more than 20 years ago as a set of employee's and organization's needs which should be taken into consideration when examining the efficiency of work motivation in any organization. McCoy asserts that like human motivation, work motivation is a need of fulfillment and it is divided to employee's intrinsic and extrinsic needs and organization's needs to be organizationally effective and pursue economic value. For example in order to motivate employee job should satisfy basic human needs such as sense of belonging, acceptance, achievement, accomplishment and self-fulfillment. To do so organization requires human resources investment and clear plan how-what-and-why employees are being compensated. Educated managers will reward and guide their employees according to that plan in the most convenient way depending on the situation. The organization also needs an effective organization's culture and environment that supports the business objectives of the organization so it can benefit from the work motivation and reward planning and attain economic value from these efforts.

i. The Relationship Between Rewarding and Motivation

Armstrong (2006) agreed that there is a relation between rewarding and motivation. For example rewards like work itself, opportunities to achieve and possibilities to develop and use skills are self-generated factors that influence employee's behavior and motivation. Rewards like incentives, promotions, praises and appraisals are related to career development and they aim to promote employee motivation too. It is however argued whether rewards affect work motivation or just the quality of work life since it is commonly agreed that monetary rewards like bonuses or incentives have only short time influence on human behavior. Cameron & Pierce (2002) even claimed that money or other valuable rewards can be harmful or lead to negative motivation if they are frequently used since employees might get used to them and when monetary rewards are being discontinued, it can make employees do less and more importantly enjoy less of their doing.

Cameron & Pierce (2002) analyzed the concept of motivation by dividing it to intrinsic and extrinsic motivation as social psychologists do. Intrinsic motivation refers to behaviors that humans are doing because they are interested in them, they enjoy and they do the activity for their own sake rather than for the reward. Actually usually there is no apparent reward waiting except the activity itself. Extrinsic motivation whereas refer to behavior which is controlled by external variable or reward which is readily identified. This is commonly applied in work organizations; employees work for their projects for beforehand set goals and bonuses and adjust their input depending on the size and benefit of the reward. Separating these two motivation concepts assists to understand that instead of discovering the effect of individual rewarding methods on motivation, the concentration should be in motivational factors which designate if employer should rather develop the work environment and conditions to meet with employee's needs and intrinsic motivation or increase the extrinsic rewards to increase employee's motivation.

What makes it even more difficult to research motivation in organizations is that the results vary considerably across investigators and investigations. Persons as well as organizations are largely different which makes it difficult to find relationships between two factors or creating fully covering theoretical framework. (Elliott & Dweck, 2005) Also Epstein & Manzoni (2008) underline that even though motivation and rewarding have proven relation, it is nearly impossible to evaluate the effect of an individual rewarding method on one employee's not to mention whole organization's motivation. Hence the focus should be in total rewarding and that rewarding principles are being felt-fair among employees. No one should be rewarded any less or more than they deserve and people from equal background and performance level should be rewarded same way. This can be ensured with open communication, objective reward determination and by including employees into decision making.

Combining the previous arguments regarding rewarding and motivation it is hypothesized that: Rewarding and recognizing employees will have positive effect on employees' motivation. However how and what kind of rewarding methods should be used are not constant and they vary from organization to organization. Although there is a consensus in literature that the relationship between these two factors exists, the methods used can affect separately and in different ways. For example using social events as a rewarding method in a team-based organization will develop performance culture but might not work in any other organization. (Baron & Armstrong, 2007) The study is made only in one organization because results vary strongly depending on the organization and no generalization can be made. Also ready data from other organization cannot be found due the sensibility of the topic so no comparison between other organizations can be made. In addition this is the first research about rewarding and motivate   ion in the examined organization.

Methodology

ii. Sampling

Probability sampling method was chosen for the study since the research was made survey-based and researching the whole population was not possible in this case. The research was conducted in Istanbul, Turkey in a large international financial institution's IT-department. For the purpose of the study, the IT-department was valuable sample as its culture, innovative work environment and performance management is ideal for using and developing rewarding methods to increase employee motivation. Bowen (2000) claims that constructive culture, which is common in IT-field, supports rewarding and recognition as motivation methods and IT-organization is therefore good example for the research. The department practices energizing, interesting and challenging work environment and it appreciates what people do and want to do in future. This gave competent research platform for the research and ensured that the research was carried out successfully in chosen organization.

The total size of the IT-department is around 400 employees and the survey was sent to the employees of two selected teams which totally have 80 employees. For research limitations no more teams were approved to the research. However the sample size, 80 employees out of 400 employees, is still as big as 20% of the total population thus the results are considered truthful and comprehensive. Nonetheless it is important to notice that due the nature of the research topic the results cannot be completely generalized and they are only directive rather than absolute truth.

The sample teams have earlier participated different researches and experimentations which minimized the error of misunderstanding the purpose of research and survey questions and thereby it supported the research validity. The research was made anonymously to ensure employees will respond truthfully and that the results will not harm employees' reputation. The anonymity presumably affected positively to survey's response rate which was 77,5%. Total 62 employees out of 80 responded the survey which was sent to the employees' corporate e-mail addresses on March 2015. 24 of the respondents were women and 38 men and more than half of the employees were under 30 years old who had been working in the organization less than three years and have average seven years total work experience.

iii. Measurement and Analysing

The survey included ten questions and it was made by online survey software. Questions varied from basic information to open questions and multiple choice questions. The satisfaction to the rewarding methods was measured by using the questionnaire which was based on the earlier interview with one of the manager in the organization and general research about the research topic. The format of the questionnaire and individual questions were however formulated by the researcher itself. Previous investigations about rewarding and motivation have not been made in the organization before. Questionnaire was made easy and simple to understand to avoid misunderstandings and hold the interest of respondents in order to get representative responses.

The satisfaction to total rewarding was evaluated by set of claims such as “I am satisfied with the rewarding” and “Work performance has effect on rewarding”. For example 50 respondents out of 62 said that the social environment at the company helps them to do their job better. According to Bowen (2000) investing in social environment is common and effective way to motivate employees in IT sector since feedback, open conversations and mutual appreciation and trust come naturally in such organizations. This reveals that the social environment is proper in the examined company. However 27 were not satisfied in the overall rewarding in the organization and 21 stated that the rewarding is not fair. Also 20 of the respondents measured the rewarding system worse than in the previous companies they have been working. This states that rewarding is not arranged well enough in the company according to employees. Still the motivational factor such as work environment is sufficient and as the survey disclosed 54 consider their job is important, and 40 that their job is challenging. 42 said that managers give feedback and 45 that managers trust on them. Kressler (2003) notes that managers’ function in motivating employees is to provide good work conditions, offer responsibilities and help employees to grow and develop themselves. These features will have positive impact on employee performance which eventually will effect on their motivation too. The survey presented managers have succeeded in this and that employees feel motivated.

This study discovered that rewarding has a certain degree of impact on motivation. However, the findings show that the relationship is vague and complicated since employees seemed to be satisfied to their work and social environment and they believed they are being recognized in their job. These matters according to literature are not just motivation related but also strong rewarding methods too which means that employees should also be satisfied in total rewarding in the organization. The reasons for dissatisfaction to rewarding in the organization are likely manifold but this underlines the importance of communication between employees and employers. Rewarding is not just monetary ways to recognize from good work even though 49 of the respondents claimed that financial rewards motivate them most.

Discussion

In terms of motivation this survey did not found evident relation with rewarding. The survey however presented that employees feel motivated and satisfied with their jobs but it is clear that employees do not think motivation is directly depended on rewarding methods. When employees were asked to state the most important rewarding method 44 said money and 22 favored promotion. Only 7 people said challenging job rewards them even though in other question 40 said that their job is challenging. This reveals the complexity of motivation and instead of stating that motivation is dependent on rewarding, the concepts can be determined to function side by side and influence one another. Just as motivated employee do not always perform to the expectations of the organization. (Podmoroff, 2005)

Adding more monetary rewards is not necessarily needed even though employees believed that money motivate them most. Incentives like bonuses are too specific to increase or decrease motivation but they rather boost employees' performance momentary. (Kressler, 2003). Money is not the only way to reward employees even though it is a needed way to for example measure achievements or compare people's performance among others in the organization. (Deeprose, 2006) Also Bagshawe (2011) amplified that sometimes asking for promotion or monetary rewards the deepest reason can be lack of success or self-esteem, which some people measures by money. Also covering other elements that cause dissatisfaction such as monotonous job, unsuitable working hours or tedious work conditions can be the reason for asking more money or monetary rewards.

It is important to remember that relatively young employees who are in the beginning of their careers value methods that measure success than techniques which attend to combine work and private life. This can justify why money or monetary rewards are so important for the employees in this organization.

Regardless of how the current rewarding and motivation methods are felt the employees came across with practical development proposals how the rewarding system could serve better its purpose. Social activities such as team events or supporting sport activities could bring variety to work day and might increase physical well-being as decrease sick leave absences too. Nevertheless the amount of annual bonuses and salary upgrades the more important is to understand that the activities leading to monetary rewards should be equally and frankly evaluated. Few of the respondents believed that the bonus calculations are not made fairly and that jealousy and talks start after the announcements every year. To avoid this Armstrong (2008) suggest transparent rewarding decisions that visibly show how rewarding processes operate and how rewarding policies and practices effect on individual's performance. Official pay policies and principles which are visible for all of the employees will increase the feeling that rewarding is fair and thus increase employee satisfaction.

Conclusion

In today's workplace employees want respect, they want to be trusted and have autonomy to decide how to do their job best. Needless to say participation in decision making and asking opinion when decisions affect their job is important in every modern organization and for every employee. Money is little by little been displaced as a rewarding method especially in successful positions where people are already been paid well. (Nelson, 2012) This survey unveiled that the organization and managers are already using these recommended ways to motivate and reward their employees. Managers are sharing responsibilities and giving important daily feedback to recognize their employees, but they could be more innovative when organizing activities that are not work related.

The purpose of this research was not only to find out the relationship between motivation and rewarding but also to discover how the currently used rewarding and motivation methods succeed and how they could be even better. The research could not find unambiguous relation between motivation and rewarding as Kressler (2003) predicted; rewarding alone is not the case that motivates instead it boosts employee's performance. Rewarding methods however contribute employee's motivation and can keep up the existing motivation but claiming that individual reward has a direct effect on motivation is not true. However this research clarified that employees are motivated, their managers know how to motivate them, they are satisfied with the social environment and they are willing to create new innovative ways to reward themselves, which in the end can increase the sense of belonging to the organization and health competition between the teams and other employees.

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Horberg, E. J., & Chen, S. (2010). Significant others and contingencies of self-worth: Activation and consequences of relationship-specific contingencies of self-worth. *Journal of Personality and Social Psychology*, 98, 77 – 91. doi: 10.1037/a0016428.

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Chang-Schneider, C., & Swann, W. B. The role of uncertainty in self-evaluative processes: Another look at the cognitive-affective crossfire. In R. M. Arkin, K. C. Oleson & P. J. Carroll (Eds.), *Handbook of the uncertain self* (pp. 216-231). New York, NY: Psychology Press.

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