
Journal of Economic and Social Studies

Volume 2

Number 1



Print ISSN: 1986 - 8499
Online ISSN: 1986 - 8502

January 2012

PUBLISHER

International Burch University
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ISSN (Print)	1986 - 8499	
ISSN (Electronic)	1986 - 8502	
Frequency	Biannually	
Current Volume	2/2012	
Indexing and Abstracting :	Econlit (Journal of Economic Literature) Ebscohost Academic Search Complete ASOS Index (Sosyal Bilimler İndeksi) Index Copernicus Journal Master List	

STATEMENT OF PURPOSE

Journal of Economic and Social Studies (JECOSS) aims to develop scientific knowledge in the areas that include, and are related to Economics, Business Administration, Public Administration, Political Studies, International Relations, Labor Economics and Industrial Relations, Econometry, Sociology and Psychology. As an international social sciences journal with interdisciplinary feature, it will set a ground to bring social science communities across disciplines identified above with a view for sharing information and debate. The journal publishes refereed articles and technical research notes that build on theory and contemporary scientific knowledge. Articles submitted to JECOSS will be peer-reviewed and expected to report previously unpublished scientific work. Submitted manuscripts should follow journal guidelines and should not be under consideration elsewhere.

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English Language and Economic Growth: Cross-Country Empirical Evidence

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ABSTRACT

This paper addresses the effect of English proficiency on economic growth empirically with Barro-type cross-sectional growth regression. The empirical results provide evidence of positive correlation between initial English proficiency and economic growth only for the countries in the Asia and Europe. Therefore, countries with higher levels of English proficiency among the fraction of its population are likely to grow faster. This paper suggests that the ability to absorb knowledge is positively related to the level of English proficiency. It implies that the level of English proficiency can be viewed as a component of human capital.

KEYWORDS

English Language, Economic Growth

ARTICLE HISTORY

Submitted: 6 October 2011

Resubmitted: 15 November 2011

Resubmitted: 15 February 2012

Accepted: 28 March 2012

JEL Codes: O10, O50

Introduction

The accumulation of knowledge is generally recognized as having positive effect on economic growth, in particular, knowledge creation through the firms' research and development activities (Romer, 1990; Grossmann and Helpman, 1991; Aghion and Howitt, 1992; Jones, 1995). At a given point of time, the stock of knowledge available to an economy is just a subset of existing stock of knowledge. New ideas and insights created by a developed economy may not be aware by others, although Keller (2002) suggests that increasing economic integration and the advent of new means of telecommunication ensure that people in all countries have access to the same stock of knowledge. This is because the rate of diffusion of new knowledge to an economy depends heavily on the economy's absorptive capabilities and the existence of international knowledge spillovers (Coe and Helpman, 1995; Coe, Helpman, and Hoffmaister, 1997; Falvey et al., 2002; Falvey et al., 2004). Therefore, the production, diffusion and absorption of knowledge determine the volume of knowledge that is available to an economy.

It is widely accepted that the majority of new knowledge created by developed countries in which English has enjoyed a special status. Furthermore, it is also recognized that developing countries enjoy efficiency gains if they adopt the knowledge created in developed countries (Caselli and Coleman, 2000; Caselli and Coleman, 2001; Hall and Jones, 1999). Crystal (2003) has provided a lengthy discussion on the growth of the influence of English language and the evidence of the importance of English language in the modern society. Since knowledge itself is largely intangible, it is difficult to quantify the stock of knowledge. If the number of internationally accepted journals and published papers can be used as a proxy for the stock of knowledge, we can conclude easily that English has become an effective means of getting access to knowledge. This is because English language has been an important medium of academic publications. For instance, German Economic Review, the official publication of the German Economic Association (Verein für Socialpolitik), and Spanish Economic Review, the official publication of the Spanish Economic Association (Asociación Española de Economía), are published in English. After 49 volumes with the majority of articles in German, the Konjunkturpolitik was relaunched as Applied Economics Quarterly at the beginning of 2003, and now publishes exclusively in English.

The impact of English on daily activities can also be examined. Machinery usually comes with instructions or manuals in English. Without a basic understanding of English, workers are generally unable to use this machinery in productive activities

effectively. Keller (2002) indicates that the language of communication among R&D engineers in Germany and Italy are invariably in English in the manufacturing industry level. Based on these examples, we cannot deny that individuals are more likely to be in touch with new knowledge if they have learned English.

The importance of other languages cannot be denied. But, the importance of the English language as the international language of communication should be emphasized because knowledge is gained either by experience, learning and perception or through association and reasoning. Sometimes, important creations and discoveries in countries where English has no special status are published in a local language. But, to enable the created knowledge to reach much further around the world and to obtain a higher recognition, they would have been translated into English. This does not mean all workers in a country must master English. It just suggests at least a fraction of workers must be fluent in English. The group of workers who are proficient in English will gain access to the new knowledge and then they can translate the learned knowledge into the local language to allow the learned knowledge to reach a wider audience.

To date, no known study in economic growth has been carried out to investigate the effect of English on growth either empirically or theoretically. A small number of studies have considered the importance of language for spillovers (Caselli and Coleman, 2001; Keller, 2002). Caselli and Coleman (2001) investigate the determinants of computer-technology adoption with a large sample of countries between 1970 and 1990. They found that the fraction of the population speaking English is statistically insignificant. Keller (2002) finds that language skills are important for international technology diffusion. He shows that speaking the same language facilitates the diffusion of technology. Hall and Jones (1999) argue that the differences in output per worker across countries can be explained by the differences in social infrastructure of which is partially determined by language. They show that the fraction of the population speaking one of the five primary Western European languages: English, French, German, Portuguese and Spanish explains the variation of social infrastructure. This variable also explains the variation of natural logarithm of output per worker. But, the fraction of the population speaking English is insignificant in these two equations.

The intention of this paper is to fill the existing gap with empirical evidence. This paper is organized as follows; the first section describes the data collected and also presents empirical evidence on the relationship between the level of English proficiency and economic growth and the last section is the conclusion.

Data

In this study, data is combined from three data sources: Sorensen and Whitta-Jacobsen (2005, table A, 390-393), TOEFL Test and Score Data Summaries: 1993-1994 and 1995-1996 Editions (www.ets.org), and Barro and Lee (2000). The description of variables and their sources are summarized in Table 1.

Table 1. Description of Variables and Their Sources

Variable	Explanation	Source
GROWTH	Average annual growth rate of real GDP per worker from 1960-2000.	Sorensen and Whitta-Jacobsen, (2005, Table A, p. 390-393)
INVEST	Average investment rate in physical capital (investment share of GDP) from 1960-2000.	Sorensen and Whitta-Jacobsen, (2005, Table A, p. 390-393)
GDP60	Real GDP per worker in 1960	Sorensen and Whitta-Jacobsen, (2005, Table A, p. 390-393)
ENGLISH93	TOEFL total score mean of examinees who took TOEFL from July 1993 through June 1995.	TOEFL Test and Score Data Summary 1995-96 Edition
ENGLISH91	TOEFL total score mean of examinees who took TOEFL from July 1991 through June 1993.	TOEFL Test and Score Data Summary 1993-94 Edition
ASIA	1 if a country is classified as Asia or Middle East, 0 otherwise by TOEFL.	TOEFL Test and Score Data Summary 1995-96 Edition
AFRICA	1 if a country is classified as Africa, 0 otherwise by TOEFL.	TOEFL Test and Score Data Summary 1995-96 Edition
EUROPE	1 if a country is classified as Europe, 0 otherwise by TOEFL.	TOEFL Test and Score Data Summary 1995-96 Edition
SCHOOL60	Average schooling years in the group of the population aged 15 and above in year 1960.	Barro and Lee (2000)

Initially, the fraction of population speaking English compiled by Hall and Jones (1999) that has been used by Caselli and Coleman (2001) is intended to be utilized as the proxy for English proficiency. However, on further investigation this data was found to be unsuitable for this study. Firstly, there are only 35 countries with positive values; others had a value equal to zero. Secondly, this data contains only information about the fraction of population who use English as the «first» language. Thirdly, the reliability of this data has been questioned. For instance, the value for Singapore is 0.089, Sri Lanka 0.009, Philippines 0, India 0 and Malaysia 0 in Hall and Jones (1999). However, the English language has been widely used in the commercial sector of the above-mentioned five countries. English language is also taught as a compulsory subject at least at high school level in these five countries. Lastly, the data of Hall and Jones does not provide a measure of English proficiency for the fraction of population who know English.

To determine the suitability of a variable as the proxy for English proficiency, we probably have to go through a heated debate similar to the case for the proxies for human capital and environmental pollution. Based on the illustration in the Introduction, it is anticipated that the rate of absorption of knowledge for an economy would be greater if a larger size of the population has a better command of English. A proxy that can capture these two dimensions: the fraction of population who know English and the level of English proficiency of this group of individuals has to be identified. Currently, there is no data source that can capture these two dimensions.

Recognizing that the perfect proxy for English proficiency required by this study may not be available, this study will look for a close proxy which is widely available in the public domain. Since TOEFL and IELTS are two of the widely recognized tests of English proficiency, this study intends to consider the scores of one of the tests as the measure of English proficiency. Generally, these two tests are used to evaluate the ability of an individual to use and understand English in an academic setting. Although both tests consist of four parts: Listening, Reading, Writing and Speaking, they are assessed differently and have different measure of competence in each part. For instance, IELTS test is scored on a scale of 0 to 9 and the Internet-based TOEFL test is scored on a scale of 0 to 120. The mean score of IELTS for a country is not available in the public domain. The mean score of TOEFL can be downloaded from www.ets.org. Since the mean score of TOEFL examinees is the only widely recognized measure of English proficiency that is available in the public domain, it is used as the proxy for English proficiency of a fraction of the population who can speak English. The mean score of TOEFL examinees is not a perfect proxy required for this study. It does not fully capture the fraction of population who can speak English because TOEFL exams are taken by those who plan to live, work or study abroad, particularly in the US, UK, Canada, Australia and New Zealand. Therefore, only a small fraction of the individuals in a country enroll in TOEFL exams.

The number of TOEFL examinees also varies considerably from one country to another. The number of TOEFL examinees may reflect the amount of resources allocated in the provision of English teaching and also the fraction of population who have some competence in the English language. The mean score of TOEFL examinees may reflect the average proficiency level of the mentioned group of individuals. Creating a new variable by allowing the mean score of TOEFL examinees to interact with the data of Hall and Jones (1999) has been avoided because this only generates a sample with 35 positive values. Although there are limitations associated with the mean score of TOEFL examinees, it is the only widely available measure for English proficiency.

English language TOEFL Test and Score Data Summary: 1993-1994 Edition provides the earliest available information on TOEFL scores. The number of examinees for TOEFL Test and Score Data Summary varies from one country to another. For instance, in 1993-1994 Edition among the countries where score means are reported, the lowest number of examinees is 34 and highest is 260513. Since outliers can distort average, countries with low number of examinees are excluded. Only countries with at least 1000 examinees are included. The cut-off point of at least 1000 examinees is chosen arbitrarily. A higher cut-off point is avoided so that a reasonable sample size can be maintained.

Crystal (2003, pp. 62-65) identifies seventy-five economies in which English has held or continues to hold a special status as either the primary language or second language. These economies include New Zealand, United States, Singapore and others. In these countries, the use of English is high among the general population. Therefore, this group of countries has been omitted from this study because TOEFL is designed to measure the English proficiency of people whose native language is not English. Although this group of countries is the main creators of knowledge in terms of the aggregate volume of created knowledge, some of them are not major creators of knowledge individually. High percentage of knowledge is transmitted from some of these countries to others. Putting these data sources together, the total number of usable observations is only 43 economies, as reported in Table 2. Some of the included countries have to be recognized by this study, for example France, Switzerland and others are major creators of knowledge also.

Table 2. Economies Included in This Study

Argentina	Dominican Republic	Israel	Portugal
Austria	Ecuador	Italy	Romania
Belgium	Egypt	Japan	Spain
Bolivia	El Salvador	Jordan	Sweden
Brazil	Ethiopia	Korea	Switzerland
Chile	Finland	Mexico	Syria
China	France	Morocco	Taiwan, China
Colombia	Greece	Netherlands	Thailand
Costa Rica	Guatemala	Norway	Turkey
Cyprus	Indonesia	Panama	Venezuela
Denmark	Iran	Peru	

Dummy variables are created for different regions based on the classifications of TOEFL Test and Score Data Summaries. In this study, countries have been grouped under the classifications of Middle East and Asia regions into a single regional dummy. The Asia regions are included in this group because there are only four countries classified under Middle East region and traditionally the countries under these two TOEFL classifications are classified as Asian countries in the atlas. All regional dummies are not used as intercept dummies that are the common approach in existing empirical studies (Barro, 1991, 1997; Easterly and Levine, 1995; Feng, 2003). They will be used as slope dummies to interact with either ENGLISH91 or ENGLISH93.

Results

The Barro-type cross-sectional growth regression is utilized in this study. This cross-sectional regression captures conditional convergence by introducing the initial GDP per capita that is measured by real GDP per worker in 1960, GDP60, as an independent variable. GROWTH is the dependent variable used in this study. There is a possibility of the endogeneity problem arising in this research due to the reverse causality between economic growth and English proficiency. For instance, economic growth leads to increased demand for English speaking employees and thus to higher English proficiency. To tackle this issue, initial English proficiency is used as an independent variable. Mean scores of TOEFL obtained from the TOEFL Test and Score Data Summaries: 1993-1994 and 1995-1996 Editions computed from paper-based TOEFL test are used as the initial English proficiency level. They are denoted as TOEFL91 and TOEFL93, respectively. Both TOEFL91 and TOEFL93 are used to represent the initial English proficiency level in different regression model because in the earlier cross-country studies related to human capital, it has been observed that the empirical results are highly sensitive to the choices of proxy and the types of dataset been used. Since GROWTH is the average annual growth rate of real GDP per worker from 1960-2000 and the year associated with either TOEFL91 or TOEFL93 is within the whole period, the issue related to endogeneity may not be fully addressed.

The panel data estimation methods, which are commonly used in the estimation growth equation, for instance the works of Baldacci, Clements, Gupta, and Cui (2008) and Caselli et al. (1996), was not used in this study because it is not possible to obtain long enough data for the mean score of TOEFL of each selected country. New TOEFL tests have been developed over the last decade. Initially, the TOEFL test was paper-based.

However, in 1998, the computer-based TOEFL test was introduced. Subsequently, the Internet-based TOEFL test was developed in September 2005. With the introduction of Internet-based TOEFL tests, computer-based TOEFL tests were discontinued in September 2006. Currently, paper-based TOEFL test is offered on a limited basis to support the Internet-based TOEFL testing network. The maximum score of each test is different. For instance, the maximum score of Internet-based TOEFL test is 120, paper-based TOEFL test is 677 and computer-based TOEFL test is 300.

The regression results are reported in Tables 3, 4 and 5. It has been noted that, in the existing empirical studies, the significance of one independent variable can be affected by the choices of data and groups of independent variables used (Levine and Renelt, 1992; Sala-i-Martin, 1997). Equation (1) is the base model, which captures common control variables observed in the literature and the proxy for initial English proficiency is only introduced in the remaining equations. Two control variables (INVEST and GDP60) were used to keep the regression models simple and to prevent the debate on the suitability of other variables. INVEST and GDP60 are both statistically significant at 1% level for all equations reported in Table 3. They showed the expected result. These results are consistent with previous studies.

ENGLISH91 and ENGLISH93 are statistically insignificant in Equation (2) and Equation (3), respectively. But, they have the expected positive result. The lack of significance of the coefficient of either ENGLISH91 or ENGLISH93 warrants some careful analysis. At this stage, it is premature to conclude that English proficiency has no impact on economic growth because it is assumed that the effects of English proficiency are homogeneous across continents. Whether English proficiency has an effect on economic growth is a problem of the specification of a model. To overcome this problem, slope regional dummies were introduced into Equation (4) and Equation (5) of the study. ENGLISH91 and ENGLISH93 are still statistically insignificant. The signs for both of them are different. ENGLISH91 has a negative sign which against the argument that the level of English proficiency has a positive effect on economic growth. Among the slope regional dummies, only ASIA and EUROPE are significant. There are only 3 countries associated with AFRICA. The low number of observations in AFRICA may be the reason why this slope dummy is statistically insignificant. Comparing Equation (4) and Equation (5), each regional dummy has same sign and similar magnitude. Based on F-test, ENGLISH91 and ENGLISH91xAFRICA are jointly insignificant even at 10% level in Equation (4). ENGLISH93 and ENGLISH93xAFRICA of Equation (5) are also jointly insignificant at 10% level. Therefore, these jointly insignificant variables are omitted to estimate Equation (6) and Equation (7).

In Equation (6) and Equation (7), all left-hand side variables are significant at 1% level. The coefficient of each left-hand side variable for these two equations has a similar magnitude. Both these final equations also have \bar{R}^2 of slightly above 0.7. All the earlier equations have \bar{R}^2 lower than both these two final equations reported in Table 3. Interaction terms between ASIA and either ENGLISH91 or ENGLISH93 are significant

Table 3. Regression Results: GROWTH as the Dependent Variable

	Equation						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
INTERCEPT	9.98x10 ⁻³ (3.84x10 ⁻³) ^b	5.69x10 ⁻³ (0.0292)	4.71x10 ⁻³ (0.0306)	0.0135 (0.0265)	8.64x10 ⁻³ (0.0265)	0.0137 (3.76x10 ⁻³) ^a	0.0137 (3.76x10 ⁻³) ^a
GDP60	-1.26x10 ⁻⁶ (1.86x10 ⁻⁷) ^a	-1.29x10 ⁻⁶ (2.33x10 ⁻⁷) ^a	-1.29x10 ⁻⁶ (2.25x10 ⁻⁷) ^a	-1.19x10 ⁻⁶ (1.73x10 ⁻⁷) ^a	-1.19x10 ⁻⁶ (1.67x10 ⁻⁷) ^a	-1.22x10 ⁻⁶ (1.41x10 ⁻⁷) ^a	-1.22x10 ⁻⁶ (1.40x10 ⁻⁷) ^a
INVEST	0.1400 (0.0170) ^a	0.1397 (0.0171) ^a	0.1397 (0.0171) ^a	0.0783 (0.0223) ^a	0.0787 (0.0221) ^a	0.0728 (0.0218) ^a	0.0727 (0.0217) ^a
ENGLISH91		8.52x10 ⁻⁶ (5.58x10 ⁻⁵)		-3.11x10 ⁻⁶ (4.79x10 ⁻⁵)			
ENGLISH93			1.04x10 ⁻⁵ (5.76x10 ⁻⁵)		6.00x10 ⁻⁶ (4.66x10 ⁻⁵)		
ENGLISH91x AFRICA				8.47x10 ⁻⁶ (1.13x10 ⁻⁵)			
ENGLISH93x AFRICA					8.89x10 ⁻⁶ (1.13x10 ⁻⁵)		
ENGLISH91x ASIA				2.93x10 ⁻⁵ (8.70x10 ⁻⁶) ^a		2.84x10 ⁻⁵ (8.90x10 ⁻⁶) ^a	
ENGLISH93x ASIA					2.94x10 ⁻⁵ (8.52x10 ⁻⁶) ^a		2.82x10 ⁻⁵ (8.79x10 ⁻⁶) ^a
ENGLISH91x EUROPE				2.62x10 ⁻⁵ (6.38x10 ⁻⁶) ^a		2.62x10 ⁻⁵ (5.46x10 ⁻⁶) ^a	
ENGLISH93x EUROPE					2.56x10 ⁻⁵ (6.17x10 ⁻⁶) ^a		2.60x10 ⁻⁵ (5.42x10 ⁻⁶) ^a
\bar{R}^2	0.5598	0.5487	0.5488	0.6992	0.6994	0.7096	0.7096

^a Statistically significant at the 1% level in a two-tailed test.

^b Statistically significant at the 5% level in a two-tailed test.

^c Statistically significant at the 10% level in a two-tailed test.

Standard errors are in the parentheses and are constructed from White's (1980) heteroskedasticity-consistent covariance matrix.

at 1% level as reported. The same conclusion also applies to interaction terms between EUROPE and either ENGLISH91 or ENGLISH93. This implies that the level of English proficiency has a positive impact on the economic growth of Asian and European economies only. The economies in other regions do not enjoy the positive effects of English language on growth probably due to internal factors, such as political instability, market distortion, policy uncertainty and lack of political freedom. These internal factors may disrupt market activities and threaten the effective use of human capital.

To keep the models simple, the regression models obtained in Table 3 have only two control variables: INVEST and GDP60. These regression models lack a general education variable, which may lead to misspecification of model. Furthermore, some researchers may suggest that the results in Table 3 are obtained because the English language variable has acted as a proxy for general education. To check whether the results of English language variable are robust to the inclusion of other common independent variables and to prevent the misspecification of model, initial average years of schooling, SCHOOL60, is introduced in the regression models reported in Table 4. Recognizing that the interaction of the dummy variable associated with African countries and initial English proficiency is insignificant in the earlier results and there are only three African countries in this sample, ENGLISH91xAFRICA and ENGLISH93xAFRICA are omitted.

Table 4. Regression Results: GROWTH as the Dependent Variable

	Equation				
	(8)	(9)	(10)	(11)	(12)
INTERCEPT	0.0115 (0.0047) ^b	0.0109 (0.0333)	0.0107 (0.0354)	0.0338 (0.0321)	0.0295 (0.0332)
GDP60	-1.32x10 ⁻⁶ (2.4x10 ⁻⁷) ^a	-1.33x10 ⁻⁶ (2.5x10 ⁻⁷) ^a	-1.33x10 ⁻⁶ (2.43x10 ⁻⁷) ^a	-1.24x10 ⁻⁶ (1.95x10 ⁻⁷) ^a	-1.25x10 ⁻⁶ (1.91x10 ⁻⁷) ^a
INVEST	0.1273 (0.0296) ^a	0.1273 (0.0309) ^a	0.1273 (0.0311) ^a	0.0542 (0.0352)	0.0550 (0.0354)
SCHOOL60	4.5x10 ⁻⁴ (1.1x10 ⁻³)	4.4x10 ⁻⁴ (1.2x10 ⁻³)	4.4x10 ⁻⁴ (1.2x10 ⁻³)	6.6x10 ⁻⁴ (1.0x10 ⁻³)	6.2x10 ⁻⁴ (1.1x10 ⁻³)
ENGLISH91		1.05x10 ⁻⁶ (6.18x10 ⁻⁵)		-3.57x10 ⁻⁵ (5.6x10 ⁻⁵)	
ENGLISH93			1.46x10 ⁻⁶ (6.5x10 ⁻⁶)		-2.73x10 ⁻⁵ (5.72x10 ⁻⁵)
ENGLISH91x ASIA				2.77x10 ⁻⁵ (8.57x10 ⁻⁶) ^a	
ENGLISH93x ASIA					2.78x10 ⁻⁵ (8.44x10 ⁻⁶) ^a
ENGLISH91x EUROPE				2.87x10 ⁻⁵ (6.99x10 ⁻⁶) ^a	
ENGLISH93x EUROPE					2.82x10 ⁻⁵ (6.82x10 ⁻⁶) ^a
\overline{R}^2	0.5429	0.5302	0.5302	0.7007	0.6998

^a Statistically significant at the 1% level in a two-tailed test.

^b Statistically significant at the 5% level in a two-tailed test.

^c Statistically significant at the 10% level in a two-tailed test.

Standard errors are in the parentheses and are constructed from White's (1980) heteroskedasticity-consistent covariance matrix.

Table 5. Regression Results: GROWTH as the Dependent Variable

	Equation			
	(13)	(14)	(15)	(16)
INTERCEPT	0.0116 (4.8x10 ⁻³) ^b	0.0116 (0.0048) ^b	0.0254 (4.6x10 ⁻³) ^a	0.0253 (4.6x10 ⁻³) ^a
GDP60	-1.35x10 ⁻⁶ (2.51x10 ⁻⁷) ^a	-1.35x10 ⁻⁶ (2.5x10 ⁻⁷) ^a	-1.3x10 ⁻⁶ (2.0x10 ⁻⁷) ^a	-1.3x10 ⁻⁶ (1.99x10 ⁻⁷) ^a
INVEST	0.1258 (0.0282) ^a	0.1259 (0.0281) ^a	0.0630 (0.0241) ^b	0.0630 (0.0240) ^b
ENGLISH91x SCHOOL60	9.92x10 ⁻⁷ (1.8x10 ⁻⁶)		-4.82x10 ⁻⁶ (2.0x10 ⁻⁶) ^b	
ENGLISH93x SCHOOL60		9.7x10 ⁻⁷ (1.79x10 ⁻⁶)		-4.77x10 ⁻⁶ (1.98x10 ⁻⁶) ^b
ENGLISH91x SCHOOL60x ASIA			7.44x10 ⁻⁶ (2.31x10 ⁻⁶) ^a	
ENGLISH93x SCHOOL60x ASIA				7.39x10 ⁻⁶ (2.29x10 ⁻⁶) ^a
ENGLISH91x SCHOOL60x EUROPE			6.84x10 ⁻⁶ (1.67x10 ⁻⁶) ^a	
ENGLISH93x SCHOOL60x EUROPE				6.79x10 ⁻⁶ (1.65x10 ⁻⁶) ^a
\overline{R}^2	0.5442	0.5441	0.7170	0.7166

^a Statistically significant at the 1% level in a two-tailed test.

^b Statistically significant at the 5% level in a two-tailed test.

^c Statistically significant at the 10% level in a two-tailed test.

Standard errors are in the parentheses and are constructed from White's (1980) heteroskedasticity-consistent covariance matrix.

Equation (8) is the base model reported in Table 4 with the addition of SCHOOL60 but without any initial English proficiency and the interaction terms of dummy variables. The results associated with GDP60 and INVEST are similar to those obtained from Equation (1). SCHOOL60 is statistically insignificant but its estimated coefficient has the expected positive sign. The proxies for initial English proficiency are in-

roduced in Equations (9) and (10). SCHOOL60 is still statistically insignificant. The results for other independent variables are similar to those obtained from Equations (2) and (3). Interaction terms, ASIAxENGLISH91 and EUROPExENGLISH91, are introduced into Equation (9) for the estimation of Equation (11). To estimate Equation (12), interaction terms, ASIAxENGLISH93 and EUROPExENGLISH93, are added to Equation (10). In both Equations (11) and (12), INVEST becomes statistically insignificant. Initial English proficiency variable in both equations is statistically insignificant with negative sign. The interaction terms of initial English proficiency with either ASIA or EUROPE are statistically significant at 1% level with sign and magnitude similar to the earlier estimated equations.

Table 4 has produced surprising results indicating that initial schooling is not correlated with economic growth. Furthermore, investment becomes statistically insignificant when the interaction terms between initial English proficiency and regional dummy variables have been introduced as additional independent variables. Instead of analyzing the effects of initial English proficiency and initial schooling separately in this study, these two variables have been allowed to interact to obtain a new proxy for initial human capital: ENGLISH91xSCHOOL60 or ENGLISH93xSCHOOL60. Table 5 provides the results of the estimated models where this new proxy for initial human capital has been introduced as an independent variable. Equations (13) and (14) are the base models with 3 independent variables: GDP60, INVEST and either ENGLISH91xSCHOOL60 or ENGLISH93xSCHOOL60. All these independent variables are significant at 1% level, except ENGLISH91xSCHOOL60 in Equation (13) and ENGLISH93xSCHOOL60 in Equation (14). These two new proxies for initial human capital are allowed to interact with ASIA and EUROPE dummy variables in the estimation of Equations (15) and (16). In both equations, all independent variables are statistically significant at least at 5% level. All these independent variables have the expected signs with the exception of the estimated coefficient of either ENGLISH91xSCHOOL60 or ENGLISH93xSCHOOL60. The negative estimated coefficient of the initial human capital in each estimated equation implies that for Latin American and African countries, this initial human capital and economic growth are negatively correlated. However, for Asian and European countries the initial human capital is positively correlated with economic growth because in absolute value the estimated coefficient of ENGLISH91xSCHOOL60 is smaller than that of either ENGLISH91xSCHOOL60xASIA or ENGLISH91xSCHOOL60xEUROPE and the estimated coefficient of ENGLISH93xSCHOOL60 is smaller than that of either ENGLISH93xSCHOOL60xASIA or ENGLISH93xSCHOOL60xEUROPE.

The empirical results reported in Tables 3, 4 and 5 are unable to find statistically significant correlation between economic growth and the proxy for initial English proficiency if the effects of initial English proficiency are treated homogeneously across continents. With the introduction of interaction terms between continental dummy variables and initial English proficiency into the regression models, statistically significant correlation between economic growth and the proxy for initial English proficiency can be found for countries in Asia and Europe. Therefore, there is no unanimous evidence to support the positive contribution of English proficiency to economic growth across all countries. English proficiency will have a positive impact on economic growth if the increase in English proficiency is complemented with a minimum threshold of physical capital, technology, political stability, good governance and other factors. The improvement in English proficiency without sufficient accumulation of physical capital, technology and social capital will be add significantly to the economic growth of a country. This probably explains why English proficiency does not contribute to the economic growth of the countries outside Asia and Europe. Hence, English proficiency can be seen as a necessity but not sufficient condition for economic growth.

Conclusion

The spectacular growth of Asian countries can be attributed to the heavy investment in the creation of human capital that fosters a English-speaking culture and promotes a climate of the use of English. An increase in English proficiency will directly accelerate the knowledge absorptive capabilities of workers. A similar argument can be applied to European economies, which also enjoy a positive growth rate. This study does not find any evidence about the effects of English language on the economic growth of Latin American and African countries. This indicates that a satisfactory understanding of the effect of English language on economic growth requires an appreciation of how the formation of institutions, stability and certainty can encourage the accumulation of knowledge. It is important not to forget the fact that even if this study is able to find a positive relationship between the proficiency level of English and the growth rate in a cross-sectional data, establishing this relationship can be very difficult under different empirical framework and different measures for the proficiency level of English.

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Living and working in retirement, a new paradigm in the US exploring retirees attitudes and beliefs toward working

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ABSTRACT

This paper investigates the problem that an increasing number of people in the United States are financially unprepared for retirement, leading to a rise in post-retirement employment. The purpose of the study was to explore attitudes and beliefs toward continued or actual employment behaviors among a set of retirees who have chosen to continue working after reaching retirement age. The grounded theory study design was applied in the efforts to explain, at a broad conceptual level, the reasons older workers have chosen to continue working after reaching retirement age. Data gathered from 25 workers age 65 and older were analyzed. The analysis revealed five work motivators, five inhibitors of saving, six methods of saving, four lifestyle accommodations, and four work attitudes. Implications of the research were presented. The results suggest the new retirement funding structures have not been favorable to saving. Suggestions for a more positive retirement outlook are offered.

KEYWORDS

Retirement, Retirement Living, Post-Retirement Employment, Retirement Funding, Defined Benefit Pension Plans, Defined Contribution Pension Plans, Social Security Benefits

ARTICLE HISTORY

Submitted: 17 February 2012

Resubmitted: 27 March 2012

Resubmitted: 5 April 2012

Accepted: 10 April 2012

JEL Codes: D14, D19, Z00

Introduction

The post-1960s era was the era of increasing prosperity and conservative retirement programs in American society, which allowed older workers to retire on time. Recently, the major sources supporting these programs, Social Security, defined-benefit plans, and savings, have changed significantly. Specifically, Social Security faces a financial shortage by the middle of 2032 (Cahill, Giandrea and Quinn 2006). This financial shortage condition will result in reduced benefits, lower rates of replacement, later traditional or early retirement age, including eligibility for benefits and increases in social security taxes and other government revenues. Defined-contribution (DC) plans like the 401ks that carry substantial investment risks are fast replacing the traditional pension plans; and the U.S. National Income and Product Accounts recently reported savings have decreased to the lowest levels since the Great Depression of the 1930s (Cahill et al.). As these income sources continue to face reductions and create under funding of retirement, many older workers in America will be faced with two choices: working for more years or enduring a lower standard of living during retirement (Cahill et al.). While a portion of retirees have always chosen to remain in the labor market for a variety of reasons, the changing economics of retirement funding threaten to change both the proportion of working retirees, and the mix of factors that motivate them to work.

The existence of retirement underfunding, resulting primarily from the changing structures of the retirement funding vehicles and extravagant lifestyle during the accumulation years by many, and the extent to which the underfunding affects retirees is fast becoming a problem (Cahill et al. 2006; Robertson 2006). In general, the U.S. retirement accounts savings are expected to experience a shortage of about \$400 billion between the years 2020 and 2030 (Marquez 2006). Robertson (2006) reported American spending habits and lack of financial planning the primary reasons for this shortage; suggesting baby boomers who are yet to retire will have to make a dramatic change in their savings, spending, and investing habits if they wish to enjoy their retirement. According to U.S. Department of Labor, over 70% of all workers must now rely on their 401(k) rather than a pension plan (Wasik 2004). "As 401(k)s have grown from covering 7.5 million workers in 1984 to more than 42 million today, its counterpart—the guaranteed defined benefit pension—has gone from covering more than half the workforce to only 35 percent" (Wasik 2004, p 6). The continued shift away from guaranteed defined benefit pension toward 401(k) plans has precluded some Americans who could afford to retire from doing so (Baker 2007). Persistent erosion of employer-sponsored health benefits is also likely to

continue (Mermin, Johnson and Murphy 2006); adding to this problem; and creating a condition for lifestyle adjustment by retirees.

Continuing to work has been one method used by people to address this condition (Utkus 2006); but the erosion of Social Security and health benefits have resulted in a complexity of factors that cause retirees to work. These factors undermine how retirees feel about working; further complicating the problem this study researched: that an increasing number of people in the United States are financially unprepared for retirement; resulting primarily from the changing structures of the retirement funding vehicles and extravagant lifestyle during the accumulation or working years. As a result, this study's purpose was to explore attitudes and beliefs toward continued and actual employment behavior among a set of retirees in Hartford County, Connecticut, who have chosen to continue working after reaching retirement age. For purpose of the study, age 65 was designated the retirement age.

Literature Review

Retirement has been redefined, particularly as the first phase of the baby boom generation (those born in 1946) has reached traditional retirement age (Cahill et al. 2006). Fundamental changes in retirement funding sources, improved health among older people, and increased longevity have rendered many Americans unable to finance over 25 years of leisure in later years without reducing their living standards by more than 40%. Permanent or one-time retirement in America may have come to an end, as indicated by the trend toward early retirement among older men (Cahill et al. 2006).

Historical overview

Working to earn money is widely recognized as an important aspect of living in many societies (Herzberg, 1966). As people approach retirement, they may be motivated by other factors to remain employed. Maslow (1954) noted these factors to include belongingness, fulfillment and meaning, happiness, and leisure. According to Maslow, the reason is that satisfying any one need is consequential to that need

becoming submerged and a new need emerging as the higher need. Recently, the changing structure of the retirement funding vehicles has resulted in seniors continuing to work, and a different trend toward retirement (Utkus 2006).

During the 20th century, the average retirement age declined dramatically among men: from 74 years in 1910 to 70 years in 1950, 65 years in 1970, and 62 years in 1985 (Cahill et al. 2006). In 1880, over 75% of 64-year-old men worked; 65% worked in 1900; 47% had jobs in 1950; and in 1998, less than 20% of 64-year-old were working (Gustman and Steinmeier 2009). According to Smith (2001), the shift in average retirement age was immediately preceded by the Great Depression and the advent of Social Security; in 1930, 58% of 64-year-old men were employed.

The decline predominantly resulted from increased prosperity during the preceding century along with growth in public and private retirement programs. Increased productivity and real wages resulted in workers spending a portion of their wealth on leisure and early retirement. Since the mid-1980s, the average retirement age for American men has stabilized because of changes in the retirement landscape. These changes included the end of mandatory retirement, the displacement of traditional defined-benefit (DB) pension plans by defined-contribution (DC) plans, increased longevity, improvements in general health, and the reduction of rigorous physical requirements in many jobs (Cahill et al. 2006). All these changes have increased incentives for older Americans to remain in the labor force.

Prior to President Franklin Roosevelt's establishment of Social Security in 1935, many Americans participated in the workforce until they could no longer work (Gallagher 2004). The reason was that private employer-funded pension plans were rare before the 1930s. Although employer-sponsored retirement plans date back to the late 19th century (Libecap 2004), during the preindustrial era, few people relied on employers or the government in saving for their retirement. The elderly continued to work as long as they could. As people's strength or acuity declined, they took on less taxing jobs; and they stopped working only when they were physically unable to continue to work (Munnell and Drucker 2006). Before the 19th century, three of four elderly Americans still worked and often owned property that provided an income (Munnell and Drucker 2006). Some workers accumulated wealth through two natural resources, farms and handicraft businesses, which could be sold or leased to fund retirement needs. Fortunate elderly relied on their children or the local community for economic support (Munnell and Drucker 2006).

Most government employees did not need to worry about funding their retirement,

because as with military pensions, public-sector pension plans date back much further in history (Libecap 2004). Between the era of the Roman Empire and the beginning of the early modern states, rulers and legislatures often provided pensions for public administrators. Prior to the 19th century, and with the exception of the military, plan offerings were specific to individual cases, because few retirement systems existed with well-defined rules for qualification and contribution (Libecap 2004). In particular, military pensions were useful for attracting, retaining, and motivating military personnel. Pensions for retired and disabled military personnel existed before the signing of the U.S. Constitution (Libecap 2004).

By 1930, public-sector pension coverage became relatively widespread in the United States; and all federal workers were covered by pension plans. State and local government employees also received pension coverage. In contrast, pension coverage for private employees remained relatively low in the first three decades of the 20th century: Only 10% to 12% of the labor force had pension coverage (Libecap 2004). By the late 1930s, the American labor movement adopted the use of President Roosevelt's Social Security program as a strategy for winning contracts, including private, employer-funded pensions for unionized workers. Those pension contracts, like Social Security, specified retirees' benefits at the onset and became generalized for Americans after World War II (Gallagher 2004).

Impact of the New Retirement Landscape

Up until the 1890s, the labor force participation rate (LFPR) in the United States, which is calculated as the percentage of the male population age 65 and older who are employed or unemployed and looking for work, remained relatively high (Lee 1998). The LFPR aligned with the incentives that had been recently created to motivate workers to remain in the labor force. In 1948, the LFPR for older American males was 70%. By 1993, the LFPR had dropped to 38%, indicating rising wealth allowed older males to retire earlier.

Consequently, the average retirement age in America fell to 64 in 1993, from 71 in 1960 ("Older Americans" 2005). Since the postwar period, the U.S. LFPR for people 65 and older has risen modestly but steadily, indicating people continued to work after they have reached retirement age particularly as the baby boom generation began to enter prime working age ("Labor Force" 2007). In contrast, the

youngest group's LFPR dropped about 5%; in particular, the LFPR for ages 24 to 54 has fallen since the recession in 2000 ("Older Americans" 2005).

The rise in the older group's LFPR resulted primarily due to few Americans having the advantage that the necessity of saving for retirement has been burned into their subconscious by society and circumstance; so that even in unfavorable economic times, or with negative returns in the financial markets, majority of the few continue to make established contributions into their retirement accounts. Such attitude toward saving results when retirement contributions are made with forgotten money, which is money that is not relied upon for daily needs. American seniors who failed to follow the same planning have experienced financial shortages in retirement as they have been forced to rely on Social Security benefits to pay for living expenses (Katz 2003). In December 2001, the Social Security Administration reported the average Social Security retirement benefits payment was \$874 per month; and 45.9 million people were paid benefits. Alternate sources, like working, are necessary for the elderly to pay for life's necessities, particularly as costs of living and inflation rise faster than their Social Security benefits (Katz 2003).

Methodology

Qualitative, grounded theory research methods were used to explore the attitudes and beliefs toward continued and actual employment behavior among a set of retirees in Hartford County, Connecticut. The process involved development of comprehensive theoretical understanding from the perspectives of the social actors engaged in the phenomenon. Such development and understanding require application of qualitative, grounded theory research methods because they aim to develop a theory, as opposed to test one already in existence (Neuman 2005). Secondly, applying an emergent-grounded theory research design aided the discovery of themes shared by the study participants, as addressed in the research questions.

The rationale for choosing qualitative grounded theory method for this study stems from the need to identify and explain the events or occurrences in a social setting, and focus on the true reality of the situation or interaction under investigation (Corbin and Strauss 1998). Grounded theory method served to generate a theory in this study because existing theories did not appropriately address the study's research problem (Glaser and Strauss 1967). Furthermore, grounding a theory in the

research data provided better explanation than a borrowed theory because it was fitted for the situation, practical and sensitive to participants in the setting, and accounted for complexities that existed in the process (Creswell 2004). These qualities of the grounded theory method contrast other research methodologies where the purpose is either to test a hypothesis or answer a question at the beginning of the research process.

Research Questions

The research questions presented in this section are qualitative in nature, and were typically used to narrow the purpose statement into specific questions sought to be answered in the study. Unlike purpose statements, which are characterized by a single statement, researchers often apply multiple research questions to fully explore a topic (Creswell 2004). One justification in case studies is the use of exploratory-type questions. Exploratory questions of how, what, and why are usually concerned with examining a contemporary phenomenon the researcher cannot influence (Yin 2008). The following qualitative research questions were used to complete this study:

1. What factors lead retirees to choose to work or not work after retirement?
2. What factors prevented retirees from accumulating what they believe to be sufficient resources for retirement, and what are the relative frequencies and perceived importance of those factors?
3. What accommodations in lifestyle have retirees had to make as a result of perceived inadequacies in their retirement funding sources?
4. How do retirees feel about the nature and amount of post-retirement employment in which they engage?

In the context of this study, “sufficient resources” are those that enable maintenance of pre-retirement or pre-planned lifestyle during retirement.

Population and Sampling Frame

The general population of interest for the study comprised all individuals who continue to remain in the labor market after reaching retirement age. The study focused specifically on an accessible set of such individuals who happen to reside in Hartford County, Connecticut. A purposive sample of individuals who have reached retirement age but continue to work was drawn from four Senior Centers in Hartford County, Connecticut. Purposive sampling is a qualitative procedure that involves intentional selection of individuals and sites for the purpose of learning and understanding the central phenomenon (Creswell 2004).

The sampling procedure for the study continued until saturation was reached, but was expected to range between 20 and 30. Based on Creswell (2007), Wicks (2004), and other researchers, sample size for qualitative grounded theory studies is typically less than 35. In order to determine if saturation had been reached, the interview data were analyzed as they were collected rather than at the end of the collection process; saturation was reached with a sample of 25.¹ The sampling strategy for the study conducted was theoretical. In grounded theory approach, theoretical sampling means that the researcher draws sample from a list of members of the population of study—the sampling frame (Creswell 2004). The sampling frame for the study conducted was generated from a list of workers age 65 and older at four Senior Centers in Bloomfield Connecticut, Enfield Connecticut, and Hartford Connecticut.

Data and Analysis

The study participants consisted of a pilot group of five, and 25 workers age 65 and older. The two groups are described below. The pilot study participants provided feedback about the interview questions for effectiveness; no comparisons were made between the pilot group and the research participants. The pilot participants comprised 3 females and two males. Of the five pilot participants, four (80%) returned to work after entering retirement, and one (20%) had never retired. Table 1 provides the demographics of the pilot study participants.

Table 1. Pilot Study Participant Demographics 2010

1	2	3	4
Gender	Age	Retired	Status
Female	66	Retired prior to current employment	Currently employed
Female	66	Retired prior to current employment	Currently employed
Female	70	Did not retire prior to current employment	Currently employed
Male	65	Retired prior to current employment	Currently employed
Male	67	Retired prior to current employment	Currently employed

Source: **Author's analysis of the pilot study population.**

Summary of Pilot Study Feedback

All five pilot study participants affirmed their understanding of the interview questions, and agreed that the information contained in the survey questionnaire provided opportunities to explore attitudes and beliefs about post-retirement employment. Participants also expressed they were comfortable with organization and flow of the interview questions.

Summary of Study Demographics

The final study demographics collected and tracked included participant gender, age, whether the participant officially retired or not, job title before retirement, year returned to work, current job title, and length of time between retirement and current employment. The only requirement for participation was that participants be 65 or older, and employed. Table 2 presents the demographic information of the study participants. Of the 25 participants interviewed, five (20%) had never retired, three (12%) immediately went back to work after they retired, eight (32%) returned to work in less than one year after their retirement, six (24%) went back to work in under three years, and three (12%) returned to work between five and 13 years following their retirement.

Table 2. Study Participant Demographics 2010

1	2	3	4	5	6
Gender	Age	Officially Retired/Job Title	Year Returned To Work	Job Title	Years Between Jobs
Female	69	No	NA	Cashier Clerk	0.5
Female	74	Administrative Assistant	2005	Senior Center Volunteer	5.0
Female	69	Cook for State Prison	2004	After School Program Teacher	.05
Female	81	Nutrition Manager	1980	Senior Center Volunteer	0.5
Female	70	Handicapped Kids Caring	1992	Senior Center Volunteer	0.5
Female	73	Payroll Supervisor	1991	Senior Center Volunteer	0.5
Female	77	High School Teacher	2001	Senior Center Volunteer	2.0
Female	75	Administrative Assistant	1996	Administrative Clerk	13.0
Female	70	Check Clearing Supervisor	2002	Senior Center Volunteer	3.0
Male	65	Grade School Teacher	2001	Senior Citizens Supervisor	8.0
Male	74	Truck Mechanist	1990	Bowling Alley Manager	0.0
Male	74	Vice President Imaging/Graphics	1998	Co-owner Graphics Business	0.0
Male	68	Construction Equipment Operator	NA	Construction Equipment Operator	0.0
Male	70	Loan Officer	NA	Loan Officer	0.0
Male	66	Jewelry Store Owner	NA	Real Estate Agent	0.0
Female	73	Toys Manager	NA	Grocery Clerk	0.0
Male	69	President, Auto Repair Shop	NA	Administrator Auto Repair Shop	0.0
Female	80	Machine Operator	1992	Grocery Cashier	0.0
Female	70	Retail Manager	2002	Retail Cashier	0.5
Female	66	Day Care Provider	NA	Day Care Provider	0.0
Female	77	Elevator Operator	1998	Telephone Operator	1.0
Male	71	Investment Consultant	1989	Investment Software Developer	0.5
Male	70	MBTA Instructor	1996	School Bus Driver	1.0
Male	71	Train Supervisor	2002	Supervisor Trolley Museum	1.0
Male	67	Psychology Professor	2009	Psychology Professor	0.5

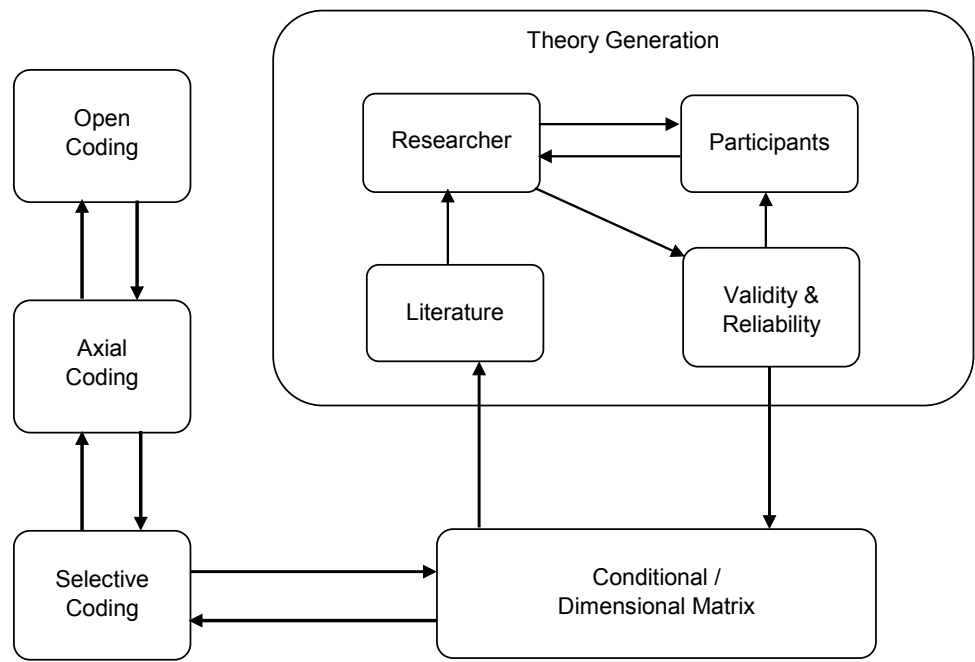
Source: Author’s analysis of the study population

Themes

As suggested by Neuman (2005), and other research methodology authors, the analysis was done to identify emerging themes that aligned with the experiences lived by the study participants, and focused in five areas: (a) work motivators; (b) inhibitors of saving; (c) method of saving; (d) lifestyle accommodation; and (e) work attitude. The first pass through of the coding process (open coding) produced 625 distinct

codes for the 25 interviews. Selective coding was used to sort the codes into five categories: work motivators, inhibitors of saving, method of saving, lifestyle accommodation, and work attitudes in development of the theory. Figure 1 presents the procedural analysis for generating the theory.

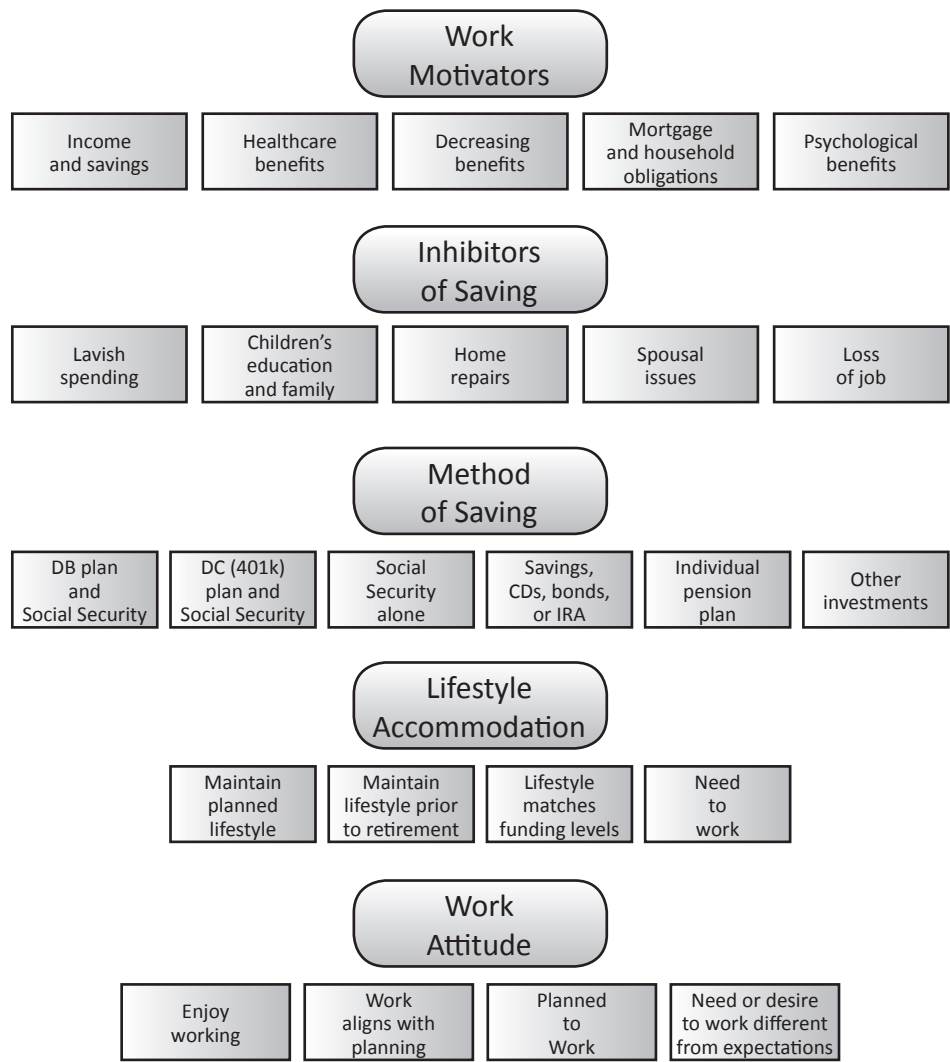
Figure 1. Procedural Analysis for Generating the Theory



Source: Author's analysis of the theory generation.

Figure 2 depicts the 24 themes that emerged in each of the five categories. The themes under each category emerged through analysis of interviews conducted in small groups. The data were transcribed and coded after interviewing each group to discover what new themes were emerging. No new theme emerged after 22 interviews, but the process was extended to 25 interviews to ensure non-emergent of new themes.

Figure 2. Predominant Codes Arranged by Major Areas of Focus



Source: Author's presentation of the study themes.

The category work motivators produced five themes: income and savings with 19 responses, healthcare benefits with 13 responses, decreasing benefits with 14 responses, mortgage and household obligations with three responses, and psychological benefits, such as happiness, healthy lifestyles, leisure and fulfillment, and meaning with 18 responses. Five themes emerged within the inhibitors of saving category: lavish spending generated five responses, children's education/family produced 16

responses, home repairs had 14 responses, spousal issues—divorced/separated generated two responses, while loss of job had no response.

The method of saving category produced six themes: DB plan and social security with eight responses, DC (401k) plan and social security with 10 responses, social security alone with seven responses, savings/CDs/bonds/IRAs with nine responses, individual pension plan with six responses, and other investments with six responses. The lifestyle accommodation category generated four themes: maintain planned lifestyle had nine responses, maintain lifestyle prior to retirement had 11 responses, lifestyle matches funding level produced 16 responses, and need to work had 18 responses. Lastly, four themes emerged within the work attitude category, namely, enjoy working with 16 responses, work aligns with needs with 14 responses, planned to work with 14 responses, and desire or need to work not to expectations with eight responses. Table 3 provides participants' responses by themes under each category.

Table 3. Participants' Responses by Themes under Each Category

1	2	3	4	5	6
Themes referenced under each category by number of responses	Category 1 Work Motivators / number of responses	Category 2 Inhibitors of Saving / number of responses	Category 3 Method of Saving / number of responses	Category 4 Lifestyle Accommodation/ number of responses	Category 5 Work Attitude / number of responses
Income and saving	19				
Healthcare benefits	13				
Decreasing benefits	14				
Mortgage and household obligations	3				
Psychological benefits	18				
Lavish spending		5			
Children's education and family		16			
Home repairs		14			
Spousal issues		2			
Loss of job		0			
DB Plan and Social Security			8		
DC (401k) plan and Social Security			10		

1	2	3	4	5	6
Themes referenced under each category by number of responses	Category 1 Work Motivators / number of responses	Category 2 Inhibitors of Saving / number of responses	Category 3 Method of Saving / number of responses	Category 4 Lifestyle Accommodation/ number of responses	Category 5 Work Attitude / number of responses
Social Security alone			7		
Savings, CDs, bonds, or IRA			9		
Individual pension plan			6		
Other investments			6		
Maintain planned lifestyle				9	
Maintain lifestyle prior to retirement				11	
Lifestyle matches funding levels				16	
Need to work				18	
Enjoy working					16
Work aligns with planning					14
Planned to work					14
Need or desire to work different from expectations					8

Source: Author's analysis of participants' responses.

Findings and Interpretations

The content analysis involved identification of important structures of the properties of textual and audio-recorded information communicated, that were later organized according to the themes identified in the categories, in alignment with the research questions. The following sub-sections have been organized based on the research questions (RQs), and the sequence of the areas of focus (categories).

RQ1—What Factors Lead Retirees to Choose to Work or Not Work After Retirement?

In the category work motivators, the major themes of income and saving, health-care benefits, decreasing benefits, mortgage and household obligations, and psychological benefits were reviewed with the view of evolving a theory of post-retirement employment. The data clearly revealed that income and savings, theme one, rank highly among the reasons seniors commit to various employment engagements after the age of 65. A major emphasis was the changing economics of the retirement funding structures, such as from the defined benefits (DB) to the defined contribution (DC) model. Some participants blamed the underfunding of their retirement accounts and their financial shortfalls to the introduction of, or switch to, the DC structure by their employers. Participants commented on how the devaluing of their retirement accounts, resulting from the relationship of the DC model to the stock markets, has contributed to their decisions to work.

The economic crisis that began in 2008 and spending habits during the accumulation years were also emphasized by participants. The data for themes two and three, health care benefits and decreasing benefits, are consistent with study finding that health insurance is among the major reasons Americans continue to work after reaching retirement age (Block 2008). Between 52% (13) and 56% (14) of the participants interviewed reported they are working for health care benefits or to supplement health care costs, in addition to other reasons. Other studies also reported that many older Americans extend their working years in order to continue receiving employer-offered benefits, such as dental, health, disability, and life insurance (Leyes 2008; Mermin et al. 2006).

A new theme emerged in the data: in addition to receiving healthcare and life insurance benefits, rising Medicare costs and deductibles, and decreasing benefits are forcing even more retirees back to work. Theme four, mortgage and household obligations, was also affirmed as a work motivator. Participants commented on real-

izing later in their lives they could have saved more for retirement if they had less mortgage obligations and household expenses. Stein (2007) found that exorbitant mortgage payments and other household obligations distort the wealth accumulation process during the working years. The data coding process also produced a new theme: obtaining a mortgage to purchase a home later in life is causing some Americans to retire with substantial amounts of debt, constraining their cash flow and lifestyle options during retirement. Participants referred to the inability to obtain a mortgage to purchase a house until late in life, rendering certain obligations, like mortgage payments, which would be part of life during the accumulations years, a necessity in retirement. This new theme is centered on the American dream of owning one's home. Consistent with Hass (2007), a majority of the participants (18) referred to psychological needs, such as happiness, healthy lifestyle, leisure and fulfillment, or meaning as work motivators, in addition to referencing other work motivators.

RQ2—What Factors Prevented Retirees from Accumulating What They Believe to Be Sufficient Resources for Retirement and What Are The Relative Frequencies and Perceived Importance of Those Factors?

Five themes constituted the category inhibitors of saving: lavish spending, children's education and family, home repairs, spousal issues, and loss of job. Discussions about the method of saving category with five themes are also presented. Participants were clear about the impact of extravagant lifestyle as unfavorable to savings, while emphasizing indiscriminate spending, theme one, a hindrance to wealth accumulation during the working years. Paying for children's education and caring for one's family members, theme two, and theme three—spending to renovate and upgrade homes during working years were also noted by participants to negatively impact savings. Additionally, spousal issues, such as loss of spouse, through death, divorce, or separation, theme four, were reported to inhibit savings, but no reference was made about theme five—job loss in this study under the category inhibitors of saving.

Six predominant methods of saving for retirement (themes) exist for people during their working years: DB plan and Social Security; DC plan and Social Security; Social Security alone; Savings, CDs, bonds, or IRA; Pension fund; and other investments. Of the six methods, DC plan, DB plan, and Social Security were mostly relied upon by participants to fund their retirement. The other methods of saving were used as supplements. On the surface, the DB plan appears to be preferred to the DC plan. Participants criticized the voluntary nature of the DC plan and its

relationship with the stock markets, while commending the DB plan for its guaranteed payments. Nevertheless, more of the participants relied on the DC model to fund their retirement; reflecting statement by Wasik (2008) that the guaranteed defined benefit plan has gone from covering more than half the workforce to only 35 percent. Participants, who saved with the DB plan and social security, theme one, were very appreciative of its guaranteed payment nature.

A larger proportion of the participants, 40%, as opposed to 32% with the DB plan model, relied upon the DC or 401k plans and social security, theme two, to fund their retirement. The finding is consistent with report by the U.S. Department of Labor that the DC plans have grown from covering 7.5 million workers in 1984 to more than 42 million in 2004, while the guaranteed defined benefit, or the DB, plan has gone from covering more than half the workforce to less than 35% (Wasik 2004). Participants who had to depend on Social Security, theme three, as the primary source of saving for their retirement, blamed the condition on their employers for not offering retirement plans of any sort. Mermin, Johnson, and Murphy (2006) found that some employers did not have DC plans, such as 401ks and 403bs, because they are not required by law to offer them. Participants commented that reliance on social security alone has led to the employment of alternate sources, such as working, to pay for life's necessities because social security benefits are not enough, especially when considering out-of-pocket health care expenses. In addition to employer-sponsored retirement savings plans and social security described above, participants noted they used saving accounts, certificate of deposits (CDs), bonds, and contributions to individual retirement accounts (IRAs)—theme four to save for retirement.

In many cases, participants used these retirement funding vehicles to supplement their DB plans, DC plans, and Social Security. Some remarked they often fell short keeping up with monetary contribution into these retirement funding vehicles, particularly during difficult financial times. Others commented that trying to save with CDs or savings account required high levels of discipline which they often lacked when their families needed additional funds to pay for non-daily needs, such as a new refrigerator, stove, car, and so on. Individual pension plans—IPPs, theme five, were also used to save for retirement, but mainly as an alternative to employer-sponsored plans, and to supplement social security. Even after transferring to new jobs that offered 401k plans, few participants left funds to grow in pension accounts established at their prior employments, but the financial crisis that began in 2008 raised concerns about deficits in those accounts. There were complaints about

reduced savings in the pension plan structures as a result of limits placed on the amount of earnings contribution so that participants can earn tax breaks at the Internal Revenue Service (IRS). Participants also used other investment vehicles, such as purchasing stocks, real estate, life insurance, gold, and private business ventures—theme six to save for their retirement. These investment vehicles were reported to have lost values rapidly following the economic and financial events which began in 2008. Working was emphasized as the alternative for alleviating perceived reduction and cuts in the pension accounts.

RQ3— What Accommodations in Lifestyle Have Retirees Had to Make as a Result of Perceived Inadequacies in Their Retirement Funding Sources?

Four themes were presented for the category lifestyle accommodation: maintain planned lifestyle, maintain lifestyles prior to retirement, lifestyle matches funding levels, and need to work. These themes were extracted from responses to questions about lifestyle adjustments, in relation to funding levels, in retirement.

Nine of the participants reported they were able to maintain the lifestyle they planned in retirement—theme one, but five of the nine participants noted they could only partially maintain the lifestyle they planned in retirement. The five participants remarked that unexpected decreases in their income levels created a condition in which they have to work to sustain their income; preventing them to fully achieve the lifestyle they planned in retirement. A majority of the participants could not maintain the lifestyle they planned in retirement due to lack of proper guidance in structuring their retirement planning. Eleven of the 25 participants made references to being able to maintain the same lifestyles as they enjoyed prior to retirement—theme two. Among the 11 are seven who depended on social security, supplemented by working, to fund their retirement. The seven participants reported they had not planned any lifestyle adjustments, but noted that working allowed them to do the type of things they enjoy doing. Grewal, Nazroo, Bajekal, Blane, and Lewis (2004) found that an increasing number of retirees need paid work to improve their pension packages, and, or maintain their pre-retirement living standards. A majority of the participants, including those who have achieved their planned lifestyles, reported living lifestyles that matched their funding levels, theme three. In general, there were remarks about adjusting living standards to suit funding levels, or lifestyle in retirement being a function of funding level. Participants highly praised paid work for enabling them improve their retirement incomes, achieve planned lifestyles, or maintain pre-retirement lifestyles. Achievement and maintenance of lifestyle as mo-

tivating factors for post-retirement employment were also emphasized. There were many references to working as a necessity. On the surface, participants noted working as a way to mitigate shortages resulting from hard economic and financial times, extend retirement savings, and improve quality of life in retirement. Researchers identified having wealth and income as one of the influences of quality of life in retirement (Grewal, Nazroo, Bajekal, Blane and Lewis 2004).²

RQ4—How Do Retirees Feel About the Nature and Amount of Post-Retirement Employment in which They Engage?

Four themes constituted the category of work attitude. The themes were the outcome of responses to the questions used to explore how retirees feel about the nature and amount of post-retirement employment in which they engage. A summary of the outcomes provide further clarity. A majority of the participants expressed liking working in retirement, theme one; some emphasizing the various work motivators described above. Several comments indicated working for income and savings, leisure or meaning and fulfillment, or some other combination creates a source for enjoyment and mental engagement, and adds to retirement asset base. Participants depending on social security, supplemented by working, to fund their retirement reported they did not like working in retirement. Fourteen participants reported their work aligned with their retirement plan—theme two. A majority noted that working for additional funding, leisure, meaning, and fulfillment were part of their retirement planning; some remarked engaging in their type of work was pre-planned as well. Participants reported being aware prior to retiring that they needed to supplement their incomes doing things they like to do, such as, having an engagement that produced happiness, or making meaningful contributions to the society. Haas (2007) reported that even those in our society who are considered to be better positioned financially perceive continuing to work in retirement as paying substantial dividend.

In general, participants noted that their plan to work, theme three, was inspired by the possibility of shortages in their retirement benefits due to general economic conditions, the extent of social security benefits, the availability of health insurance, and the quality and design of employer-sponsored retirement plans. Working for fulfillment and meaning was also reported as part of planning. Working in retirement was perceived as a way to broadened one's horizon and enrich life through mingling and interacting with people. Eight of those interviewed referenced their need or desire to work has been different from their expectations—theme four, based on work schedules, work structures, need for additional funding, and nature of work.

Analysis of Early Recollections

Six participants were able to recall specific memories about the stage in their lives they began to realize their desire and need to work when they retire. Table 4 presents the themes of early recollections—individual beliefs of each participant. Participant 1’s individual beliefs seem to be centered on loss of spouse, the relationship between money and the importance of working. The themes seem to reflect beliefs that losing one’s spouse during the accumulation years lead to distortion in the resource accumulation process, the need for employment in later years, and working as part of retirement planning. Participant 10’s individual beliefs seem that being in a field of work that a person likes can encourage extension of one’s working years, and that can be realized earlier, than later, in that person’s career. Participant 12’s individual beliefs seem about planning retirement engagement, the level of funding, and the relationships of funding level to retirement engagement. Participant 14’s individual beliefs seem that family obligations determine the desire or need to work in retirement.

Table 4. Themes of Early Memory Reflection

1	2
Participant	Themes of Early Memory Reflection
1	Right after I lost my husband 10 years ago I went into the surviving mode. I knew I will be working through my retirement. Money became the first priority.
10	I realized my desire, not necessarily need, to work early. I liked to maintain contact with the children and their parents. Halfway through my career I knew I will teach much later in life. Working for money came late—when I realized the loss in my investment and retirement accounts.
12	I always planned to do something I enjoy doing in retirement. I love doing this very much; it provides us with extra money. It aligns with my planning.
14	I have always known that I would need to supplement my retirement income, as a result of family obligations. I also knew I can continue to do my type of work as long as I wanted.
15	I knew I would work until my later years because I love what I do; and because I spent lavishly. As long as I have good health, I will always be employed in real estate.
23	I started saving later in my career; so I knew I had to work later.

Source: Author’s presentation of early recollections.

While overlap of themes, such as being in a field of work that a person likes can encourage extension of one's working years, seem apparent among participants, no predominant theme emerged. Based on the literature on early recollection, at least five early memories are required for effective evaluation of patterns and themes within an individual (Mosak and Di Pietro 2006; Clark 2002). Even though participants' memories in the study conducted suggested tentative themes, enough data were not collected to fully highlight the cognitive beliefs of each participant individually or to evaluate all of the memories so that associated patterns and themes could be determined.

The design of the study allowed participants free expression of their specific examples and any distinct moments. However, asking participants for subsequent explanation about the most vivid part of the examples would have distracted the natural flow of the discussion and inhibited assessment of their cognitive beliefs, hence proved invaluable. Rather, coding the specific examples provided a richer understanding of the need and desire to work in retirement. Questions about the most vivid moments, associated feelings and reasons for the feelings were not answered, but analysis of early recollections proved valuable.

Discussion of Results

Although questioning participants about content-specific examples and early memories inhibited assessment of their cognitive beliefs, there was value in the information obtained. Fifty-six percent of the participants presented recollections that had substantial impact on their decision to, or not to, work in retirement. Included in the 56% are the 40% whose retirement accounts were based on the DC model and 16% that had their accounts switched from the DB to the DC structure. The recollections included recent past awareness of needs or desire to work, or not work, in retirement based on perceptions about the extent of support from individual retirement accounts; and alignment of those needs, or desire, to participants' expectations in terms of levels of finances in retirement.

The fact that 56% of the participants noted late recollections that had substantial impact on their decisions to remain in the workforce, based on payout expectations of their retirement accounts, suggests there may be implications about the relationship of the DC plan with the financial markets and the changing economics of the retirement funding structures. Purcell (2007) found that participation in the labor force among people age 55 and older has been affected by both the trends toward

the DC plan and away from the DB plan structures. The U.S. Department of Labor reported that the DC plan have grown to cover more workers between 1984 and 2004, while coverage by the DB plan continues to decline (Wasik 2004).

Data about the lifestyle accommodation category suggest that a majority of those interviewed could not maintain the lifestyle they planned in retirement, but participants remarked the security offered by the DB model could have facilitated ability to estimate their funding levels at retirement. In general, nine participants noted they were able to maintain their planned lifestyle in retirement. Five of the nine participants reported they could partially maintain the lifestyle they planned in retirement, due to unexpected decreases in their income levels, which led to a condition in which they have to work to sustain their incomes. The finding suggests existence of difficulty in estimating income levels at retirement. Cahill et al. (2006) noted that income levels at retirement could often be estimated prior to replacement of the DB pension plan with the DC structure in 1986.

Comments about working to mitigate shortages resulting from hard economic times were mostly associated with participants whose retirement plan structures were based on the DC model, such as the 401k plan. Some participants remarked that the continued shift away from guaranteed defined benefit pension toward 401k plans precluded them from retiring. There were also comments about how the devaluing of participants' retirement accounts, as a result of the relationship between the DC model and the financial markets, has contributed to their decisions to continue working.

The results suggest that the changing economics of the retirement funding structures may have forced retirees back to work to mitigate resulting financial shortages in their retirement accounts; contributing to the increase in the number of employed retirees. The results also suggest that the three attitudinal responses to bridge employment: occupational self-efficacy, retirement attitudes, and job satisfaction may affect (a) how retirees feel about working (Dendinger et al. 2005), and (b) the work-related attitudes of non-retired workers and bridge employees. The changing economics of the retirement funding structures may also be a contributory factor in extending working years by older employees. Daugherty (2007) noted that non-retired older workers who sense the possibility of shortage in their retirement income choose to work longer as a way to boost the average income for calculating their retirement benefits, and ensure entitlement of larger Social Security benefits. Implications of the research findings, significance of the study, and suggestions that may assist interested parties in establishing a more positive outlook of the retirement landscape follow.

Implications of the Research Findings

The current study presented and documented how a set of retirees deal with their mix of saving, spending, income, and working since replacement of the traditional DB pension plan with the DC model in 1986 (Cahill et al. 2006).³ The results showed that retirees are addressing the problem of underfunding, created by the continued reductions in their retirement accounts, by working longer. Based on the structure of the study, retirees cited five motives for engaging in post-retirement employment, in their efforts to cope with the financial shortfall created by the shift to the DC model from the DB plan structure: income and savings, healthcare benefits, decreasing benefits, mortgage and household obligations, and psychological benefits. The new theme of obtaining a mortgage in retirement, which emerged in the data coding process, creates an awareness that can help finance professionals in tailoring retirement income strategy based on a two-step process: (1) understanding the client's needs and objectives, and (2) obtaining an appropriate strategic fit through matching of those needs and objectives with the most appropriate retirement income streams combinations. Understanding a client's needs can lead to effective determination of spending needs at retirement, what the size of that client's portfolio must be at the beginning of his or her retirement in order to fulfill those needs, and how much the client must save and invest between current period and the age he or she plans to retire, in order to achieve those financial goals (Lee 2007).

The results indicate that (a) participants who saved under the DB plan structure could support their retirement living better than those whose retirement plan structure was based on the DC model; (b) the voluntary nature of the DC plan model has resulted in severe shortages in retirement savings for many older Americans, as a result of its relationship with the financial markets; (c) the relationship of the DC plans with the financial markets could warrant that prospective retirees seek the services of finance professionals to gain the benefits of money management strategies designed to provide needed cash for retirement living; (d) working was more necessary to retirees who had the DC plans than those with the DB plans; and (e) working in retirement would be more enjoyable if it extends beyond provision of economic means to gaining psychological benefits.

Significance

The results are significant for providing employers, financial services providers, educators, and the government with information needed to determine if relationships exist between the changing economics of the retirement funding structures and the mix of factors that motivate retirees to work. Information about the relationships between post-retirement employment and the changing economics of the retirement funding structures be can useful to finance professionals, and others seeking to educate or advise individuals about retirement planning. Such information can also help employers, financial planners, financial services providers, and the government to address the problem of financial shortfall experienced by many retirees in America. Knowledge about the characteristics of factors that cause retirees to work, and their relationships to the changing economics of the retirement funding structures, will also affect future individual retirement planning endeavors and can provide a basis for evaluating the effectiveness of the current retirement funding structures. Additionally, prospective retirees can benefit through realizing that services of finance and investment professionals may be necessary to effectively manage their retirement accounts, based on the relationship with the new (DC) structure and the financial or stock markets.

Suggestions for a More Positive Retirement Outlook

Suggestions are offered in the areas of minimizing income shortage during retirement, handling healthcare costs, managing mortgage expenses, and to encourage post-retirement employment for psychological and other benefits.⁴ To minimize income shortages during retirement, financial planning for retirement should start as early as possible. One initiative may be educative programs that teach about retirement investment management in the schools system. Thus, the necessity of saving for retirement can be taught to the younger generation's subconscious through early education and society. Based on the study's confirmation that retirement planning is complex and difficult for many, individuals should be encouraged to seek professional advice at the beginning phase of the planning process. Shad (2006) suggested that planning for retirement early with the help of a professional can lead to increased savings, revenue, and disposable income, and help people maintain desired lifestyle in retirement. Employers may offer an option of such services, at subsidized fees, in their retirement packages to employees.

In an effort to curb rising medical costs and decreasing Medicare benefits for seniors, employers should consider extending medical benefits for retirees and offer that option in the retirement packages they offer to their employees. Additionally, finance professionals should offer advice to their clients about incorporating supplemental medical insurance in their retirement planning. If Medicare could not provide 100% coverage or offer the same services for every retired person, as indicated by the study participants, then a well structured supplemental medical insurance may serve to fill in any resulting gaps in Medicare coverage. The government may also consider regulating physicians' care and prescription drugs costs for Medicare recipients.

The trend of entering retirement with a mortgage, which is expected to continue (Groat, 2005), requires educative initiatives that can help retirees make careful selection of mortgages based on income levels and inclination. Prospective retirees aspiring to own a mortgage should be advised to consider spending ability based on disposable income in retirement. For example, a good budget that incorporates housing costs likely to be forgotten, such as property taxes and homeowner's insurance, may be helpful. Further, because a retiree's income is often fixed, use of a fixed-interest mortgage to secure fixed payments for easier cash flow estimates should be sought by retirement advisers for their clients. Individuals can also benefit from directives about reviewing their financial situation to ensure availability of savings needed to pay for any emergencies, such as needed home repairs, accidents, or death in the family.

The finding that working in retirement provides for healthier and happier lifestyles, including mental fitness (Hass, 2007; Updegrave and Light 2007) leads to recommendation that post-retirement employment is to be encouraged. Working in retirement should also be encouraged due to certain embedded advantages: First, the economy can be enriched through production of additional goods and services; especially as the labor force participation rate (LFPR) for people aged 24 to 54 has fallen since the recession in 2000 ("Older Americans" 2005). Second, working in retirement can lead to growth in a person's asset base, and increase in his or her annual social security benefit through withdrawal of funds over a shorter period of time. Increases in individual retirement asset base can help alleviate longevity risk—the possibility of people outliving their retirement savings. Third, working in retirement can help lower social security deficits through delay of benefits payouts. Fourth, working in retirement can create additional employment tax payments which could be used to support other government programs.

Conclusions

With respect to minimizing income shortage during retirement, financial planning for retirement should start as early as possible. The necessity of saving should also be taught in schools through educative programs so that the younger generation can subconsciously become accustomed to saving with little regard to financial conditions. Based on the complex and difficult nature of retirement planning, individuals should seek professional advice at the beginning phase of the planning process. With respect to rising medical costs and decreasing Medicare benefits, employers could offer an option for extending medical coverage for retired employees under the retirement packages they offer their employees. Additionally, finance professionals should advise their clients to incorporate supplemental medical insurance in their retirement planning, and government may consider regulating physicians' care and prescription drugs costs for Medicare recipients. To ease financial burden, retirees who aspire to purchase a home could be advised to do so with due consideration of their spending ability based on disposable income. Post-retirement employment could be encouraged as a strategy for allowing seniors to inherit embedded psychological benefits. Post-retirement employment could also be encouraged for other advantages: production of additional goods and services by retirees while upholding the labor force participation rate (LFPR), growing personal asset base to ease longevity risk, prevention of social security deficit through delay of benefits payouts, and creation of additional government revenue through employment taxes.

The Ensuing Grounded Theory

Charmaz (2006) noted: "Grounded theory involves taking comparisons from data and reaching up to construct abstractions and simultaneously reaching down to tie these abstractions to data" (p. 181). In the study conducted, the central themes emerged through data coding focused on the category of work motivators. The consistency of the responses to these themes provided a way to examine the processes that made the themes central to the study. The creation of abstract interpretation through the evident themes provided responses to the research questions. Transformation of the data collected into interpretations evidenced as the central themes formed the foundation of the grounded theory (Charmaz 2006). Constructing a grounded theory required the integration of process, action, and abstractions into comprehensive analysis of the data.

The grounded theory that would have developed from this research study would suggest the importance of influence of the changing economics of the retirement funding structures on post-retirement employment. The post-retirement employment theory would clearly present evidence of the effects of the relationship of the new retirement funding structures, like the DC (401k) plans, with the stock markets on retirement savings, the proportion of working retirees, and the mix of factors that motivate retirees to work. However, the sample of 25 concentrated in the Hartford County Connecticut area may be too small and not a true representative of retirees. Nevertheless, the results of the study proved very useful for further research in order to develop a more generalized theory that can assist leaders, finance professionals, and others seeking to educate or advise individuals about retirement planning in consideration and evaluation of the new retirement landscape.

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NOTES

1. In qualitative research data analysis, saturation is reached when the researcher subjectively determines that new data no longer provides new insights (Creswell 2004).
2. Leyes (2008) found that even those thought to be able to afford engaging in traditional retirement (retirement without working) in the American society, are often seen using paid work to alleviate post-retirement risks, such as longevity risk—outliving one's assets or investments, inflation, and rising health care costs.
3. Previous literature comprised documentation about the effect of the underfunding created by the continued reductions in the retirement income sources, but the current study was the first to explore the characteristics of factors that cause retirees to work. The current study was also the first to explore what retirees are doing to cope with the financial shortages experienced in their retirement accounts.
4. The suggestions are offered as recommendations for leadership and individual practices in the areas of minimizing income shortage during retirement, handling healthcare costs, managing mortgage expenses, and encouraging post-retirement employment for embedded benefits.

Stock Return and Trading Volume Distribution across the Day-of-the-week: Evidence from the Japanese Stock Market

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ABSTRACT

In this paper, we examine the behavior of stock returns and trading volume across the day-of-the-week in the context of the Japanese Market. Several hypotheses are used to explain the day-of-the-week effect. Results indicate that Mondays have abnormal losses and low trading volume. Over other days the returns and the trading volume increase significantly once the market thickens, prices become more informative and the information effect diminishes. Our results do not support the outliers' hypothesis, the half-of-the-month hypothesis and the autocorrelation hypothesis. They are, however, consistent with the adverse selection and the overconfidence hypotheses.

JEL Codes: G1, G14.

KEYWORDS

*Stock Return, Trading Volume,
Day-of-the-week, half-of-the-month,
overconfidence, Japanese market.*

ARTICLE HISTORY

*Submitted: 21 June 2011
Resubmitted: 27 September 2011
Resubmitted: 4 October 2011
Accepted: 16 November 2011*

Introduction

Earlier studies on financial framework support widely the efficient market hypothesis of which one implication “*is that the expected returns on assets should be evenly distributed across the days, weeks, months, years, or any other unit of time*” (Tripathy, 2010). However, observations in the international market context (see Cross (1973) and French (1980) for the US market, Jaffe and Westerfield (1985) for the Japanese and the Australian markets, Syed and Sadorsky, 2006 for the context of emerging markets, Agathee (2008) for the Mauritius market, Ulussever, Guranyumusak and Kar (2011) for the Saudi Arabian market) show that significant variances in assets returns are associated with the unit of time. The day-of-the-week effect is especially common and can be observed in the majority of the aforementioned markets. This specific anomaly constitutes one of several arguments opposing the efficient market hypothesis.

Several hypotheses are given in theoretical and empirical studies to explain the day-of-the-week influence on stock returns and on trading volume. However, in spite of the importance of these hypotheses, the investor's sentiment plays a pivotal role in the decision process. Overconfidence particularly leads investors with greater information to make aggressive decisions and to increase their trading volume on Mondays since they overestimate their knowledge and their judgment skills and underestimate public information and the skills of those with less information. On the contrary, these latter act in a more rational way and delay trades until the market thickens and prices become more informative. Consequently, operations end with abnormal losses and trading volume decreases on Mondays.

The aim of this paper is to investigate the day-of-the-week effect on the stock return in the context of the Japanese market. We chose the specific case of the Japanese market since the Asian population is the most exposed to the overconfidence bias¹. Different hypotheses, of which the overconfidence hypothesis is one, are examined to explain the day-of-the-week influence on stock returns and trading volume. In this vein, one question that could have greater importance is:

What explains the influence of the day-of-the-week effect on stock returns and trading volume?

To find some response to this question we used a sample including returns and trading volume of the Nikkei 225 index over the period from June 06, 2002 to Mai 10, 2011. Results show that stock returns and trading volume diminish dramatically

on Mondays and increase abnormally over the other days. Results do not support in any special way the *outliers*' hypothesis, the half-of-the-month hypothesis and the autocorrelation hypothesis. They are, however, consistent with the adverse selection and the overconfidence hypotheses.

The remainder of the paper proceeds as follows. Section 1 presents the literature review on the day-of-the-week influence on the stock returns and gives theoretical explanations. Section 2 summarizes the relationship between the investor's sentiment and the distribution of returns and trading volume. Section 3 provides the sources of the data and a sample selection as well as estimated models. Section 4 contains empirical results. Concluding remarks are provided in the last section.

The day-of-the-week effect on return and trading volume

Earlier studies concerning major international markets show that returns on assets and trading volume are not evenly distributed across days, weeks, months or years. This report is not consistent with the implication of the efficient market hypothesis. In this vein, Foster and Viswanathan (1993) show that in the context of the US market Mondays have abnormal losses, high return volatility and low trading volume.

Mondays' abnormal losses can also be seen in different international markets. Particularly, empirical studies show that Mondays have abnormally low returns and Fridays have significantly high returns (see Lakonishok and Smidt (1988) for the Dow Jones Industrial Average for the period from 1887 to 1986, Keim and Stambaugh (1984) for the S&P500 returns for the period from 1928 to 1982, Schwert (1990) using different sources for the period from 1802 to 1987).

Several other authors find that the lowest average returns are observed on Tuesdays (Solnik and Bousquet (1990) in the French stock market, Athanassakos and Robinson (1994) in the Canadian market). Similar results are found in the context of Asian countries (Aggarwal and Rivoli (1989) in the stock markets of Hong Kong, Malaysia and Philippines, Wong, Hui and Chan (1992) in the markets of Singapore, Malaysia, Hong Kong, and Thailand, or Kim (1988) in the stock markets of Japan and Korea).

Tuesdays' low returns are observed also on the Istanbul stock exchange (Balaban, 1995; Bildik, 1997), and several other stock markets such as those of Australia,

Hong Kong, Japan, Korea, Malaysia, New Zealand, Philippine, Singapore, Taiwan and Thailand (Ho, 1990). The same results are observed in Wong et al. (1992) in the context of the markets of Singapore, Malaysia, Hong Kong and Thailand or in Dubois and Louvert (1996) for the stock markets of Japan and Australia.

For the Turkish stock market, Balaban (1995) investigated the day-of-the-week effect over a period dating from January 1988 to August 1994. Results show that Fridays have high returns and low standard deviations. The day with second highest return and second lowest standard deviation is Wednesday. Low returns are, oppositely, observed on Tuesday and high standard deviations on Mondays.

Kiyamaz and Berument (2003) examined the trading volume in the Japan, the United Kingdom and the United States. They found that trading volume on Mondays and Fridays is on average lower than on other days.

Several hypotheses are used to explain the variability in stock return across the days the week. Theoretical and empirical studies argue, first of all, that low returns on Mondays are due to isolated rare events that can be detected using a robust regression test (see Conolly, 1989). This hypothesis is known as the *outliers'* hypothesis.

Moreover, authors Wang, Li and Erickson (1997) distinguish between days of the first and of the latter half of the month. They consider that the day-of-the-week effect on the stock return changes according to whether the day comes in the first or the latter half of the month. Mondays' low returns are observed especially in the latter half-of-the-month. This hypothesis is known as the latter-half-of-the-month hypothesis.

Theoretical and empirical studies argue also that abnormal losses are linked to the frequency of short sales. They document, moreover, that short sales are more frequently observed on Mondays. In this sense, Chen and Signal (2003) have documented that "*Monday losses are caused, at least in part, by short sellers unwinding short positions prior to the weekend and reestablishing short positions on Monday*". These authors find in the US market particularly that Monday losses and Friday abnormal returns increase significantly when stocks have greater short interest.

Moreover several authors such as Bessembinder and Hertz (1993) have documented that the autocorrelation between Monday's return with the prior Friday's return has been unusually higher for several decades. This hypothesis is widely confirmed in empirical studies. Particularly, Boynton, Oppenheimer and Reid (2009) find in the Japanese market that Mondays have higher AR (1) than other days of the week.

Investors' sentiment, returns and trading volume

On the other hand and in the same vein of explanation as the day-of-the-week influence on stock returns, several studies deal with the relationship between stock returns and the trading volume. A point of view commonly shared in financial literature is that there exists a positive correlation between trading volume and prior stock returns.

Researches in behavior economics and behavioral finance provide some explanation for this relation. Authors argue that an investor's sentiment plays a pivotal role in the stock market. Sentiment beliefs particularly influence the decision process. In this sense, Chuang, Ouyang and Lo (2010) argue that *"investors have a tendency to adjust their beliefs to the most recent data and to make decisions based on information they have at the present time. They also extrapolate past experiences into future"*.

Investors increase their trading volume when they consider companies to be good investments. Oppositely, they stop trading when they foresee companies as bad investments. In this way, past trading volume reflects the investors' expectations. According to Chuang et al (2010), *"investors would buy securities with good prospects. If more and more investors extrapolate good news into future, they tend to overvalue these firms and to invest in them. Their irrational beliefs thus increase trading volume."*

These authors also examined the effect of investor sentiment on stock prices in the specific context of the Taiwanese stock market. They found that investors usually observe past trading volume to make future investment decisions. Considering this result, trading volume can be used as a proxy for measuring investors' expectations.

In the same line, several authors such as Lee and Swaminathan (2000) have documented that not only return but also trading volumes are influenced by investor expectations. Behavioral theory argues, especially, that more informed investors are more exposed to the overconfidence bias than less informed ones. They overestimate the precision of their private information and their skills and underestimate public information and the skills of less informed investors. Consequently, they trade irrationally and their irrational trading can lead to abnormal variability in trading volume and consequently on returns. In this vein, *"many empirical results show that the irrational investor behavior not only exist in the stock market but also has significant influences on the formation of prices"* (Chuang et al., 2010).

Taken together these arguments indicate that investors' sentiments, especially

overconfidence, play a pivotal role in the decision process. They lead investors to make irrational and aggressive decisions thus increasing trading volume. Since less informed investor expects this irrational behavior they delay trading, which dramatically influences the result of the operation.

Data and methodology

The data we used includes daily returns and trading volume on the “*Nikkei 225*” index over the period from June 06, 2002 to May 10, 2011. We include all data corresponding to every trading day. Final sample includes 2176 daily observations.

In order to investigate the influence of the day-of-the-week on the stock returns we regress returns on each of the day of the week. The estimated equation is:

$$R_t = \alpha_0 + \sum_{i=1}^N \alpha_i d_i + \varepsilon_t \quad (1)$$

with $i = 1, \dots, 5$ (1 : Monday, 2 : Tuesday, 3 : Wednesday, 4 : Thursday, 5 : Friday).

$$R_t = \left[\ln(I_{[N]t}) - \ln(I_{[N](t-1)}) \right] \times 100 \text{ with } I_N : \text{the Nikkei Index.}$$

ε_t : is the error term.

To investigate the effect of the day of the week on trading volume, we regress this latter on each of the day of the week. The estimated equation is:

$$V_t = \alpha_0 + \sum_{i=1}^N \alpha_i d_i + \varepsilon_t \quad (2)$$

With: V_t : the logarithm of the daily trading volume.

We estimate, first of all, both equation (1) and equation (2) using the whole of the data with daily classification and half-of-the-month classification. This allows us to test the latter-half-of-the-month hypothesis. To test the *outliers*' hypothesis we use, in a second step, robust regression for the two equations.

The test for the short-sales hypothesis will be, however, withdrawn since there is no short-sale interest in the Japan.

In the third step we test the autocorrelation hypothesis. In order to do this, we

investigate the relation below:

$$R_t = \alpha + \beta_t R_{(t-1)} + \varepsilon_t \quad (3)$$

With R_t the return in the day t.

Equation 3 can be presented as follow:

$$\begin{bmatrix} R_{Mo(t)} \\ R_{Tu(t)} \\ R_{We(t)} \\ R_{Th(t)} \\ R_{Fr(t)} \end{bmatrix} = \begin{bmatrix} \alpha_{Fr(0)} & \beta_{Fr(t)} \\ \alpha_{Mo(0)} & \beta_{Mo(t)} \\ \alpha_{Tu(0)} & \beta_{Tu(t)} \\ \alpha_{We(0)} & \beta_{We(t)} \\ \alpha_{Th(0)} & \beta_{Th(t)} \end{bmatrix} \times \begin{bmatrix} R_{Fr(t-1)} \\ R_{Mo(t-1)} \\ R_{Tu(t-1)} \\ R_{We(t-1)} \\ R_{Th(t-1)} \end{bmatrix} + \begin{bmatrix} \varepsilon_{Fr(t)} \\ \varepsilon_{Mo(t)} \\ \varepsilon_{Tu(t)} \\ \varepsilon_{We(t)} \\ \varepsilon_{Th(t)} \end{bmatrix}$$

With: Mo : Monday, Tu : Tuesday, We : Wednesday, Th : Thursday, Fr : Friday.

We test, in the final stage, the adverse selection and the investor's sentiment hypothesis (investor's beliefs and overconfidence sentiment). We investigate, especially, the impact of investors' beliefs on the variability of trading volume across the days of the week. Using the return in the day (t-1) as a proxy, we regress trading volume across every day (t) on the return of the day (t-1). The estimated equation is:

$$V_t = \alpha + \beta_t R_{(t-1)} + \varepsilon_t \quad (4)$$

With V_t : the trading volume in the day t.

Equation (4) can be presented as follow:

$$\begin{bmatrix} V_{Mo(t)} \\ V_{Tu(t)} \\ V_{We(t)} \\ V_{Th(t)} \\ V_{Fr(t)} \end{bmatrix} = \begin{bmatrix} \alpha_{Fr(0)} & \beta_{Fr(t)} \\ \alpha_{Mo(0)} & \beta_{Mo(t)} \\ \alpha_{Tu(0)} & \beta_{Tu(t)} \\ \alpha_{We(0)} & \beta_{We(t)} \\ \alpha_{Th(0)} & \beta_{Th(t)} \end{bmatrix} \times \begin{bmatrix} R_{Fr(t-1)} \\ R_{Mo(t-1)} \\ R_{Tu(t-1)} \\ R_{We(t-1)} \\ R_{Th(t-1)} \end{bmatrix} + \begin{bmatrix} \varepsilon_{Fr(t)} \\ \varepsilon_{Mo(t)} \\ \varepsilon_{Tu(t)} \\ \varepsilon_{We(t)} \\ \varepsilon_{Th(t)} \end{bmatrix}$$

With: Mo : Monday, Tu : Tuesday, We : Wednesday, Th : Thursday, Fr : Friday.

Results and discussion

Figures 1 to 5 show the time series of day-of-the-week Return Distribution. The X-axis gives the time series (day of the week over the analysis period). The Y-axis gives, however, the distribution of the returns on the day of the week across the time.

Figure 1. Monday Return Distribution

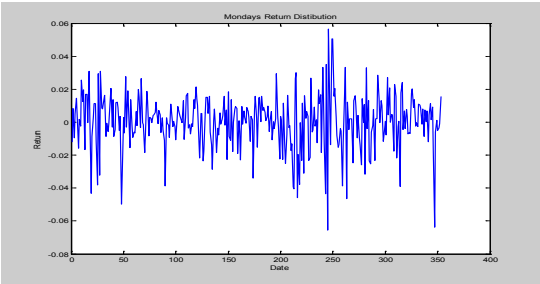


Figure 2. Tuesday Return Distribution

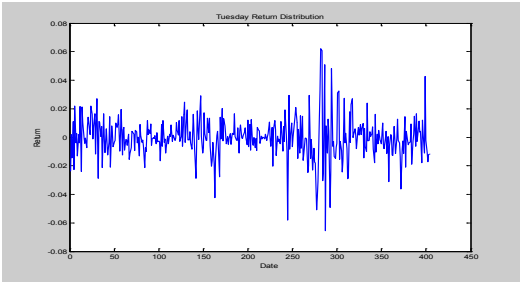


Figure 3. Monday Return Distribution

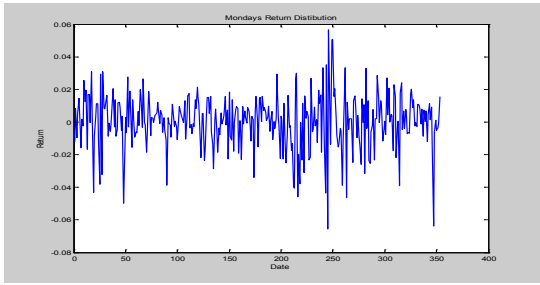


Figure 4. Tuesday Return Distribution

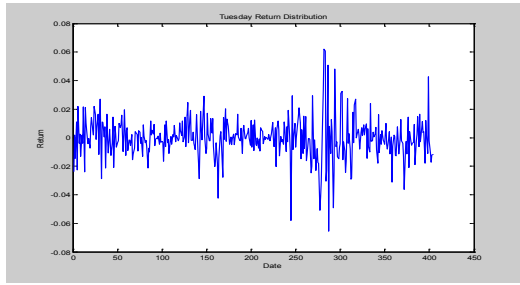
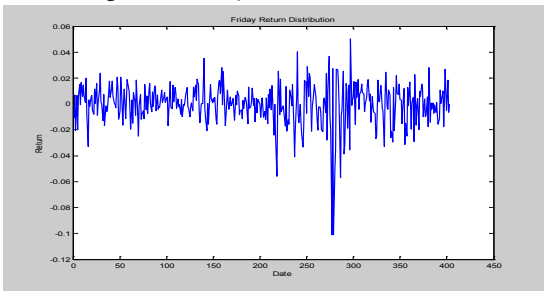


Figure 5. Friday Return Distribution



Figures 1 to 5 show that the volatility of stock returns changes significantly over the days of the week. The volatility is very high on Mondays and becomes much lower on Thursdays. Moderate volatility is observed on Tuesdays, Wednesdays and Fridays. High volatility across all days is observed during the period from December 2007 to October 2008.

Figures 6 to 10 present the time series of Trading Volume by day of the week respectively, starting from Monday until Friday. The X-axis gives the time series evolution. The Y-axis gives the distribution of the trading volume across the days of the week from January 2002 to March 2011.

Figure 6. Monday Trading Volume Distribution

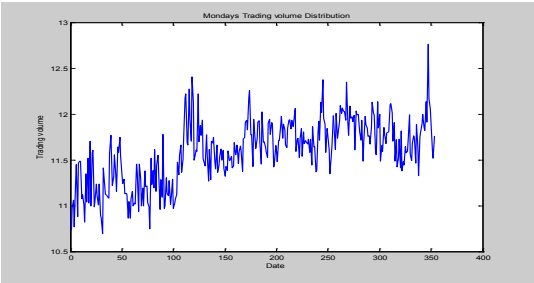


Figure 7. Tuesday Trading Volume Distribution

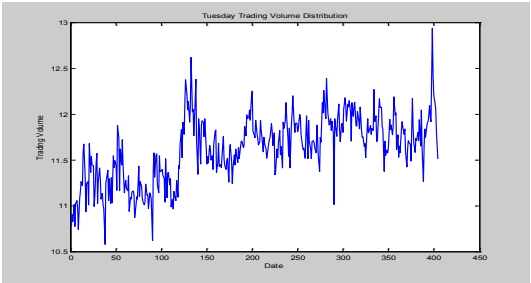


Figure 8. Wednesday Trading Volume Distribution

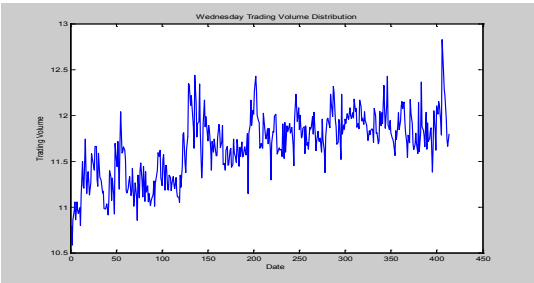


Figure 9. Thursday Trading Volume Distribution

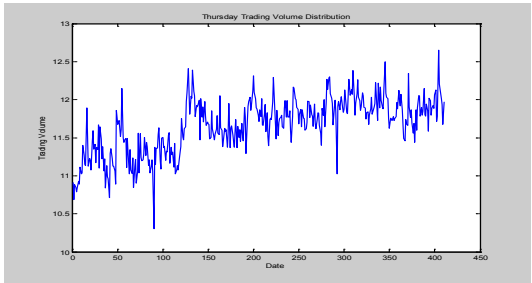
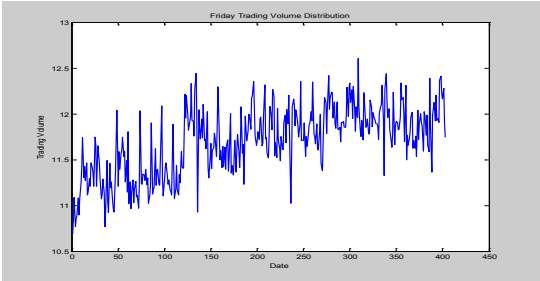


Figure 10. Friday Trading Volume Distribution



Figures 6 to 10 show that the volatility of the trading volume changes significantly over the course of the week. Trading volume volatility is very high on Fridays and then on Tuesdays and Mondays. Thursdays have, however, lower volatility of trading volume.

Taken together, these results indicate that both stock return volatility and trading volume volatility remain lower on Tuesdays. Over the other days, the volatility of both returns and trading volume changes dramatically.

Table 1 presents results for the regression of the return on the day of the week.

Table 1. Day-of-the-week Returns regression (overall, first and latter half-of-the-month)

Variables	Returns		
	Overall	First half-of-the-month	Latter half-of-the-month
Mo	-0,001039 (-1,84)*	-0,0010162 (-3,07)**	-0,0007256 (-1,81)*
Tu	-0,004554 (-1,24)ns	-0,0002864 (-1,54)ns	-0,0005789 (-1,74)*
We	-0,002016 (-0,857)ns	-0,0008466 (-0,83)ns	0,0003819 (1,67)*
Th	0,004116 (1,73)*	-0,001614 (-1,54)ns	0,0027343 (1,97)*
Fr	0,007390 (2,17)**	0,0013137 (1,68)*	0,0003445 (2,86)***
Cons_	0,000944 (6,49)***	0,0004478 (4,18)***	-0,0004353 (-1,42)ns
R-Square	0,2796	0,3871	0,1367
Adjusted R-Square	0,2782	0,3859	0,1351

*** Significant at 1% level, ** Significant at 5% level, * Significant at 10% level.

Results in table 1 indicate a significant negative effect of Mondays on stock returns ($\alpha_{Mo} = -0,001039; t_{Mo} = -1,84$). On the other hand, Thursdays and Fridays have significantly positive effects ($\alpha_{Th} = 0,004116; t_{Th} = 1,73$ and $\alpha_{Fr} = 0,007390; t_{Fr} = 2,17$). Tuesdays and Wednesdays have non-significant effects on stock returns. This indicates that stock returns are not evenly distributed across the days of the week. They are consistent with the results observed in several international markets such as those of French (1980), Aggrawal and Rivoli (1989) Barbee, Jeong and Mukherji (2008) Tripathy (2010) and Ulussever et al. (2011) according to which the average return on Mondays is significantly less than the average of the other days of the week.

Considering the half-of-the-month classification, results remain similar whether the days are in the first or the last half of the month. Whichever the half of the month,

returns decrease significantly on Mondays and increase abnormally starting from Thursdays. Fridays have a higher positive effect on the stock returns. Abnormal losses are especially observed on Mondays during the first half of the month. Similarly, higher Friday returns are observed during the first half of the month. These results are not consistent with the latter-half-of-the-month hypothesis according to which Mondays' abnormal losses are shown in the latter half of the month.

Table 2 presents results for the regression of the trading volume on the day-of-the-week.

Table 2. Day-of-the-week Trading volume regression (overall, first and latter half-of-the-month)

Variables	Trading volume (ln)		
	Overall	First half-of-the-month	Latter half-of-the-month
Mo	-0,115013 (-1,93)*	-0,1435844 (-2,84)***	-0,0906864 (-1,94)*
Tu	0,0623029 (1,84)**	0,0831203 (1,73)*	0,0442832 (1,94)*
We	0,1163678 (1,63)ns	0,1319225 (1,86)*	0,1035988 (1,27)ns
Th	0,1180755 (2,16)**	0,1251352 (1,98)*	0,1120267 (2,48)**
Fr	0,1631291 (1,98)**	0,2343976 (1,84)*	0,1019931 (3,17)***
Cons_	0,390471 (3,17)***	1,433481 (2,96)***	1,263122 (2,83)***
R-Square	0,3851	0,4408	0,2642
Adjusted R-Square	0,3839	0,4397	0,2628

*** Significant at 1% level, ** Significant at 5% level, * Significant at 10% level.

Results in table 2 indicate that trading volume decreases abnormally on Mondays and increase significantly over the other days. Higher effects of the day of the week on trading volume are, however, observed on Fridays. These results are consistent with the adverse selection hypothesis. In this sense, individual investors expect that on Mondays institutional investors, as more informed investors, have greater information and will exploit their information advantage in trades. Consequently, they (i.e. individual investors) postpone trades as a best strategy until the market thickens and the prices become more informative. The delay of trade induces a decrease in trading volume on Mondays. Starting from Tuesday, the information effect diminishes and prices start to become more informative. Consequently both institutional and individual investors trade together which induces an increase in trading volume.

Results for the robust regressions of returns and trading volume on the day of the week are given in table 3.

Table 3. Return distribution and trading volume (Robust regression)

Variables	Return Distribution (robust regression)	Trading Volume Distribution (robust regression)
Mo	-0,0000944 (1,74)*	-0,1150134 (-2,37)**
Tu	-0,0004554 (-1,14)ns	0,0623029 (1,62)ns
We	-0,0002016 (-1,48)ns	0,1163678 (1,19)ns
Th	0,0007116 (1,36)ns	0,1180755 (2,08)*
Fr	0,000439 (2,58)**	0,1631291 (2,36)*
Cons_	-0,0001039 (3,17)***	1,27545 (4,12)***
R-Square	0,1207	0,1738
Root MSE	0,01623	2.3847

*** Significant at 1% level, ** Significant at 5% level, * Significant at 10% level.

Results in table 3 indicate the persistence of low returns on Mondays even using a robust regression test. These results challenge the *outliers* hypothesis according to which low returns on Mondays are due to isolated rare events that can be detected using a robust regression test.

Taken together, results associated with the latter-half-of-the-month and with the *outliers* hypothesis are consistent with those of Boynton et al (2009), who did not confirm the two hypotheses.

Table 4 presents results associated with the autocorrelation hypothesis and those testing the effect of the investors' expectation on returns and on trading volume.

Table 4. Results on autocorrelation and overconfidence hypothesis tests

Model (Days relation)	N	Endogenous Variable	Exogenous Variables	T-statistic	R-squared Adj. R-squared
Tu/Mo	257	$R_{Tu(t)}$	$R_{Mo(t-1)} = -0,1137036$ $Cons_ = -0,0004668$	-2,42 (0.016)*** -0,66 (0.513)ns	$R^2 = 0,2204$ Adj. $R^2 = 0,2141$
		$V_{Tu(t)}$	$R_{Mo(t-1)} = -0,12992$ $Cons_ = 2,50003$	-1,74 (0.083)* 7,36 (0.000)***	$R^2 = 0,1174$ Adj. $R^2 = 0,1103$
We/Tu	434	$R_{We(t)}$	$R_{Tu(t-1)} = -0,0186290$ $Cons_ = -0,0001872$	-0,43 (0.667)ns -0,26 (0.798)ns	$R^2 = 0,0814$ Adj. $R^2 = -0,0771$
		$V_{We(t)}$	$R_{Tu(t-1)} = 0,3085539$ $Cons_ = 2,40007$	0,05 (0.964)** 8,10 (0.000)***	$R^2 = 0,1623$ Adj. $R^2 = 0,1584$
Th/We	439	$R_{Th(t)}$	$R_{We(t-1)} = -0,0280665$ $Cons_ = 0,0006791$	-0,55 (0.585)ns 0,87 (0.384)ns	$R^2 = 0,0951$ Adj. $R^2 = 0,0909$
		$V_{Th(t)}$	$R_{We(t-1)} = 1.40344$ $Cons_ = 2,40132$	2,04 (0.042)** 8,36 (0.000)*	$R^2 = 0,1358$ Adj. $R^2 = 0,1318$
Fr/Th	148	$R_{Fr(t)}$	$R_{Th(t-1)} = -0,0530225$ $Cons_ = 0,0010738$	-0,64 (0.524)ns 1,03 (0.307)ns	$R^2 = 0,0816$ Adj. $R^2 = 0,0689$
		$V_{Fr(t)}$	$R_{Th(t-1)} = 2,99868$ $Cons_ = 3,64075$	1,06 (0.292)ns 4,34 (0.000)***	$R^2 = 0,0507$ Adj. $R^2 = 0,0376$
Mo/Fr	252	$R_{Mo(t)}$	$R_{Fr(t-1)} = 0,0671137$ $Cons_ = -0,0011966$	0,93 (0.355)ns -1,24 (0.216)ns	$R^2 = 0,0934$ Adj. $R^2 = 0,0861$
		$V_{Mo(t)}$	$R_{Fr(t-1)} = -0,754204$ $Cons_ = 2,53782$	-0,65 (0.517)ns 6,79 (0.000)***	$R^2 = 0,1017$ Adj. $R^2 = 0,0944$

*** Significant at 1% level, ** Significant at 5% level, * Significant at 10% level.

Results in table 4 indicate that only Tuesdays have a significant AR(1). Mondays' returns have negative effects on those of Tuesdays ($\alpha_{R_{Mo(t-1)}/R_{Th(t)}} = -0,1137036; t_{R_{Mo(t-1)}/R_{Th(t)}} = -2,42$). These results challenge the autocorrelation hypothesis according to which Mondays have higher AR(1) than other days and which is confirmed in the context of the Japanese market by Boynton *et al.* (2009).

These results can be explained considering the investor's sentiment (investor's beliefs and the overconfidence hypothesis). On Mondays the overconfident investors overestimate the precision of their knowledge and their judgment skills. They underestimate, at the same time, the public information and the skills of less informed investors. They make, consequently, aggressive decisions and increase their trading volume. Since the less informed investors act in a rational way, they delay trading and the operation ends with abnormal losses. Once the prices become more informative, the less informed investors change their strategy and increase their trading volume. Operations end, consequently, with higher gains.

Conclusion

We can conclude from our analysis that stock returns and trading volume are not evenly distributed across time. Mondays have abnormal losses and Fridays have higher returns. Trading volume decreases abnormally on Mondays and increases significantly over the other days.

Results, using the NIKKEI 225 data for return and trading volume over a period from June 06, 2002 to May 10, 2011 show that stock returns and trading volume diminish dramatically on Mondays and increase abnormally over the other days. Results do not support, particularly, the *outliers'* hypothesis, the half-of-the-month hypothesis and the autocorrelation hypothesis. They are, however, consistent with the adverse selection and the overconfidence hypotheses. In this sense, information plays a pivotal role in the decision process. More informed investors overestimate the precision of their knowledge and their judgment skills and underestimate public information and the skills of the less informed investors. They therefore make aggressive decisions and increase their trading volume. On the other hand, less informed investors postpone trades since they know that on Mondays the more informed investors will exploit their information advantage in trades. The delay of trade driven by the less informed investors' behavior induces a decrease in returns on Mondays.

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(Endnotes)

- 1 In this sense, psychologists have demonstrated that the Asian population exhibits overconfidence in general knowledge (see Yates, Lee and Shinotsuka (1996) and Yates, Lee and Bush (1997) for more details). This specifically implies, among other things, that Asian investors may suffer from psychological biases of which one is the overconfidence bias.
- 2 For more details see Boynton et al. (2009).

The Impact of Microcredit Programs in Alleviating Poverty and Restoring Livelihoods of the Targeted Populations in Bosnia And Herzegovina

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ABSTRACT

The effective design and delivery of micro-credits is difficult under all circumstances. However, in conflict-affected societies, the task of microcredit institutions that seek to provide financial stability to its most impoverished members is more complicated. This paper aims to investigate the role and the impact of the microcredit industry in Bosnia and Herzegovina. Data for this study were gathered from both microcredit institutions and recipients of microcredit funds using both qualitative and quantitative techniques. The research results show that refugees, internally displaced persons and returnees are less likely to get loans compared to those with stable incomes, meaning the population with stable incomes has benefited more from these credits in improving their living conditions. Most of the targeted populations of the interest free microcredit foundation (MCF) that was taken as a case study in this research expressed their satisfactions with the loans and service provided by the particular MCF. From a policy perspective, it is important to focus attention on the most affected population groups, those least able to pull themselves out of poverty. Microcredit foundations should find a balance between being non-profit based and achieving their full sustainability.

Jel Code: G21

KEYWORDS

Microcredit program, Bosnia and Herzegovina, Microcredit Foundations, Microcredit Institutions, Interest rate, Poverty, Debt, Borrowing.

ARTICLE HISTORY

Submitted: 22 February 2011

Resubmitted: 27 March 2011

Resubmitted: 4 May 2011

Accepted: 4 July 2011

Introduction

This paper explores whether microcredit (MC) programs have any effect on alleviating poverty and restoring livelihoods for the targeted populations in Bosnia and Herzegovina (BH). Doyle, who conducted a comprehensive review on the general impact of MC in helping refugees, returnees and IDPs in improving their living conditions and restoring their livelihoods, seems to believe so (Doyle, 1998 & 2008). As a mechanism that has a stated directive and the objective of targeting the most impoverished groups of society, the role of microfinance in BH deserves much more attention and serious exploration.

Bosnia and Herzegovina is a country that endured a devastating war from 1992-1995. The traditional best-practice paradigms of microfinance are inapplicable in war and conflict-affected situations because of the instability of the governmental and financial institutions, and the lack of communal and social trust among individuals. Within these post-war environments, refugees, returnees and internally displaced populations (IDPs) are among the most marginalized and helpless of the affected groups. Providing microfinance to them is then perhaps the most challenging problem facing practitioners and MC institutions engaged in this kind of relief and development work. Various micro-financial institutions have been active in Bosnia-Herzegovina since 1996 and struggle with providing services in such a challenging environment. An insight into their work promises to uncover strategies that may be employed with the problems and successes of such endeavors. Therefore, this paper will shed light on the work of these organizations and their effectiveness.

The following relevant research questions are addressed in this study:

Research question number one: How do micro-credits affect the livelihoods of the targeted groups, and to what extent do refugees, internally displaced persons and returnees have access to micro-credits in Bosnia and Herzegovina?

Research question number two: What are the objectives of the microcredit programs, and what are the most requested loans in Bosnia and Herzegovina?

Research question number three: What are the perspectives of the beneficiaries of micro-credits in Bosnia and Herzegovina regarding this service and its impact on them?

There is a big debate and doubts about the certain impact of the MC industry in BH both at the local and international levels. The reports from the World Bank, Microfinance Information Exchange (MIX) and the Association of Microfinance Institutions in Bosnia and Herzegovina (AMFI) show that; among peers in Kosovo and in the Balkans (Albania, Croatia, Macedonia, Montenegro, Serbia) in general, as well as peers similar in size and market outreach from Eastern Europe and Central Asia (ECA), the Bosnian MFIs are some of the most highly leveraged, more than 70 percent of all funding to MFIs in BH during 2007 came from foreign lenders. In 2007, most Bosnian MFIs showed high growth rates in active borrowers and especially loan portfolio. More than half of the non-bank MFIs grew by more than 50 percent in outreach. On the other hand, others like Karnani (2007a) suggested that governments, businesses and civil society should work together to reallocate their resources away from microfinance and instead support larger enterprises in labour intensive industries. A strong critique comes from Bateman (2007a) 'new wave commercial microfinance' where he asks whether microfinance can actually undermine medium-term economic development because it supports inefficient activities. Bateman found that there is little solid evidence to confirm that commercial microfinance facilitates sustain economic and social development.

However, this paper might provide some evidence as to whether the MCI in BH, with it's both commercial and non-profit institutions, helps in alleviating poverty and promotes economic and social development.

Literature Review

Origin and Philosophy of Microcredit

Micro-credits, as a viable tool of development, began in 1976 when Bangladeshi economist and social reformer Muhammad Yunus began lending small amounts of money to rural poor women of Jobra village to start or expand their businesses. That initial and modest foray into microcredit eventually culminated in the formal establishment in 1983 of the Grameen Bank based on principles of group-based lending of small-sized loans with zero collateral. (Yunus, 2004)

Focusing specifically on the agency, entrepreneurial skills and innovation of the marginalized and poverty-stricken populations in developing countries, the “*greatest triumph of microfinance was the demonstration that poor households could be reliable bank customers*” (Cull, 2008). Moreover, Yunus utilized microfinance to directly mitigate a significant and core problem in development economics: that the poor remain poor because they do not have access to productive capital to grow their way out of poverty (Kanishka, 2009).

Historically, microfinance programs have been developed and targeted to address the concerns and needs of poor households that markets and governments fail to adequately confront. More specifically, according to Heen (2004), the client-base of microfinance institutions includes: female heads of households, pensioners, displaced persons, retrenched workers, small farmers, and micro-entrepreneurs, each of whom fall into one of four poverty levels: destitute, extreme poor, moderate poor, and vulnerable non-poor. These programs typically offer a wide range of financial services such as: deposits, loans, savings, payment services, money transfers, and insurance to the poor and low-income households and their micro-enterprises who are excluded from the formal financial systems (Swain, Ranjula, Nguyen, & Vo Tuan, 2008). According to Legerwood (1999), microfinance institutions may also provide social intermediation services such as: group formation, development of self confidence, and training in financial literacy and management capabilities among members of a group. Thus, microfinance is more than simple banking; it is a development tool as she asserts (Legerwood, 1999, p. 1). In BH a Center for Financial and Credit Counseling (known by its Bosnian acronym CFKS) opened its doors in Tuzla in 2010 and aims to offer debt mediation and financial education to borrowers.

The most successful of the microfinance development philosophy is evidenced by reports of the top micro lenders which boast repayment rates of 98 percent or higher, all achieved without securing any collateral for the loans. This success is attributed, by Cull, Demirguc-Kunt, & Morduch (2008), to “*new lending practices, especially “group lending” (also called “joint liability” lending)*. Authors described this model in which customers were typically formed into small groups and required to guarantee each others’ loan repayments, aligning their incentives with those of the bank. This practice was rarely used in Bosnia and Herzegovina, due to lack of the trust between groups and society as a direct consequence of the recent war.

Rhyne (2001) best summarizes the common philosophies and goals driving the current microfinance movement as follows: using the client’s character rather than collateral as the primary loan security, streamlining the administrative processes to lower costs, responding rapidly to late payments, providing positive incentives for repayment, charging interest rates that approach or cover costs, and emphasizing the long-term sustainability of the lending organization (Rhyne, 2001, p. 7).

However, this is not to say that microfinance has been credited as an unprecedented success. Microfinance programs are also weakened by a serious and well-acknowledged lack of comprehensive and tough impact evaluations. Morduch (1998) explained this very fact in his book *The Microfinance Promise*. In his summary of the problems confronting the microfinance industry he argued that the promise of microfinance was founded on innovation: new management structures, new contracts, and new attitudes. The leading programs came about by trial and error. Once the mechanisms worked reasonably well, standardization and replication became top priorities, with continued innovation only around the edges. As a result, most programs are not optimally designed nor necessarily offering the most desirable financial products. Such weaknesses and difficulties facing the MC industry in BH are easily noticed since 2009 till today. Many critics, articles and analysis have been published locally and overseas tackling issues like: indebtedness of MC clients, high profit generated by MCFs, lack in pricing transparency regarding interest rates, skyrocketing salaries and privileges of MCF managers. The harshest criticism came from Milford Bateman during a round table conference in September 2011 when he concluded that the MC industry in BH is a failed experiment.

Microfinance in Post-War/Conflict Environments

The fundamental point according to Doyle (1998, 2008) is that of microfinance being viewed as a tool that can serve multiple goals. Predominantly, it remains an economic development strategy that focuses on rebuilding and restarting local economies by providing needed financial services for enterprise creation, but there is also consideration of its use as a relief and survival strategy in the immediate wake of disaster, and as a tool for peace and reconciliation.

At the same time, Heen (2004) believes that just because microfinance programs focus on marginalized groups in a given society does not mean that microfinance automatically avoids the broader problems and risks of development and that microfinance products and programs may, in fact, create conflicts in a number of ways. According to her, microfinance programs may cause conflicts in two ways; first, by reinforcing or creating new social divisions through client or geographical targeting, and second, by causing conflicts among clients especially if group lending mechanisms are used and one member of the group is unable to repay, and the whole group suffers as a consequence (Heen, 2004, p. 12-13).

Uvin (1999) argues that a purely economic-technical approach to development may help to lay the groundwork for further inequality and mal-development, as well as structural, and eventually acute, violence. This point is only further underscored by Doyle (2008) when she writes that microfinance professionals in conflict-affected environments must understand the dual imperative of being proactive as well as careful. While, doing nothing or retreating could result in prolonged human suffering and the need for more extensive, costly, and difficult involvement down the road, acting hastily or unwisely could create unintended, potentially severe repercussions (Doyle, 2008, p. 1). Most of the above mentioned unfavorable consequences could occur in BH as well.

Essential and Preferred Conditions of Microfinance in Post-Conflict Areas

Keeping the primacy of good preparation in mind, Doyle lists several essential conditions that must be in place to institute microfinancial activities in a conflict-affected area. She then goes on to list several preferred conditions which while not entirely necessary, are still entirely desirable (Doyle, 2008, p. 7-11).

Essential Conditions include: low intensity of conflict, reopening of markets and long-term displacement (18 months or longer). In the case of BH the long term repatriation process is one of the biggest concerns for both politicians and individuals, so this could be considered an important condition to be taken into consideration by the MC industry.

Preferred Conditions include; relatively dense population, enabling legislation for microfinance (MF) institutions, a skilled and educated workforce, social capital, and trust in the local currency and financial institutions. In the case of BH the legislations for MF started late in 2006 and were officially applied in 2008. This delay could be one of the root causes of current problems that both clients and MC industry have been facing since 2009.

However, keeping in mind the obstacles, and the critical need to be careful as well as proactive, Doyle notes several steps to be undertaken before embarking on microfinance refugee programs. These include; first, investigating the current political situation to learn whether refugees are likely to be repatriated within the next 12 months. Second, ensuring that there are activities that can gradually integrate refugees into the local markets and in a nonthreatening way. Third, asking refugees what sort of financial services or non-financial services they need most now, then building a program around the existing situation. Fourth, instilling confidence in the permanence of the microfinance services as long as refugees are in their current location to ensure repayment, and implement the program with a longer-term vision.

Microfinance for Refugees, Internally Displaced and Returnees

Even before counting the challenges that would be inevitable to the implementation of a microfinance program for refugees, returnees and internally displaced populations, it is valuable to discuss some more general constraints on the economic lives of these groups. Jacobsen (2005), writes in her book that the abilities of refugees and internally displaced persons in camps to engage in viable economic activities that go beyond subsistence is determined by their access to productive assets such as arable land, economic infrastructure such as mills and storage facilities and perhaps most importantly, credit. Jacobsen goes on to list several factors which restrict access to these productive assets, one of which being freedom of movement in and out of camps in order to pursue these economic activities. Moreover, she writes, “refugees in protracted situations must also cope with shifts in attitude from the host community,

which can affect both the willingness of authorities to implement restrictions, and refugees' economic activities" (Jacobsen, 2005, p. 31). This is very true in the case of returnees in BH, as the unwillingness of the dominant majorities and restrictions created by authorities are some of the biggest obstacles facing MCFs in targeting this vulnerable group of the population.

In light of the above, in the world of post-conflict reconstruction and development evaluating, designing and implementing a microfinance program for refugees, returnees and internally displaced populations presents an additional layer of difficulty and complexity. Bartsch (2005) outlines some of these difficulties. First, microfinance is oftentimes founded on the notion of group solidarity to replace the conventional banking requirement of material or monetary collateral. It is exactly this group solidarity which is most absent from refugee populations. Second, microfinance as an industry is more closely related to the principles of banking than to relief and will need to seriously review and also perhaps check its measures of success. Third, while the provision of relief is supposed to benefit the poorest and most affected populations, microfinance in its current form, is bound to benefit only people already endowed with business acumen and, often enough, sufficient resources to sustain themselves. Fourth, to be successful microfinance must be implemented as one strategy among an entire array of relief and development strategies such as business training and, most importantly, an enabling environment.

In post-war countries like BH assuring a smooth approach from relief to development strategies in MC is very crucial in order to avoid or minimize the consequences of immediate shifting or jumping from the relief and emergency phase to the development phase without considering or going through the rehabilitation phase. The MC industry should apply and adopt a rehabilitation strategy before moving further in the development phase, and this could be considered one of the main root causes of the current crisis facing the industry since 2009.

Debt Capacity and Repayment Suspension

One of the reasons for the popularity of micro-credits is the performance on loan recovery where anything below 95 percent is considered unsatisfactory by donor organizations (Harper, 2007a, p. 39). However, loan recovery does not give any indication of whether people are able to pay back the loans without suffering additional destitution, something that has become much clearer during the current global economic crisis

which has affected the debt recovery of large number of borrowers in Bosnia and Herzegovina. In other words, debt recovery relies heavily on the debt capacity of the borrowers which was defined by Von Pischke (1991, p. 177) as follows; lenders are able to recover loans on schedule only when the repayment capacity of the borrower equals or exceeds debt services which consist of principal and interest due for payment. Borrowers are able to repay their loans on time without suffering hardship only when their repayment capacity equals or exceeds the debt service due according to the loan contract. In order to be consistent with the Microcredit Foundations (MCFs) aim to serve as a catalyst for economic development, the repayment capacity should exceed the debt service by a considerable margin. However, according to the available data on most of MCFs' websites and reports in BH, this is commonly not the case. And early warning signals sent by a few local practitioners as a result of their internal surveys and observations were not taken seriously nor could they prevent the sudden explosion of the current crisis that the industry is facing since 2009.

In spite of this, the lack of debt capacity, repayment suspension is granted only in very exceptional circumstances as Rutherford (2002) stated. As Mareen (2008, p. 402) state: "*Even during major disasters, such as the 1998 and 2004 floods in Bangladesh, payments were at best postponed until flood waters had receded*". While in Bosnia and Herzegovina since the 2009 global economic crises, the loans reconstructing (rescheduling) technique was used to overcome the delay on repayments, such approach guaranteed borrowers longer periods but loaded them with extra interest charges.

MCFs Organizational Structures and Loan Recycling

Organizational Structure; According to Wood and Sharif (1997), and Hulme and Moseley (1996), in many MCFs the "discretionary power" to grant a stay of payment does not rest with the fieldworker or the branch manager but rather with managers higher up in the hierarchy. This is important as hierarchical decision making and operational autonomy notably affects the ability of borrowers to cope with and recover from emergencies both in positive and negative terms. The same could be said for the MCF that will be used as a case study in this paper as well as all other MCFs in Bosnia and Herzegovina.

Loan Recycling; According to Yunus (2002); "*once half the outstanding loan is repaid, clients are allowed to take out a second loan to help pay off the previous loan*". Loan recycling has become a common practice in many MCFs in Bosnia and Her-

zegovina, as this has been approved by the Federal Banking Agency (FBA) which controls the activities of all MCFs since June 2008. But in the case of Bosnia and Herzegovina, the practice of loan recycling has been applied regardless of the above condition mentioned by Yunus. MCFs varied in initiating conditions to secure getting back their money from borrowers; some of them asked borrowers to only have guarantors who are working in governmental sectors, while others asked for additional interest or offered larger loans and longer repayment periods with conditions to close the whole amount of the previous loan immediately.

Alleviating Poverty and Pricing Transparency

The extra liquidity was intended for daily expenses during the crisis, as well as for productive investment. However, handing out more money on credit should never be a solution in itself as over time it can change attitudes and erode cautiousness according to Nagarajan (1998), Dichter (2007) and Allen (2007). Microcredit is generally most appropriate where ongoing economic activity and sufficient household cash flow already exist as explained by (CGAP, 2005, p. 8). In spite of MCFs having long been highly transparent in some areas, due to the complications of market conditions and lack of regulation, the true price of loan products has never been accurately measured or reported. This is a serious weakness in the industry, although there has been a serious effort made since 2008 regarding the transparent pricing issue, even though this still listed prominently in all consumer protection efforts currently underway. Elizabeth Littlefield (2009), the former CEO of CGAP, stated: *"MF Transparency aims at giving microfinance institutions information to offer better value to customers. And it will give investors and others the information they need to put pressure on those institutions that may be charging unreasonably high fees or hiding the full cost of their services. We applaud the effort."*

Social and Economic Stagnation in Bosnia and Herzegovina

The social and economic situation of many people living in Bosnia and Herzegovina is difficult, particularly for the IDPs and returnees. Many IDPs still live in collective accommodation, while the returnees are suffering from an extremely high unemployment rate in majority dominated areas, the loss of a social assurance system, poor health care, education and infrastructure facilities. Furthermore many families lost their main breadwinner and are therefore being confronted with poverty that they did

not know before the war. Bosnia and Herzegovina has not yet managed to overcome economic stagnation. The market is still split because of a federal fragmentation and non-standardized regulations; there is no uniform economic, tax or legal policy. The transformation from a socialist to capitalist economy has exacerbated the social situation, which is already precarious in the aftermath of the war. Fifteen years after the war, many young people are leaving the country to search for work and better living conditions as they can no longer see their future in Bosnia and Herzegovina.

Table 1 and table 2 show general statistics on Bosnia and Herzegovina that reflects the multi-ethnic composition of the country, and how much it is crucial for those who offer such services to be very sensitive and careful in regards to neutrality and impartiality. It is also crucial to target the host community in addition to returnees, refugees and IDPs. In order for the host community not to feel disadvantaged by the presence of these vulnerable groups, and in order not to obstruct the services that are offered to them, it is very crucial that the host community, in one way or another, gets benefits from the same services that the other target groups are enjoying. The table also shows that almost more than one million IDPs and refugees have been resettled in their prewar houses, something which is very important to remember when comparing this (in the next sections of this study) to the accessibility of these groups to micro-credits.

Table 1. General statistics on BOSNIA AND HERZEGOVINA according to 1991 census

Indicators	FBH	RS	BD	Total
Surface area in km ² / %	26.110,5 (%51)	24.605,7 (%48,0)	493 (%1,0)	51.209,2
% of population by territory	%62,1	%35,9	%2,0	%100

Source: **Statistics on BOSNIA AND HERZEGOVINA** (ISSN 1512-5106)

Table 2. General statistics on BOSNIA AND HERZEGOVINA according to 1991 census

Ethic Population	Bosniaks	Croats	Serbs	Yugoslavs	Others	Total
Population by ethnicity/%	1.902.956 (%43,5)	760.852 (%17,4)	1.366.104 (%31,2)	242.682 (%5,5)	104439 (%2,4)	4.377.03 (%100)
Returnees from1996-2006	630.730	129.612	249.020	-	8.071	1.017.43

Source: **Statistics on BOSNIA AND HERZEGOVINA** (ISSN 1512-5106)

Table 3 shows different human development indicators taken from the UNDP 2009 annual report, which reflects the need for more efforts to improve the quality peoples’ lives. Around 20% of the population of Bosnia and Herzegovina are definitely poor or on the edge of poverty, while Bosnia and Herzegovina is ranked 76th out of 177 countries in human development index. The encouraging figures coming from life expectancy where Bosnia and Herzegovina is ranked 51st and in adult literacy is ranked 39th with rate of 96.7%.

Table 3. Human Development Indicators of BOSNIA AND HERZEGOVINA

Human Development Index “HDI” (rank/rate),	76. (out of 182) / %81,2
Life expectancy at birth (rank/year)	51./ 75,1 years
Under 5 mortality rate (per 1,000 live births)	18
Adult literacy for ages 15 and above (rank/rate)	39. / %96,7
People not using an improved water source (rank/rate)	27. / %1
GDP per capita (rank/PPP US\$)	92. / 7,764
% of Poverty level - definitely poor, on the edge of poverty, not definitely poor	%11,3, %7,8, %73,9
Population below poverty line during 2009, 2010, 2011(rank/rate)	88. 86. 106 (%25, %25, %18,6)

Conflict Background and History

The signing of the Dayton Peace Agreement (DPA) in December 1995 ended the conflict and established Bosnia and Herzegovina as a federal state made up of two entities: the (mainly Bosnian Serb) Republic of Srpska (RS) and the (mainly Bosniak and Croat) Federation of Bosnia and Herzegovina (FBH). According to the DPA each entity has its own government, president, parliament and police, and until 2005, each had its own army. The north-eastern Brčko district (BD) is a self-governing administrative unit with territory in both (FBH) and (RS). In the aftermath of the war, the international community set out to establish a peaceful, multi-ethnic state by: stabilizing the country militarily, promoting the return of displaced people and by reforming national institutions. The DPA provided for a strong internation-

al presence including a North Atlantic Treaty Organization (NATO)-led military force, and the Office of the High Representative (OHR) to oversee the civil implementation of the DPA. Specific to refugees and internally displaced people, the DPA focused on the right of the displaced to return to their homes and reclaim their properties. As of June 2008, the number of internally displaced persons estimated by United Nations High Commissioner for Refugees (UNHCR) and the Ministry of Human Rights and Refugees (MHRR) had dropped from 1,200,000 to around 125,000 (UNHCR, June 2008 citing government figures), indicating that over one million refugees and IDPs had returned to their pre-war residences.

Research Methodology

The research methodology of this paper considered a combination of qualitative and quantitative research methods and identified the use of content analysis and questionnaires as the most appropriate. The primary data mostly from the questionnaires is complemented by secondary data from the reports of various institutions in Bosnia and Herzegovina.

The primary was data collected in March 2010 by an interest-free MCF in Bosnia and Herzegovina that was chosen as a case study in this paper and kept anonymous upon the request of the organization. In one questionnaire, 458 borrowers expressed their perspectives about the impact of microcredit on their lives, while 50 borrowers in another questionnaire expressed their perspectives about interest-free and interest-based loans. The surveys covered 40 towns within five Cantons in the FBH, RS and BD. The breakdown of these towns according to identities and Cantons is given in Table 4.

Table 4. Survey Region and Towns in Bosnia and Herzegovina

Regions	Towns
Central Bosnia Canton	Vitiz, Travnik, Novi Travnik, Gornji Vakuf, Donji Vakuf Fojnica
Tuzla Canton	Tuzla, Gradacac, Srebrenik, Sapna, Teocak, Ugljevik, Zevinica, Teslic, Kalesija, Celic, Gracanica, Lukavac, Banovic
Zenica-Doboj Canton	Doboj-Istok, Tesanj, Kakanj, Zenica, Vares, Visoko, Zavidovic, Zepce
Podrinje Canton:	Gorazde, Ustikolina
Brcko District:	Brcko
Republic of Srpska:	Bijelina, Milici, Zvornic, Bratunac, Srebrenica, Voca, Visegrad, Zepa.

The primary data also includes: five one-to-one interviews with senior managers of MCFs and a number of borrowers, many field visits and meetings with loan officers and the general population, and observations on the microcredit industry in Bosnia and Herzegovina over the past five years.

Secondary data includes the data and reports of the Association of Microfinance Institutions (AMFI) in Bosnia and Herzegovina, statistics from the “Bureau of Statistics of the Federation of Bosnia and Herzegovina”, websites of MCFs in Bosnia and Herzegovina, and the 2009 annual report of the MCF that has been taken as a case study.

Analysis of Results

This analysis aims to outline what has been compiled from data and information related to the three questions that this paper is addressing. The findings below in table 5 are related to the first research question and show that only 3% of employment has been created, 89% of borrowers were willing to get another loan, 96% solved their problems through getting loans, while 41% of them have problems in making their repayments.

Table 5. Borrowers perspectives about the impact of MICROCREDIT on their lives

Items	Yes (Number/%)	No (Number/%)
Solved problem with loan	441/ 96%	17 / 4%
Improved life standard	443 / 97%	15 / 3%
Created new employment	15 / 3%	443 / 97%
Have problems with repayment	186 / 41%	272 / 59%
Willing to get another loan	406 / 89%	52 / 11%
Total number of questionnaires	458	

The findings in the table below (Table 6) related to the second part of the first research question show that only 3% of returnees and 2% of IDPs have access to microcredit, despite the fact that more than one million refugees and IDPs have managed to return and settle to their pre-war houses.

Table 6. The accessibility of returnees, refugees, and IDPs to microcredit in Bosnia and Herzegovina

% of loans disbursed to IDPs	% of loans disbursed to returnees	% of loans disbursed to refugees
2%	3%	No evidence

The results of both primary and secondary data show that overall objective of microcredit organizations in Bosnia and Herzegovina is alleviating poverty by improving the livelihoods of the poorest people. Microcredit organizations state that the following are objectively verifiable indicators of achievements: increase in the income of borrowers; improvements in the standards of living; improvements in housing standards; improvements in family health; improvements in the overall quality of life and improvements in the quality of education.

Research results further state that the main purpose of microcredit programs in Bosnia and Herzegovina is to empower and assist returnees and IDPs to return to their pre-war houses. Other objectives include reconstructing destroyed houses, starting small businesses, assisting socially disadvantaged persons, improving the living conditions of the poor and assisting poor students to afford a good education.

Microcredit organizations use a number of indicators to measure their achievements. These include: the number of businesses started and expanded through microcredit programs, the sustainability and profit level of these businesses, the decline in the poverty level of beneficiaries, the number of people moving into proper houses, the number of returnees settled in their pre-war houses, the number of returnees employed, the number of jobs created, and the number of children that continue their education in communities.

The findings in Table 7 are related to the second part of research question number two, showing that the following percentages of types of loans have been disbursed: 32% housing loans; provided to help rebuilding and renovating destroyed homes; 37% business loans, helping in establishing of small businesses; 5% orphans loans, given to families carrying for an orphan; 18% social loans, provided in most cases to socially endangered population and 8% educational loans, provided to students in order to assist them to continue their education.

Table 7. Percentage of the type of loans disbursed in Bosnia and Herzegovina

Business loans	Housing loans	Social loans	Educational loans	Orphans loans
37%	32%	18%	8%	5%

In regards to the interest issue, the findings from the secondary data show that there are two kinds of loans;

Interest-Based and Interest-Free Loans: There are 25 MCFs in BH, from which 13 are members of the Association of Microfinance Institutions in Bosnia and Herzegovina (AMFI). Only one of them is interest-free and the others are interest-based.

Interest-Based Loan: Most of the interest based MCFs began their activities in 1996. According to the 2010 first quarterly report of the AMFI these MCFs have a portfolio of around 825 million BAM, around 325.000 active loans, a gained amount of 95.535.126 BAM net profit in 2009, while their annual interest rates differ from 15% up to 36%.

Interest-Free Loans: The interest-free MCFs began their activities in 2001. According to their annual report in 2009 they have portfolio in the amount of around three million BAM, less than 1800 active loans, gained no profit but did have losses, and charged up to 7.5% as admin fees for their services.

Finally, the findings from Table 8 show that 88% of borrowers expressed their readiness to seek loans from interest-free MCFs even if they are more expensive than interest-based ones. When answering the question “Why did you seek a loan from an interest-free MCF rather than any other MCFs?” 52% said that it was due to its compliance with Shariah, while 48% said it was due to cheaper cost.

Table 8. Borrowers’ perspectives about interest-free and interest-based loans

Questions	Yes Number (%)	No Number (%)	Other answers Number (%)
1. Were there any other loans available to you when you received the loan from the interest-free MCF?	45 (90%)	1 (2%)	4 no answer (8%)
2. Why did you seek a loan from interest-free rather than any other MCFs?	-	-	26 Compliance with shariah (52%) 24 Low admin costs (48%)
3. Would you seek loans from interest-free MCF even if it is more expensive than interest-based loans?	44(88%)	6 (12%)	
4. Do you feel there is an extra obligation to repay because Interest-free is in compliance with Shariah?	34 (68%)	14(28%)	2 no answer (4%)
Total number of questionnaires	50		

Discussion

This section of the paper discusses the overall findings of this study, and determines the answer to each of the three research questions. In regards to the first question (How does microcredit affect the livelihoods of the targeted groups, and to what extent do refugees, internally displaced persons and returnees have access to microcredits in Bosnia and Herzegovina?) the findings are very modest: only 3% of jobs have been created, the reason could be better understood if one realizes that only 37% of loans were taken for creating or developing businesses, this means that most of the taken business loans were used for self employment and improving the living conditions of borrowers, but not for expanding businesses and creating new jobs.

The findings also show that only 3% of returnees and only 2% of IDPs had access to MC, although more than one million of refugees and IDPs have managed to return and settle. Obviously, it could be understood that this vulnerable group has benefited the least from MC programs in Bosnia and Herzegovina. Regarding the second question (What are the objectives of the microcredit programs, and what are the most requested loans in Bosnia and Herzegovina?) the findings from the case study carried by one MCFs (interest-free) operating in more than 64 municipalities in Bosnia and Herzegovina during 2009, concluded that only 37% of the disbursed loans were used in a productive manner (business loans), such as livestock/poultry rearing, trading and farming, agriculture, handicrafts, etc, while 32% have been used for renovating and reconstructing houses (housing loans), 18% have been used to cover social needs such as food, medication, etc (social loans), 8% have been used for educational purposes, such as paying university fees, buying books, computers, etc, (educational loans), and 5% have been used to support families caring for orphans (orphans loans). This shows that despite the fact that 15 years have passed since the war ended in Bosnia and Herzegovina, there is still a need for reconstruction and renovation of devastated houses.

The findings also show that enough funds, from different donors and investors including the World Bank, are available for the interest-based MCFs, as they have portfolios of around 825 million BAM and around 325.000 BAM in active loans. While the interest-free ones have limited funds with a portfolio of around 3 million BAM, as they have no access to banks and international funds and investors due to Shariah restrictions that forbid taking or giving interest under any circumstances. On the other hand, the interest-free MCFs seem to have two advantages; the first one is that they are much cheaper than other MCFs, and the second advantage is the willingness of the majority of the target population, who are Muslims, to comply with Shariah in regards to the issue of the interest.

In relation to the third question (What are the perspectives of the beneficiaries of micro-credits in Bosnia and Herzegovina regarding this service and its impact on them?) the findings from the previously mentioned case study reflect the need of MCFs to continue operating in Bosnia and Herzegovina, as more than 95% expressed that MCs solved their problems and improved their living standards. On the other hand, by analyzing the figures of at risk portfolios (9,7%) and write offs loans (9,8%), and the 41% of borrowers who expressed having problems with their repayments, it seems that MCFs, in one way or another, had encouraged borrowers to get more loans, thus burdening them with more debts. Another meaningful finding from the same case study is that even though 41% of borrowers have problems with repayment, 89% expressed their willingness to get more loans, something that has a positive side and a negative side. The positive side reflects the feeling of people that, with the passing of time, they can rely on getting more loans to develop their business and solve their financial problems, while the negative side is that they might become overloaded with loans and find themselves sinking deeper and deeper into poverty.

Conclusion

As a conclusion, the findings reflect the meaningful objectives that were set out by MCFs in Bosnia and Herzegovina, and the direct impact of MC on the population's life, as most of them expressed their satisfaction with getting loans as a solution to their daily problems. In practice, it seems that MC in Bosnia and Herzegovina has contributed mostly by helping people who have regular income to cover their loans, more than helping those without stable income. The findings also suggest that despite the long existence and wide availability of micro-credits in Bosnia and Herzegovina, many people do not generate enough income to become self-sufficient, and the number of jobs created is very modest. The statement of a senior manager in one MCF is insightful in this respect: "Even though microfinance may meet the varied and immediate needs of many people, meeting those needs does not mean that microfinance is lifting them out of poverty". Therefore many clients often fail to break out of income poverty and many even get caught up in an increasing debt-burden syndrome and slide further into poverty. While interviewing a number of borrowers, many of them stated that they had been encouraged and facilitated to get many loans from same MCF; one of them admitted that he/she got more than 20 active loans from only one MCF.

The demographic of returnees, refugees, and IDPs have the least access to MC, and those who do have access are those who have the greatest difficulties with their

repayments. This emphasizes that these categories should be much more targeted, with much better facilities, which current MCFs in Bosnia and Herzegovina may not be able to offer. Most of MCFs in Bosnia and Herzegovina are interest-based and have qualified human resources and adequate financial resources as well, something that led some of them to consider transitioning to banking institutions. Also, some of them have won international awards, confirming that it is possible for MC in Bosnia to record its contribution to the development of this industry at the international level. In contrast, there are very few interest-free MCFs, with very limited human and financial resources. However, this study has shown that these types of institutions have the acceptance of a large segment of the Bosnian Muslim society, as the findings affirm the willingness of the target population to adhere to Islamic rules related to the interest issue. But in order for these kinds of institutions to attract more donors and investors and to deliver a better service, they should: allocate much more funds, advocate on behalf of the poorest population and initiate new techniques to reach and target them, end suspicions as whether charging administration fees on a percentage basis is compliant with Shariah or not, have a qualified shariah board, or shariah consultant to supervise and give directions to the work in the field, and adopt new techniques “even if they are not fully lawful by shariah” to secure their funds and to avoid the delay issue in repayments. It is wise to remember and adopt the Shariah principle that rules: Choosing the lesser of two evils.

The findings also show that the MC industry in Bosnia and Herzegovina seems to not be cheap enough, as the interest rates in most of MCFs are pretty high and might not be transparent enough; while advertizing relatively lower rates, extra expenses will be paid by the client in many other forms, such as: application fees, loan monitoring, etc. During one-to-one interviews and discussions with several senior managers of MCFs, one of them admitted that the annual interest rate comes up to 36%. Another senior manager explained the success of his/her organization, where the annual net profit exceeded one million Euros. The findings also reflect that despite the fact that more than 15 years have passed since the war ended, there is still a need for the reconstruction and renovation of devastated houses, as large scale of loans have been taken for this purpose.

Finally, the limitation of this paper is that it mostly reflects the perceptions of the clients of only one interest free MCF which was taken as a case study in this research. This confirms the need for more comprehensive future studies on the MC industry in Bosnia and Herzegovina; particularly the interest based ones, in order to explore the real impact of these institutions on the local economy and peoples' lives, and to serve as a guide and reference for the industry.

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Participation Banking in European Context

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ABSTRACT

The purpose of this study is to find a common ground for participation banking in Europe, by explaining a new way of banking practice which has its roots in the European business tradition of partnership, investment, trading and providing services, as well as the status of usury in Christian, Jewish and other traditions. It deals with questions related to the openness of European societies to this invention of Islamic culture, the main characteristics of participation banking, its benefits, the chances for building better relations with the Muslim world, and the possibilities of participation banking in non-Muslim environments. It is concluded that participation banking is an opportunity for rather than a threat to, Europe which will open new dimensions for the banking industry, diverse responsibility, bring people together, increase competition and bring better services with more competitive prices and, what is quite important is that it might activate the savings of European Muslims that are currently out of the banking system.

KEYWORDS

Participation banking, Usury, Sharia, Murabaha, Musharaka, Mudaraba, Salam, Istisna, Ijara

ARTICLE HISTORY

Submitted: 21 October 2011

Resubmitted: 4 January 2012

Resubmitted: 12 February 2012

Accepted: 25 March 2012

JEL Code: G29

Introduction

The biggest success of European society is reflected in the fact that it has largely managed to build a pluralistic society that accepts and respects differences among people. This achievement has opened the road to new success in the political and economic fields, so that today we have the European Union in front of which are great opportunities if it succeeds to maintain the direction towards pluralism and respect for diversity among its citizens. The principle of pluralism is consistent with the natural law of Allah Almighty because He has created people different and prescribed to them to meet and know each other: "O mankind! We have created you from a male and a female, and made you into nations and tribes, that you may know one another" (Qur'an, Al-Hujurat 13). Whatever is natural, whatever is consistent with the natural law of God, has a chance of success, because it brings to human beings what is in harmony with their nature, what is good and useful for them.

Although, as noted, European society is pluralistic, although it respects pluralism, some people within society, sometimes, reluctantly accept when something comes from the Islamic culture. There is prejudice, and even open opposition, at the first glance, just because it comes from Islamic culture. Given the objectives that European society proclaims, it would be fair to give participation banking fair treatment and a chance to participate and compete in the European market. Thus, the revival of the following universal values and principles on which European society is built is necessary:

1. A universal attitude toward human beings: that all human beings are blood-brothers and sisters with the same rights and obligations.¹ People should be valued according to their actions-how beneficial or harmful their deeds and actions are to themselves, to other people and to the environment, but not based on their ethnic origin or religion.
2. The freedom of expression of ideas should be fully implemented. Restriction should only be on the usage of insulting words and expressions. It will enable people to present their products and ideas freely.²
3. Equal rights and obligations in society and equal rights in front of the law: This principal requires European secular states to revive the original idea of secularism, according to which all citizens are equal in their rights and obligations and equal in front of the law.³
4. Equal opportunity for all human achievements: It can be achieved if the cultural and other achievements of all Europeans are equally treated and given equal opportunity to compete in the field of ideas and products.⁴

Rational Behind Prohibition of Interest

The Qur'an and the Sunnah do not provide any detailed rational for the prohibition of interest (*riba*). However, the implicit meaning of Qur'anic verses and sayings of the Prophet, p.b.u.h., about interest may suggest that the charging of interest is an act of injustice. This is why Muslim scholars, when speaking about reasons why Islam has prohibited interest, say that the main reason behind the prohibition of interest is the prevention of injustice. The injustice in dealing on the basis of interest can be observed at different levels. For example, the fact is that the lender is guaranteed a positive return while the borrower takes all the risks. Therefore, taking interest represents *akl amwal an-nas bi-l-batil* because the lender and the borrower are in an unequal position. "Such injustice may result based on significant price fluctuations, or any of a number of other considerations. Moreover, there is a very real danger of exploitation of poor debtors by creditors, which Islam strives to eliminate." (Zuhayli, 2001:1/337)

Furthermore, it opens the way for the accumulation of wealth in a few hands. After explaining that as a whole, socio-economic and distributive justice, intergenerational equity, economic instability and ecological destruction are considered the basis of the prohibition of interest, Muhammad Ayub concludes: "Keeping in mind all relevant texts and the principles of Islamic law, the only reason that appears convincing is that of distributive justice, because the prohibition of Riba is intended to prevent the accumulation of wealth in a few hands; that is, it is not to be allowed to "circulate among the rich" (Holy Qur'an, 59: 7). Therefore, the major purpose of Riba prohibition is to block the means that lead to the accumulation of wealth in the hands of a few, whether they are banks or individuals." (Ayub, 2007:54-55).

The way to go out, without stopping economic activities, is partnership financing through products of participation banking.

Main Characteristics of Participation Banking

The main characteristic of participation banking and finance are:

1. **Dealing on non-interest basis.** The Qur'an says: "...whereas Allah has permitted trading and forbidden usury" (Qur'an, *Al-Baqara*: 275). Due to this revelation

and some other verses and sayings of the Prophet Muhammad, p.b.u.h., Muslim scholars are unanimous that usury is forbidden in Islam. Zuhayli says: "The Islamic nation is in consensus over the prohibition of *riba*. In this regard, Al-Mawardi said: "To the point that no legal system (*sharia*) has ever permitted it", as evidenced by the verse "That they took *riba*, thou they ere forbidden to do so" (4:161), meaning in the previous revelations (Zuhayli, 2001:1/311). It is considered to be a way of unjustified taking possessions of others (*akl amwal al-nas bi al-baṭil*) by receiving monetary advantage in a business transaction without giving a just counter value. "The principal reason why the Qur'an has delivered such a harsh verdict against interest is that Islam wishes to establish an economic system where all forms of exploitation are eliminated, and particularly, the injustice perpetuated in the form of the financier being assured of a positive return without doing any work or sharing in the risk, while the entrepreneur, in spite of his management and hard work, is not assured of such a positive return. Islam wishes to establish justice between the financier and the entrepreneur (Chapra, 1995).

2. **Partnership.** The Prophet Muhammad, peace be upon him, said that Allah Al-mighty promised His support to humans who work together in partnership till one of them starts to cheat the other (Abu Dawud, 2000). This is why business in Islam is partnership oriented. Because of the same reason participation banking is partnership oriented on the basis of profit and loss sharing. The main products *musharaka* and *mudaraba* are pure partnerships, while all other products like *salam*, *istisna*, *ijara* and, even, *murabaha* have some elements of partnership.
3. **Asset backed financing.** Islam does not recognize money and monetary paper as a subject-matter for trade except in the trading of different currencies. "Profit is generated when something having intrinsic utility is sold for money or when different currencies are exchanged one for another. The profit earned through dealing in money (of the same currency) or the papers representing them is interest, hence prohibited. Therefore, unlike conventional financial institutions, financing in Islam is always in illiquid assets which create real assets and inventories (Usmani, 2002).
4. **Transparency.** There is no hidden costs, no small letters in the contract. Uncertainty (*gharar*), including deception or ignorance is prohibited. One of conditions for the contract to be valid in Islamic law is clearness, transparency, explicitness and non existence of doubtful and uncertain matters that can cause disagreement in the future.

5. **Care for the society.** This care is evident in many aspects. Islam prohibits everything that is harmful to human beings like alcohol, tobacco, gambling, prostitution, etc. Islam has prohibited *maisir* (gains made from speculative activity, or ‘unfairly earned income’) because it harms society. Therefore, participation banks do not finance those products and activities or anything else that is harmful to human beings. Participation banks help poor people through a product called *qard hasan* (benevolent loan). Through special funds they try to find solutions for the micro financing of poor people on terms that are suitable for them. If a partner of a participation bank experiences hardship the bank has the obligation to help because the Qur’an says: “And if the debtor is in hard time, then grant him time till it is easy for him to repay, but if you remit it by a way of charity, that is better for you if you did but know (Qur’an, *Al-Baqara*: 280). In all cases participation banking is keen for the successes of its clients, because it is the only way that the bank can be successful.
6. **Real economic activities.** Participation banking is not the mere lending of money, but rather a very large spectrum of economic activities that represents an alternative method to profit making in trade, partnership in project financing and providing all banking services that modern customers require. It is widening the ways of financing and opening new opportunities. These are the main characteristics of participation banking. All of them should be evident in practice if participation banking is implemented according to the teachings of Islam.

Expected Standing of Europeans about Participation Banking In Europe

Participation banking has a religious dimension for Muslims⁵, but for non-Muslims it would be, at least, a human product, like other human products. Most Europeans certainly have a positive attitude toward the previously mentioned values and principles and as a result of that they should accept participation banking as a human product and achievement.

Sharia is the religious law for Muslims that regulates their daily activities, and for those who don’t believe in Islam as sense of divine source, it should be a cultural achievement of their fellow human beings. That cultural achievement has the right to be treated equally alongside the cultural achievements of others. Therefore, Muslims

in Europe and elsewhere are expecting that kind of treatment towards their cultural achievements. Any treatment by which Muslim culture is placed in a second-rate position may be a sign of intolerance, prejudice, or lack of knowledge.

All products of human beings have to be judged according to their usefulness or harm to society, not on the cultural background of a certain product. Therefore, when discussing participation banking in Europe what should be discussed is whether it would work properly in a certain European environment, how it can be incorporated in the European legal system, whether it will improve economic activities, bring benefits to the society and so forth.

Is Participation Banking for Muslims only?

Certainly, it is not. These products can be used by all people, Muslims and non-Muslims⁶, by participation and conventional banks. Participation banking does not require the introduction of *Sharia* law on the state level and participation banks can be run by non-Muslims, too.⁷ Even more, conventional banks can, under certain conditions, have windows which operate in accordance with *Sharia* standards⁸.

Therefore, correct and impartial relation to the products of participation banking requires a discussion of it in the light of its benefits to society, possibility of its implementation in different environments, not in the sense of imposing Islam and *Sharia* law on non-Muslims.⁹

Usury in the Past and Contemporary World

The practice of usury - lending money with interest can be traced back 4,000 years¹⁰. This activity has always been condemned, restricted or banned by moral, ethical, legal or religious entities.

In the Hindu Sutra (700-100 BC), as well as in the Buddhist Jatakas (600-400 BC), the payment of interest is mentioned along with expressions of disdain for the practice. Vasishtha, a prominent lawmaker of the era, drafted a law that banned the high caste Brahmins and Kshatriyas from being usurers or money-lenders.

Western philosophers such as Plato, Aristotle, Cato, Cicero, Seneca and Plutarch were critics of usury. Judaism, Christianity and Islam all forbid usury. The Torah discusses the prohibition against taking interest in many places: Exodus 22:24; Leviticus 25:36-37; and Deuteronomy 23:20-21. The verses in Deuteronomy says: “You must not make your brother pay interest, interest on money, interest on food, interest on anything on which one may claim interest. You may make a foreigner pay interest, but your brother you must not make pay interest” (Deuteronomy, 23:19-20)¹¹.

The Qur’an states: “That is because they say: “Trading is like usury,” whereas Allah has permitted trading and forbidden usury” (Qur’an, *Al-Baqara* : 275).

Despite these facts, only Muslims, and some non-Muslim individuals and smaller groups and organizations stand firmly against interest, and try to avoid it in their everyday life. On other side churches like the Catholic, Protestant and Orthodox churches do not object anymore to the interest charged by conventional banks¹². However, after the last prime mortgage crisis in America which affected most countries worldwide it seems that the Catholic Church has started opening its doors to the idea of participation banking. One article in the Brussels Journal on this subject is clear about the changes which can be expected in the future. The Journal states:

In yet another act of conciliation on the part of Western religions towards Islam, the Vatican newspaper *L'Osservatore Romano* has voiced its approval of Islamic finance. The Vatican paper wrote that banks should look at the rules of Islamic finance to restore confidence amongst their clients at a time of global economic crisis. “The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service,” the *L'Osservatore Romano* said. “Western banks could use tools such as Islamic bonds, known as sukuk, as collateral”. Sukuk may be used to fund the “car industry or the next Olympic Games in London,” the article says. The Vatican article is only one of many articles that have recently appeared on the acceptance by Western governments and bankers of an Islamic financing system. More than accepting it, they seem to be welcoming it, though they are certainly being pressured into this by unnamed forces bowing to the dictates of Islam (Tiberge, 2009).

France, which has opposed Participation banking for a long time, has eliminated legal hurdles, particularly levies, for Islamic financial services and products and enabled listing companies on the Paris Stock Exchange. French Finance Minister Christine Lagarde announced in 2009 France’s intention to make Paris “the capital of Islamic finance” and said that several Islamic banks would open branches in the French capital in 2009 (Aki, 2011).

On 17.01.2011, The Bloomberg news has quoted the statement of State Secretary for Foreign Trade Pierre Lellouche that France is going to develop Islamic finance and attract investment from the Gulf to its economy:

“We’ve had some delay, compared to the British particularly,” Lellouche said in an interview in Abu Dhabi today, “The legal mechanisms are getting in place and French banks are very capable and they are at it.”

The Bloomberg reported that the first Islamic bond from France could be sold in early 2011 after the government introduced guidelines for *sukuk* offerings, Thierry Dissaux, chief executive officer of the French Deposit Guarantee Fund said in an interview Dec.15.

Reuters reported on 27 October 2011 that French lender Credit Agricola (CAGR. PA) is considering either issuing an Islamic bond or creating a wider *sukuk* program that could lead to several issues, as European banks seek to diversify funding, a senior executive said on Thursday. “It’s something that we’re always looking at but it’s probably more on the agenda today than yesterday because banks need to diversify funding,” Simon Eedle, managing director and global head of Islamic banking, told the Reuters Middle East Investment Summit. “I believe it’s something that we will do. It’s only a question of time,” he said. “If Credit Agricole were to issue a *sukuk*, it would be an *ijara* structure with real Islamic assets to justify to the investors that we are using the financing to divide the liabilities to match the Islamic assets we have,” he said (Pasha& Uppal, 2011).

Despite the fact that the preparation of the legal framework and the introduction of the instruments of Islamic banking seem slow, these developments in Europe are a good sign which Muslims worldwide applaud and encourage.

Participation Banking Products

Participation banking is enjoining permanent development. It comes with new products and improves existing ones. Today, the most popular products of participation banking are the following:

1. *Murabaha*

“*Murabaha* is a particular kind of sale where the seller expressly mentions the cost of the sold commodity he/she has incurred, and sells it to another person by adding some profit thereon” (Usmani, 2002)¹³. The *murabaha* transaction exists between three parties: the financier (the bank), the vendor from whom the bank purchased the goods, and the client of the bank who will buy the goods on deferred payment basis.

More than eighty percent of participation banking financing is done through this product and due to this fact *murabaha* is known as a method of banking operations, while in the essence it is a kind of trade with a disclosed profit margin.

2. *Musharaka*

Musharaka means a joint enterprise formed for conducting some business activities in which all partners share the profit according to a specific ratio, while the loss is shared according to the ratio of the contribution (Usmani, 2002).

This mode is represented in the contribution of partners of equal or unequal ratios of capital to establish a new or to take part in an existing project, whereby each participant owns a share in the capital and deserves his share of the profit. The partnership originally is intended to continue up to the dissolution of the company. It is possible, though, for one of the partners to sell his share in the capital and to withdraw from the project one for reason or another.

The participation banks use this mode in different projects. They finance their customers with part of the capital in exchange for a share of the output that they agree upon. Mostly, they leave the responsibility of management to the customer partner and retain the right of supervision and follow up.

3. *Musharaka Mutanaqisa*

“According to this concept, a financier and his client participate either in the joint ownership of property, or equipment, or in a joint commercial enterprise. The share of the financier is further divided into a number of units. It is understood that the client will purchase the units of the share of the financier one by one periodically.

By doing that, the client is increasing his own share, till all the units of the financier are purchased by him so as to make him the sole owner of the property, or the commercial enterprise, as the case may be” (Usmani, 2002).

Decreasing or diminishing partnership differs from permanent partnership in terms of continuity. In the decreasing partnership the bank intends, from the beginning, to remain associated with the client for a defined period of time, not indefinitely. According to this concept, the bank has all the rights and obligations of the ordinary partner. The client uses the shared property or the equipment and pays rent for the part owned by the bank. The collected rent is what the participation bank earns from this kind of partnership.

4. *Mudaraba*

“This is a kind of partnership where one partner gives money to another one for investing in a commercial enterprise. The investment comes from the first partner who is called *rabb al-mal* while the management and work is an exclusive responsibility of the other, who is called *mudarib* and the profit generated are shared in a predetermined ratio” (Usmani, 2002). Mudaraba in the banking industry is a finance process whereby the participation bank contributes funds and a client contributes expertise and works to execute a potentially successful project. Profits are distributed in a percentage agreed upon beforehand. The bank shall bear any loss if the client is not negligent or in violation of the terms. Mudaraba can cover one deal, several deals, or a specified period of time up to a specified ceiling (Archer & Karim, R: 2002).

5. *Salam*

“In salam, the seller undertakes to supply specific goods to the buyer at a future date in exchange for an advanced price fully paid at spot” (Usmani, 2002). Therefore, salam is a financial transaction in which price is advanced in cash to the seller who abides the delivery of commodity of determined specification on a definite due date and place. The bank can, on parallel salam, sell a commodity of the same kind as it has previously purchased with the first salam, without making one contract depend on the other. The bank also has the option of waiting to receive the commodity and then selling it for cash or deferred payment.¹⁴

6. *Istisna*

It is a contract with a manufacturer who is to make something for the purchaser, for a defined price, which can be paid in advance or later. Therefore, *istisna* is a sale transaction where a commodity is transacted before it comes into existence. In this kind of transaction the price and all necessary specifications of the commodity and other terms must be fixed and fully settled. Participation banks frequently use *istisna* to finance building and constructing projects. The majority of the jurists consider *istisna* to be one of the divisions of *salam*.

7. *Ijara (Operating Lease)*

“In leasing an owner transfers its usufruct to another person for an agreed period, at an agreed consideration (Usmani, 2002). Leased subject must have usufruct, must be identified and quantified. It remains in the ownership of the lesser. According to this mode, the participation bank maintains a number of various assets as its property to respond to the needs of different customers. These assets usually have a high degree of marketability. The bank lends these assets to any party and after the end of the lease period the assets are returned to the bank, which looks for a new lessee. The collected rent is what the participation bank earns from this activity.

8. *Ijara wa iqtina' (Lease purchase)*

Lease purchase, or lease that ends with possession, is a new mode tailored by participation banks. The bank purchases an asset on behalf of a customer who is interested in owning it by means of lease that ends with possession. At the end of the lease period, ownership is transferred to the lessee. Generally, the bank calculates total rentals on the basis of the cost of asset plus the profit. Rentals are paid over a period of time as agreed between the bank and the customer (Usmani, Archer & Kerim, 2002).

9. *Qard hasan (Benevolent loan)*

“*Qard hasan* is a loan which is returned at the end of the agreed period without any interest or share in the profit or loss of the business.” (Chapra, 1995:68). Every participation bank has a special account for the *qard hasan* fund. They normally put

some of their annual profit in that fund and channel to that account all income that is forbidden in Sharia, like penalties etc. These funds are limited. Therefore, qard hasan financing is available to a limited extent. It is provided for financing of small businesses or to help those people who face personal hardships and need financial help.

Participation Banking in the European Tradition and Opposition to it

The above mentioned products may be traced and found in the European tradition, as well as in temporary practice¹⁵. Europeans have long traded with known and unknown profit margins; they have been establishing joint ventures, investing in different businesses, leasing properties etc. Europeans had and they still have co-operative, interest-free banks. A well known bank of this type is the JAK bank in Sweden. JAK has been operating an interest-free savings and loan system since 1970. It was licensed in 1997. It has 36,300 members and annual growth of 7 percent¹⁶ (Jak, 2011).

Despite the fact that the products of participation banking are widely practiced in the everyday lives of Europeans, it still faces some opposition, sometimes because of prejudice and mostly due to ignorance regarding the intentions of Shariah which are reflected primarily in the protection of the five core values: protection of life, religion, wealth, honour, and offspring. It can be said that the great majority of Europeans support these values as Muslims which practise Islam do. Therefore, they can, for certain, find common ground when participation banking is in question. The best proof for such a claim are European banks, many of which are trying to benefit from participation banking system by opening windows for participation banking. This trend is supposed to continue more vividly in the future. If it becomes a success story, it will remove some suspicions that still circle in Europe about participation banking.

European Experience in Participation Banking

The UK has the most and the longest experience in participation banking amongst European countries, despite the fact that it does not have the biggest Muslim population. The UK has 1.8 million, while France has 5 million Muslims. Participation banking in the UK started a quarter of a century ago, and France actively started preparations for the introduction of participation banking in 2009.

The UK has become a centre for participation banking because London, as the most influential financial centre in Europe, has become the centre for Islamic finance. The beginning was with Al-Baraka International Bank in 1982, then United Bank of Kuwait, which later became Al-Ahli United Bank. This bank still operates. The first dedicated participation bank in the UK is the Islamic Bank of Britain, which was licensed in 2004. The first participation investment bank, the European Islamic Investment Bank, was opened in UK as well.

Participation banks in the eighties had an excessive liquidity and London took advantage of this to channel money into its market and businesses. The excessive liquidity is obvious nowadays, and, maybe it is the main reason why Gordon Brown, while speaking in the conference on participation banking and finance held in London in 2006, said: “It is the vibrancy and dynamism of Britain’s Muslims, combined with Britain’s openness to the world and our historic ties with Muslim countries, that means the ambition you have set for yourselves - to make Britain the gateway to Islamic finance and trade - is one I believe Britain is well placed to achieve” (Adfero, 2006).

In his speech related to this subject Financial Services Authority (FSA) Chairman Sir Callum McCarthy laid out the UK position, saying, “It is important that we showed we were able to accommodate Islamic banking practices alongside traditional non-Islamic banking, for reasons both of principle and of practical importance” (McCarthy, 2006).

There is a need to emphasize a great potential in liquid money owned by European Muslims, who are out of the banking system due to the fact that they are trying to avoid dealing in interest. If a *halal* system is provided, they will invest, especially if they know that keeping liquid money as *konz* (unused money) is blame worthy in Islam.

When Turkey becomes a full member of the European Union, the participation banking which is growing rapidly in this Euro-Asian state will gain new dimensions.

The Participation Banking Experience in Bosnia & Herzegovina

Vakufska banka d.d. Sarajevo, founded in 1992, was the first bank in Bosnia & Herzegovina that was established to work according to the participation banking principles. However, it never introduced that practice and their business has included interest from the beginning, due to a lack of skilful professionals in participation banking.

Orient banka d.d. Sarajevo – founded in 1996, was the very first bank that provided loans on a non-interest basis. In January 2000, this bank was forced to merge with the conventional ABS banka d.d. Sarajevo and, accordingly, lost its identity as a participation bank.

In October 2000 Bosna Bank International d.d. Sarajevo was founded. It is the only bank in Bosnia and Herzegovina that operates under the principles of participation banking. The founders of BBI are: the Islamic Development Bank 45, 46%, the Dubai Islamic Bank 27,27%, and the Abu Dhabi Islamic Bank 27,27%. BBI provides all banking services, but it faces limitations because of the local legal system, which does not recognize “interest-free” business models. Therefore, the main products of participation banking like *murābaha*, *mushāraka* and *ijāra* cannot be used in their “classical” forms.

There are some other difficulties that the bank is facing, like double taxation due to tax on profit obligations at the end of the business year (participation in sharing of profit represents income for the bank, while interest represents costs charged as expenses). Since 2006, BBI is trying to amend the Law on Banking. The amendment past successfully through the House of Representatives, but it did not go to the House of People because there was not enough support from Croat representatives.

In order to remove some doubts about participation banking, BBI is organizing seminars and promoting the idea of participation banking in different ways. One seminar was organised in 2006 for the Federal Government and the Banking Agency. The speakers were Professor Rodney Wilson from Durham University, UK, Dr. Murad W. Hofmann from Germany and Sheikh Nizam Ya’qubi from Bahrain. Their presentations were well received by the Prime Minister and his cabinet ministers at that time, but the law remains unchanged until now.

The last effort was made on 19.12.2011. The Association of Banks of Bosnia and Herzegovina drafted some amendments to the Draft Law on Amendments to the Banking Act proposed by the Government of the Federation of Bosnia and Herzegovina. One of amendments is: “Banks can in its business use products based on partnership and the sale with profit margin, but only for the purpose of lending-financing banks customers.”

Participation Banking in the Global Finance Industry

Participation banking is relatively small in the global finance industry. Alexander Lis, managing director at Oliver Wyman, the consultancy, calculates that there is

\$300bn of assets managed according to participation principles, and more than 280 institutions providing participation products (Khalaf, & Tett 2007). Other experts estimate these numbers to be much higher.

The Future of Participation Banking in Europe

Participation banking today shares only 1% of the global banking industry. However, keeping in mind the great potential of Muslim countries and the annual growth of the participation banking industry by 15%, there is no doubt that it is going to play a greater role in the future. In last two decades participation banking has developed rapidly. This quick and sudden development is an un-believable phenomenon. One of pioneers in the industry and a renowned expert in participation banking Hussein Hassan from the Dubai Islamic Bank says: “What has happened has been extraordinary – no one would have believed this growth was possible a decade or two ago” (Khalaf & Tett, 2007).

This is a growth that is supposed to continue even faster in the foreseeable future and it will affect the development of the participation banking industry in Europe. European banks will continue to introduce participation banking¹⁷ and more institutions will be involved in this sector. Participation banks from the Gulf will continue coming to European countries, especially if these countries adapt their laws by skipping double taxation and allowing banks to trade in commodities. European countries will move in that direction because the market seems to be heading that way.

Because of the huge interest in participation banking, European universities will open new courses on the subject and postgraduate studies in participation banking will become very popular.¹⁸ New centres for participation banking will emerge outside London, like Luxemburg, Sarajevo, Paris and Vienna.

As the money flows, some existing opposition to participation banking will die away. The European continent will host new conferences on participation banking and finance. The liquid savings of Muslims, which are outside of the banking system at the moment, will be invested through European participation banks and it will give new incentive to the European economy. In order to meet the expectations of Muslims and others who support participation banking, participation banks have to develop more transparency, educate their employees and clients, harmonize their

products, and improve mechanisms of internal and external control etc. They have to work on the development of new products, which will meet modern human needs, like insurance, pension schemes, investment funds etc.

Conclusion

Participation banking is an opportunity rather than a threat to Europe. It revives European traditions of partnership and cooperation. It opens new dimensions for the banking industry, diverse responsibility and brings people together. Participation banking will increase competition and bring better services with more competitive prices. Participation banking in Europe will open new opportunities for cooperation with the Muslim world and enable European banks to enter new markets. The cooperation is the best way for preventing hostilities that are, unfortunately, still floating in the air between some European countries and the Muslim world. Participation banking is a big opportunity for European banks to activate the savings of European Muslims that are currently outside of banking system. All that has been mentioned gives us the right to predict a bright future for the participation banking industry in Europe.

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(Endnotes)

- 1 First article of Universal Declaration of Human Rights says: "All human beings are born free and equal in dignity and rights. They are endowed with reason and conscience and should act towards one another in a spirit of brotherhood." (Taylor, 2005:353) The Qur'an says: "O mankind! We have created you from a male and a female, and made you into nations and tribes, that you may know one another." (Qur'an, *Al-Hujurat*: 13)
- 2 This principal will allow the best ideas to be recognized pursuant to the rule, "The essence of the things is recognized through their opposites."
- 3 The fact is that in secular states of Europe, frequently, on the scene are atheistic, religious or nationalistic secularisms, where a group has privileges because of its beliefs or national belonging. The culture and products of that privileged group have advantage and that group is better protected and enjoys certain privileges in front of the law. All this is done in the name of secularism. The main condition for having people live in love and peace is to give them equal opportunity in everyday life and make them feel equal in front of the law. Practices of European courts do not give us impression that people are always equal and that they have always equal treatment. This assertion is obvious from examples provided by Taylor in his book *Freedom of Religion - UN and European Human Rights Law and Practice*.
- 4 The products of human beings should be judged according to their usefulness or harm to the society, not on the cultural background of the product. Therefore, the idea of participation banking should be discussed on the basis whether it will be working properly in a certain European environment, whether it will improve economic activities, bring benefits to the society and so forth.

- 5 Because, according to Islam, everyday life is not separated from *Sharia*. *Sharia* provides rulings for every human activity.
- 6 “Non-Muslims now make up half of the OCBC Al-Amin Bank’s Islamic banking customers, says its chief executive. ISLAMIC banking is gaining ground with non-Muslims worldwide due to its strict lending principles, Singapore’s third-largest lender OCBC said today, reflecting industry efforts to transcend religious beliefs to gain market share.”
(http://www.btimes.com.my/Current_News/BTIMES/articles/20081201152232/Article/ Accessed: 30. 12. 2011.)
- 7 The CEO of Islamic Bank of Britain was Christian Michael Hanlon, and CEO of Bosna Bank International in Bosnia & Herzegovina for a period of time was Mr. Andre van Howe, who is Christian too.
- 8 Many European banks have such windows: HSBC, Barclays Capital, ANZ Grindlays, Lloyds TSB, BNP Paribas, Societe Generale, Commerzbank, Deutsche Bank, ABN Amro, Mežkobank, UBS, etc.
- 9 In my free assessment eighty to ninety percent of European laws are in spirit of *Sharia*. In other words, all European laws that aim to establish and upheld justice, protect human lives, dignity, property, religion and offspring, have the very same goals that *Sharia* wants to achieve. Indeed, some of these laws do not always reach the high standards of *Sharia*, so that they do not protect enough these categories, but, nonetheless, they represent wonderful efforts on the part of human beings. These efforts deserve to be praised, because they protect mentioned categories in a great manner. It can be noticed that recently the European legislature on alcohol, prostitution, tobacco, is coming closer to *Sharia* standards, but that process is moving slowly due to the fact that it was not preceded by spiritual preparation and superstructure, and the fact that the groups behind alcohol, tobacco and prostitution are very powerful.
- 10 See: <http://www.henciclopedia.org.uy/autores/Laguiadelmundo/Usury.htm>,
<http://gvanv.com/compass/arch/v1405/fahey.html> Accessed: 23. 09. 2011.)
- 11 See also: Ezekiel 18:8-17; 22:12; Psalms 15:5; and Proverbs 28:8.
- 12 An extensive article on this subject entitled *In the Shadow of Deuteronomy - Approaches to interest and usury in Judaism and Christianity* by Vincent J. Cornell, can be found in the book *Interest in Islamic Economics - Understanding riba* p. 13-25 edited by Abdulkader Thomas, simultaneously published 2006 in the USA and Canada by Routledge. Another article *Comparing Islamic and Christian attitudes to usury* by Mervyn K. Lewis can be found in the book *Handbook of Islamic Banking* p. 64-81, published by Edward Elgar Publishing Limited, UK & USA.
- 13 See also: Archer, S. & Abdel Karim, R. (2002:90-97)
- 14 Due to the fact that banks are normally not interested in those commodities they use parallel *salam* very much.
- 15 Professor Rodney Wilson wrote an interesting article on *The interface between Islamic and conventional banking*, published in the book *Islamic Banking and Finance - New Perspectives on Profit-Sharing and Risk*, p.196-214. He concludes that: “Islamic banks and conventional banks should not regard each other as a threat. They of course compete with each other, but not usually by the pricing of their services. Instead Islamic banks compete by offering differentiated products that they believe will appeal to Muslim clients given their *Shariah* compliance.” (Iqbal, 2002:211)
- 16 In 2005 I was invited by JAK bank to attend a seminar on their operations. In two days they presented how the Bank operates. I did not have any remarks from the *Sharia* point of view, as far as no-interest loans were in question.

- 17 They will do it because it is a world trend. Many leading banks in the world introduced participation banking like American: *Citibank*, *JP Morgan/Chase*, *Goldman Sachs* i *UBS Warburg*, British: *HSBC*, *Barclays Capital*, *ANZ Grindlays*, *Lloyds TSB*, French: *BNP Paribas*, *Societe Generale*, German: *Germany's Commerzbank* i *Deutsche Bank*, Dutch *ABN Amro*, Russian *Mezskobank*, Japanese *Nomura Securities*, Swiss *UBS*, etc.
- 18 The biggest problem which participation banks are facing is lack of employees skilful in this industry. It is a problem for the banks that are in the industry for quarter of a century, like Abu Dhabi Islamic bank. In 2002 I visited UAE. The CEO of Abu Dhabi Islamic bank Mr. Abdurrahman Abdulmalik, *rahmetullahi alayhi*, mentioned to me the lack of skilful employees as a big problem for the Bank. We can imagine the situation of the conventional banks which have been transformed into participation in the past few years, or transforming itself these days. They are in dear need for people knowledgeable in participation banking.

Participatory Approach to Development in Pakistan

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ABSTRACT

The concept of people's participation in development is well defined but its meaning is different to different development organizations and social scientists. The objective of the paper is to unpack the concept of participation by looking at its various aspects including types, forms and stages. The paper focuses on research questions such as what kinds of participation are used worldwide with special reference to Pakistan; how the importance of people's participation is realized and incorporated in development projects worldwide and more so in Pakistan. The paper provides the rationale for conceptual understanding of participatory approach and enables to deepen the knowledge about participatory approach for development. Thus, this paper contributes to the existing theory in terms of exploring the conceptual understanding of participation, realizing the importance of participation in development. The paper is descriptive in nature, based on secondary materials (research papers and various project documents), case studies and examples.

JEL Codes: O53, P49

KEYWORDS

People's Participation, Pakistan, Development, Community, Participatory Approach

ARTICLE HISTORY

*Submitted: 27 July 2011
Resubmitted: 11 January 2012
Resubmitted: 12 March 2012
Accepted: 27 March 2012*

Introduction

In response to the failure of development projects in 1950s, social activists and field-workers observed that the populations concerned were not included in project's design and implementation. Failure was linked to the lack of local people's involvement in developmental projects. It was assumed that if local people were involved, projects would have been more successful (AWARD, 2008). Similarly, Food and Agriculture Organization of the United States (FAO) also pointed out that the traditional top-down approach of many developing and developed countries failed to reach and benefit the rural poor (FAO, 1991). The reason for this failure, identified by the international community in the World Conference on Agrarian Reform and Rural Development (WCARRD), held in Rome in 1979, is the lack of active participation of the poor in development programmes (FAO, 1990). As an alternative approach, the concept of participatory development gained significance in development debates and programmes.

Adopting a people oriented approach rather than a government outlook will bring in more peace and development. The recent people protest in Arabs called "Arab Spring" is more an outcome of young generation demanding participation in the country's governance and resource allocation processes. Such human turmoil can be minimized if not totally eliminated by adopting people participatory approach to crucial projects at least. This will have a twofold effect – strengthen the community and second bring in the better citizenship. Thus, involving people in development, governance and decision making becomes need of the day as it ensures confidence of the people. It also helps in providing equality, justice and smooth delivery of services. The low level of participation can be one of the reasons behind the recent "Arab Spring" started in 2010. The people in these countries have stood up for more freedom, equality, justice, better future prospects, employment, economic and social development and participation in the decision making process.

The phenomenon of participatory or bottom-up development has become very popular, interesting and attractive in the context of urban and regional development and has recently become virtually indispensable in the discussion on development. According to Masanyiwa and Kinyashi (2008, p 3) "participation has now become an established orthodoxy in development thinking and practice." Participation is widely accepted by many governments and international agencies including the World Bank (World Bank, 1996; World Bank, 1998; World Bank, 2000), United Nations Development Programme (UNDP, 1997), US Agency for International

Development (USAID, 1999), Japan International Cooperation Agency (JICA, 1995), Food Agriculture Organization (FAO, 1990, FAO; 1991, FAO; 1994 and FAO, 1997), Inter-American Development Bank (IADB, 1996) as an important element in development projects and programmes, and have involved people/GROs/NGOs in their development programmes/activities in order to achieve sustainable development. On the other hand, in the so-called top-down approach to development, the entire process of formulating and implementing policies and projects are carried out under the direction of government and people were put in a passive position and were rarely consulted in development and usually have no active role in development activities. This government-led approach to development remained intact or even increased deep-rooted problems including economic and social disparities between social classes, genders, regions, and between urban and rural areas. Participatory development arose from consciousness of these inadequacies.

According to the Japan International Cooperation Agency (JICA, 1995), participatory development is not an attempt to replace the top-down development approach with local community-led approach but it attempts to compensate for or overcome the limitations and shortcomings of the top-down development approach by adopting a bottom-up style of development. Participatory approach enables local people to acquire the skills needed to implement and coordinate the management of development projects themselves and thus reap more returns. For example, three years after the completion of the People's Participatory Programme (PPP) project at Sierra Leone, a FAO consultant reported after his visit to the project action area "The PPP villages have undertaken a number of community development projects, raising money to build schools, bridges and grain stores. Some groups have branched out into palm oil, groundnut and vegetable production." The visitor found that while the group no longer had regular access to credit, they continued to save, investing their capital in construction projects and in small businesses. The groups still kept record books and had adopted a participatory monitoring and evaluation system. Two former Group Promoters had formed Rural Workers' Association that meets regularly with government representatives and local leaders to discuss project ideas and to coordinate the delivery of farm inputs (FAO, 1990). Thus, participation is more than an instrument of development; it ensures sustainability and makes development efficient.

All the governments, developmental agencies and NGOs have recognized that the top-down approach possessing conventional development strategies has largely failed to reach and benefit the rural poor. For example, an evaluation found that half of

the rural development projects funded by the World Bank in Africa out rightly failed to reach the poor as the top-down approaches were used (FAO, 1990). A review of assistance to agriculture cooperatives by the World Bank reported similar results (FAO, 1990). On the other hand, an examination of 25 agriculture and rural development projects financed by the World Bank found that participation by beneficiaries was a key factor for the 12 projects that achieved long-term economic sustainability (World Resource Institute, 1992).

Similarly, a study by the International Labor Organization (ILO) of 40 “poverty oriented” projects worldwide showed that the poorest were excluded from activities and benefits (FAO, 1990). UNDP in its Human Development Report, 1990, emphasizes that the participatory approach is crucial to any strategy for a successful human development (FAO, 1991).

The literature review, to a greater extent, confirms the results of effective participation in the form of empowerment of communities, social capital and sustainability of the projects (World Bank, 2000a). However, the same approach is also criticized for being slow and complex process (Mansuri and Rao, 2004). Thus, the potential benefits attached with participatory approach are controversial (Khan, 2006).

Research questions to be explored are: what kind of participation is used in the development projects worldwide and in Kyber Pukhtoon Khwa (KPK), Pakistan and how the importance of people’s participation is realized and incorporated in development projects and programme worldwide and in Pakistan. Moreover the meaning of people’s participation in development, types and classification, importance, need, ways, principles and demerits of people’s participation has been reviewed and analyzed with the aim to provide the conceptual understanding of people’s participation which will help to enhance the knowledge about participation.

This paper is descriptive in nature and based on secondary materials (research papers and various project documents), case studies and examples.

This paper has been organized as: after introduction, a literature review followed by various kinds of people’s participation in Pakistan. Next the methods of how to promote people’s participation in development have been explained followed by the basis / principles of participation. People’s participation and argument against people’s participation is mentioned in next section. The paper ends with a conclusion.

Literature Review

Evolution / History of Participation

The concept of participation in the context of economic development is not entirely new. Its origin can be found in ancient Greek. According to Aristotle, participation in the affairs of the state as a citizen is essential to the development and fulfillment of human personality and the best state is one where there is broad participation, with no class dominating the others. At Aristotle's time, participation was a matter of voting, holding office, attending public meetings, paying taxes and defending the state. In those days there was very little consideration of participation in development. People worked and hoped for prosperity through agriculture, trade and art and craft manufacturing (Cohn & Uphoff, 1980).

After World War II, the US and other industrialized countries focused on the technological gap between developing and developed countries and foreign assistance was given to the underdeveloped countries to manage the gap. The people's participation was to adopt the new technologies. By the 1960s this theory changed into a resource gap between government revenue and expenditure, between export import and between saving and investment and the people's participation was to pay taxes, consume domestic products, produce more for export, save and invest and hold down the consumption (Cohen & Uphoff, 1980).

In 1950s and 1960, the community development gained momentum, particularly in Africa and Asia. National programmes were announced to build community infrastructure and to break down communities' exclusion from development activities (UNDP, 1997a). Thus, two important approaches to rural development were introduced in a number of countries, particularly in Africa and Asia - community development and "animation rurale" (in West Africa) which aimed at local people's participation. However, Cohen & Uphoff had a narrow view of participatory activities and felt they were largely ineffective in transforming rural communities (Cohen & Uphoff, 1980).

Participation has increased its popularity since the 1970s, when concern was felt for meeting basic needs and reaching the poorest of the poor (Michener, 1998). According to White, Nasir and Ascroft the euphoric word 'participation' has become a part of development jargon (1994). In the late 1970s and 1980s, the development

programmes were analyzed, examined the cause of underdevelopment and poverty, and came to the conclusion that the poor were excluded and marginalized both from broader societal participation and from direct involvement in development initiatives. As a result, the number of poor people rose to 900 million worldwide. In the World Conference on Agrarian Reform and Rural Development (WCARRD), held in Rome in 1979, the international community identified the reason for this failure - the lack of active participation of the poor in programming, designing, to assist them (FAO, 1990). After WCARRD, and throughout the 1980s and 90s, participation in rural development – as well as in development at large – gradually became more established among governments, donors and international organizations (UN, 2008). Thus, the long journey of top-down and non participatory practice broke down and the bottom-up approach to development came into existence.

There are many bilateral and multilateral donors, development agencies, and governments which have involved people in some aspects of planning, implementation, management and evaluation of development projects because of the fact/philosophy that sustainability cannot be achieved without the involvement of beneficiaries in the project life cycle.

Meaning of People's Participation in Development

In the existing literature, the term people's participation has been defined by various social scientists, researchers and developmental organizations such as World Bank, U.S. Agency for International Development (USAID), United Nations Development Program (UNDP), Organization for Economic Cooperation and Development (OECD), International Fund for Agricultural Development (IFAD), Inter-American Foundation (IFA), Canadian International Development Agency (CIDA) etc. They defined people's participation from their own point of view, experience and priority. Some of the definitions are:

Participation in the Eyes of World Developmental Agencies

The World Bank

“Participation is a process through which stakeholders influence and partly control the development initiatives and the decisions and resources which affect them” (World Bank, 1996).

U.S. Agency for International Development (USAID)

“The active engagement of partners and customers in sharing ideas, committing timing and resources, making decisions and taking action to bring about a desired development objective. Participation describes both the ends and the means; both the kind of results we seek, and the way we, as providers of development and humanitarian assistance, must nurture those results” (USAID, 1999).

United Nation Development Programme (UNDP)

“Participation means that people are closely involved in the economic, social, cultural and political processes that affect their lives” (UNDP, 1997a).

Organization for Economic Cooperation and Development (OECD)

“...for development to succeed, the people of the countries concerned must be the “owner” of their development policies and programs” (USAID, 1999).

International Fund for Agriculture Development (IFAD)

“...a democratic process in which people, particularly the weak and the poor, are not passive receivers of a developmental project at the end of top-down approach, but are requested to identify their needs, voice their demands, and organize themselves so as to improve their livelihood with the help of financial, technical, and human resources offered by the development project as well as their own” (USAID, 1999).

Inter-American Foundation (IFA)

“Institutional style and modus operandi which facilitate accountability to members and clients; broad participation in decision-making; availability of information about the management of resources; and equitable distribution of benefits” (USAID, 1999).

Canadian International Development Agency (CIDA)

“A process whereby individual and community are actively involved in all phases of development. It therefore involves greater equity in economic and political power” (USAID, 1999).

Food Agriculture Organization (FAO)

“An active process in which people take initiative and action that is stimulated by their own thinking and deliberation and which they can effectively influence” (FAO, 1991).

Inter-American Development Bank (IADB)

Participation in development can be defined in broad terms as the process through which people with a legitimate interest (stakeholders) influence and control developmental initiatives, and the decisions and resources which affect them, thus, participation often comprise:

- the involvement of stakeholders in any or all phases of the project life cycle;
- promotion of the role of civil society in the development process;
- specially designed facilitation methodologies and techniques;
- decentralized or devolved decision-making; or
- the institutionalization of decentralized or devolved decision-making such that broad stakeholder involvement becomes a normal, expected part of the development process (IADB, 1996).

Participation in the Eyes of Researchers and Social Scientists

Cohen and Uphoff

“With regard to rural development....participation includes people’s involvement in decision-making process, in implementing programmes, sharing the benefits of development programmes and their involvement in the efforts to evaluate such programmes” (Cohen and Uphoff, 1977).

Cernea, M. (ed.)

“Empowering people to mobilize their own capacities, be social actors rather than passive subjects, manage the resources, make decisions, and control the activities that affect their lives” (Cernea, 1985).

Wolfe and Marshall

Participation designates “The organized efforts to increase control over resources and regulative institutions in given social situations, on the part of groups and movements hitherto excluded from such control” (Wolfe, 1983).

N.C. Saxena

“Participatory is a voluntary process by which people, including the disadvantaged (in income, gender, caste, or education), influence or control the decisions that affect them” (Saxena, 1998).

Sam Joseph

“The invitations to people to take part as beneficiaries in a programme designed exclusively by a development agency in which the beneficiaries have had no input or a situation where local people have had the responsibility and the authority to analyze, plan and implement the solutions to local problems or a situation where

local people have had control of all stages of finding solutions to a local problem” (Joseph, 1996).

Angelo Bonfiglioli

“A complex social, technical and institutional process through which communities may become more fully involved in their own development, more particularly taking an active part in the design, implementation and evaluation of specific development initiatives” (Bonfiglioli, 1997).

The main crux and theme of the above definitions can be summarized as:

- the voluntary involvement of the poor, weak and needy, beneficiaries and stakeholders to share, participate and control all economic, social, cultural and political initiatives,
- to actively participate in the decisions, resources and benefits of developmental activities,
- to take part in the design, implementation and evaluation of specific development initiative,
- to involve people in all phases of development programme and policy, because:
 - participation is a means and end,
 - in order to achieve desired objectives,
 - to become owner of the project/ activities / programmes and
 - to improve their livelihood.

Pretty has pointed out that there are two overlapping schools of thought and practice. According to them: (a) participation as a means to increase the efficiency, the central notion being that if people are involved, then they are more likely to agree with and support the new development or service (Pretty, 1995). According to UNDP,

Participation is seen as a process whereby local people cooperate or collaborate with externally introduced development programmes or projects. In this way participation becomes the means whereby such initiatives can be more effectively imple-

mented. People's participation is sponsored by external agency and it is seen as a technique to support the progress of the programme or project. The term 'participatory development' is more commonly used to describe this approach and it implies externally designed development activities implemented in a participatory manner. This approach would appear to be quite widespread and essentially promotes participation as a means of ensuring the successful outcome of the activities undertaken (UNDP, 1997a).

(b) Participation as a fundamental right, in which the main aim is to initiate mobilize for collective action, empowerment and institution building (Pretty, 1995). UNDP named this fundamental right as an end (goal) of participation. According to UNDP,

Participation as an end (goal) which can be expressed as the empowering of people in terms of their acquiring the skills, knowledge and experience to take greater responsibility for their development. People's poverty can often be explained in terms of their exclusion and lack of access to and control of the resources which they need to sustain and improve their lives. Participation is an instrument of change and it can help to break that exclusion and to provide poor people with the basis for their more direct involvement in development initiatives (UNDP, 1997a).

So, very simply, the term participation or participatory approach can be defined as *The active involvement of local people/community or their representatives, local organizations, ideas, skills, knowledge and priorities in all the phases of any local project/ programs,, developmental activities and developmental policies, in order to increase the efficiency or to ensure sustainability and equitability, as it is the fundamental right of poor /local beneficiaries or because the local people know more than the government and external professional experts what problems they face and how best to resolve them.*

The importance of this definition is that it covers three aspects of human life i.e. economic, social and political. According to this definition people are involved in the development process to ensure sustainability, to achieve equitability and to prevail social justice in society.

Need of People's Participation in Development

Traditional development theory holds that development is primarily a function of capital investment and that the greater the flow of capital from wealthy countries to poor countries, the more rapid the development of the latter (Korten, 1987). However, overcoming rural poverty is not simply a matter of more investment, more aid or more technology. Poverty will persist until development reaches and benefits the world's 800 million underprivileged, undernourished and under-educated rural people. The rural poor must be given the opportunity to participate in development (FAO, 1997a). Similarly, Cohen and Uphoff (1980) found that more and more economists have come to challenge the prevailing view that capital was the prime mover in development. According to them, in this theoretical and practical context, people's participation becomes important to the same extent as it was peripheral when capital formation was considered as the primary factor. According to the World Bank (2000), "economic growth is essential to poverty reduction. However, development requires more than just a focus on macroeconomic and financial issues. Experience shows that looking at both sides-macroeconomic and financial aspects on the one side and structural, social and human considerations on the other-is essential to adequately support a country's future development." Thus, to provide the opportunity to local and poor people to participate in development is the only solution for overcoming rural poverty and securing sustainable development.

According to Saxena, people's participation (as an input or an independent variable) can contribute to the achievement of four main objectives: efficiency; effectiveness; empowerment; and equity (Saxena, 1998). Experience has shown that participation improves the quality, effectiveness and sustainability of development actions. By placing people at the center of such actions, development efforts have a much greater potential to empower and to lead to ownership of the results (UNDP, 1997a).

"Development is a complex process. It cannot be left in the hands of centralized power. Even latter-day communists such as Mikhail Gorbachev and Deng Xiaoping have come to realize this and tried to open up their societies, to provide more room and more opportunities to the people to be more participative, creative and productive" (Cleveland and Lubic, 1992). The failure of conventional, top-down and non-participatory approach in many development and developed countries led to the foundation of an alternate approach i.e. community participation, which contains the qualities of sustainability, empowerment, self-reliance, and equity. The need of a bottom-up approach was not only felt by the governments of underdeveloped and developed

countries but also all the donors, international development agencies and NGOs and was incorporated in their development programmes and activities for their successful implementation. The main characteristic of the bottom-up strategy is the community involvement in developmental activities. The question and issue is why people should be consulted, and how to link institutions and people to jointly accelerate the process of development. There are three reasons which justify people's participation:

- When people/community participates in the identification of problems and come up with their own solutions, the results can be both spectacular and sustainable.
- Participation allows communities to discover their own wealth of knowledge and capacity for problem identification and problem solving.
- The solutions that are identified by communities are more likely to be feasible and implementable than those formulated by outsiders.

Linking institutions and communities poses a twofold problem: for the institution it is very difficult to involve the isolated and uneducated people in the main stream of development. It is a problem how to access them to increase their productivity and income and to make development activities more sustainable. The same is also faced by the poor population as they are neither connected with the political system nor with the general economy. They are often isolated, with limited access to newspapers and other forms of communication. They don't know how to approach the government and other institutions and vice-a-versa, for their rights and own development. Though they know better their own problems and the solutions, the difficulty is to organize them and make their local knowledge effective. So, there is a need of a two ways communication between the two groups. To link the two is mostly done by local NGOs.

Importance and Role of Participation in Development

The importance and role of people's participation in development has been highlighted in various papers and documents of projects. It is the most important approach to enable communities to help themselves and sustain efforts in development work. Participation is important because it makes projects efficient, effective, and sustainable

in a variety of ways. According to Katsumoto, participation clarifies project goals, reduces project cost, prevents/reduces management conflicts (that may be caused between development workers and local people), promotes the technology transfer to the people and encourages a culture of self-help and a commitment among the people (Katsumoto, 2007). Participation increases sustainability, productivity, efficiency, reduces cost and builds democratic organizations (FAO, 1997b). Participation improves the status of women by providing them the opportunity to play a part in development activities (UNDP, 1997a). Participation creates the sense of responsibility and ownership in the beneficiaries which leads to sustainability (FAO, 1991). Participation breaks the mentality of dependence and promotes self-awareness and confidence (Mefenguza, 2007). Participation helps to build local capacity and develop the abilities of local people to manage and to negotiate development activities (UNDP, 1997a). Participation improves the efficiency, effectiveness, sustainability and coverage of projects and programmes and promoting stakeholder capacity, self-reliance and empowerment (FAO, 2000). Participation provides equitable development and creates a sense of self-determination, community development and self-development (CPA, 2009).

Classification of Participation

Pretty, Satterthwaite, Adnan, Alam & Brustnow and Hart have classified participation on the basis of why and how people participate in development (Pretty, 1995). They provide a complete cycle of people's participation in development. In the first part of their cycle, manipulative participation, passive participation, participation by consultation, and participation for material incentives, are the weak levels of participation and people have no power to plan or decide for their own development. In these levels of participation, the whole development programme is controlled and managed by external agents. The second part of the project cycle includes functional participation, interactive participation, and self-mobilization participation which are comparatively the stronger levels of participation. At these levels of participation, beneficiaries are in a better position to control planning, decisions and resources.

Pretty (1995) indicated that for the best results, the people should be involved in all stages of a project, from design to maintenance. If they are just involved in information sharing and consultation then, the result will be poor.

Another way of distinguishing different forms of participation is presented by United Nations Capital Development Fund (UNDP, 1997). According to this typology, participation has been classified on the basis of levels or degrees. This typology can be divided into two levels/stages. Level one contains manipulation, information, consultation and consensus building. This level is a very weak level of participation because at this stage all the beneficiaries are just manipulated, informed and consulted. However, this is a basic level and necessary for future participatory development of a project. The second stage of participation consists of decision-making, risk-sharing, partnership and self-management. This is the actual level where the beneficiaries are responsible to control, manage and share the decisions, risk, partnership and self-management of a development project. This typology of participation seems similar to the typology given by Pretty (1994). However, the difference is that this typology provides various levels/stages of participation while the previous one given by Pretty (1994) indicates various forms/kinds of participation.

Deshler and Sock (1985) also presented participatory levels ranging from pseudo-participation, (or the manipulation of beneficiaries by development professionals to meet the needs of elites) to genuine participation in which participation is empowered by having control over programme policy and management. This classification is also carried out on the basis of level. They divided the people's participation into two main levels i.e. Genuine and Pseudo Participation. At the genuine participatory level, the community is empowered and gains control over project planning, decisions and resources. Community partnership is more strengthened with the external agents of development projects. Thus, it is a very strong level of participation where people/community and project implementers have strong cooperation and share all project activities. At this level, communities are delegated more powers to become the owners of the development projects. At the pseudo participatory level, the beneficiaries are just invited, informed, consulted and manipulated with regard to project activities. There is one-way communication. All the project activities are controlled and managed by the project staff. The beneficiaries' suggestions and advice with regard to project activities are just heard. The pseudo participation seems to be a weak and less important level of participation. But, in fact, this level of participation provides a basis for future genuine participation.

White classified participation on the basis of interest of stakeholders (planners and beneficiaries). At each of the first three levels (Nominal, Instrumental and Representative), planners and beneficiaries have different interest. However, only at the

ultimate level (transformative) both groups are interested in the empowerment of beneficiaries (White, 1996). White describes four types of stakeholders' participation. According to him each type is characterized by the divergent interests of different stakeholders. Planners are identified as having top-down interests versus the bottom-up interests of project beneficiaries. Participation ranges from nominal to transformative. White's classification is important because it demonstrates that stakeholders do not share the same expectations of participation in development projects. At each of the first three levels, planners and beneficiaries employ concurrently conflicting definitions of participation. Only at the ultimate level (transformative), both groups of stakeholders are interested in the empowerment of beneficiaries (Michener, 1998).

Cohen and Uphoff (1980) presented a more comprehensive typology of participation by examining the various dimensions of participation. Their typology not only includes different type/kinds of participation but also who participates and how. The type/kind of participation has been classified with regard to the project cycle i.e. Participation in decision making, implementation, benefits and evaluation and "who" dimension divides the actors or stakeholders involved and they are for example, local residents, local leaders, government personnel and foreign personnel. Similarly, the "how" dimension describes the mechanisms by which participation takes place. For example, its basis, form, extent and effect/impact. Cohen and Uphoff's typology of participation is more comprehensive. It has an applied focus with less attention to theoretical divisions. This classification provides a complete framework for the analysis of participatory component of any rural development project. The Cohen and Uphoff dimensions of participation concerns the kind of participation which is taking place, the sets of individuals who are involved in the participatory process and the various features of how that process is occurring. Basically these dimensions provide answer to the questions: what kinds of participation take place; who participates in them; and how the process of participation takes place.

Pretty (1995) presented a participatory continuum laying out different forms of participation, from the least participatory to the most participatory. Pretty's participatory continuum is different from the all other aforementioned typologies. This typology lays down different forms of participation, from the least participatory to the most participatory. It indicates how people are involved in the project activities and how they are mobilized to carry out their own developmental activities in the absence of external initiators and facilitators.

Form of People's Participation in Pakistan

After a comprehensive overview of the participations' classification in the above section, it can be concluded that participation is classified on the basis level, degree, interest and dimensions etc. However, participation can be classified on the basis of mobilization, origins/sources, sector/activities and beneficiaries. A quick view of this classification is given below.

Classification on the Basis of Mobilization: Classification on the basis of mobilization is shown in table 1.1.

Table 1. Classification on the basis of mobilization: Participation by "Which"

Mobilization	Forces for Participation	Kind of Participation	Effect of Participation
1. Self/Internal Mobilization (Bottom-up Participation)	1. Crises / threat to community 2. Funding from donors 3. Inspiration and awareness from other community	1. Short period participation 2. Long period Participation	More effective, sustainable and genuine if supported
2. External Mobilization (Top-bottom Participation)	1. NGOs Mobilization 2. Government Mobilization	1. Obligatory Participation 2. Non Obligatory Participation	Less effective

Source: Self-developed

Participation may originate from below (beneficiaries) in that case it can be called bottom-up participation. This type of participation is usually generated during crises, or in response to some threat to community's identity, survival or values. So community mobilizes itself to protect or resist (Goulet, 1989). Self-mobilization may cast for a short time and end when the threat or crises to the community is over. However, in some cases it takes the shape of a strong platform in the form of grass-root organization that takes the responsibility of community's welfare and development oriented activities. For example, in response to the construction of Ghazi Baroota Hydral Development Project in Pakistan, the affected local people belonging to Swabi district of KPK and other adjoining areas were self mobilized and made platforms in the shape of NGOs and GROs to demand from the government compensation for their affected agriculture land, houses etc. which were damaged due to the dam's construction. Some of the NGOs have now opened windows for other developmental activities.

Bottom-up participation is more genuine and can be further strengthened if external

agents provide an enabling framework of support. Take the example of Shewa Educated Social Welfare Association (SESWA) of village Shewa, District Swabi, KPK, Pakistan. It is a self motivated organization developed by the youth of village Shewa for the welfare oriented activities of their village. However, the scope of activities of the SESWA increased by extending its development activities to other villages of the district as a result of the support provided by the German assisted “Pak-German Integrated Rural Development Project” (IRDPP) of the provincial government of KPK. With the passage of time SESWA became a development platform for people of the whole Swabi district. Other villages/communities of the surrounding areas are replicating in order to establish their own organization in the style of SESWA.

Communities may also be mobilized from top i.e. by external agents for their specific objectives. There are two types of external forces which generate mobilization/participation, the public sector and the external NGO working at the location. Participation as a result of these external agents is of two types, obligatory and non obligatory. Sometimes the external forces put condition(s) on the community to participate in the projects by providing some inputs. For example, the community may provide land or material or some percentage of the total cost or compulsory maintenance and repair cost. For example in Pakistan, for the construction of a water supply scheme, a basic health center and a primary school etc. the land must be provided by the beneficiaries. Otherwise the activity is shifted to another area where the people can provide the land for construction. Similarly, the Community Infrastructure Project (CIP) at KPK, Pakistan invited the community to participate in their development programme by providing any land required and compulsory share of 20% of the total cost. (CIP, undated) The main aim behind this obligatory approach was to reduce the cost of the project and to raise the sense of responsibility and ownership among the beneficiaries. In the non obligatory approaches, the communities are mobilized / involved in their activities without putting any conditions on them. The mechanism used for mobilization is through employed agents of change (field workers extension workers, community organizers or animators) and local institutions. The success of external mobilization depends upon the nature of project, social, cultural and economic conditions of the beneficiaries and on the mechanism and technique used for mobilization. The best mobilization approach is that which produces sense of responsibility and ownership in the community for their projects; otherwise the participation will end when project activities are withdrawn from the community.

Classification on the Basis of Origin: On the basis of origins / sources of participation, the classification model is presented in table 1.2.

Table2. Classification on the basis of sources: Participation through “whom”

Origins / Sources of Participation	Kinds of Institutions for Participation
1. Informal Institutions or Invisible Institutions	Informal social, cultural, welfare, self-help, regional, religious institutions at grass root level.
2. Formal Institutions	Multi sector institutions registered with government like Social Welfare Societies, Village Organizations etc.
3. Individual	Elders, religious and influential people of the community.

Source: Self-developed

There are many informal village or community organizations in every part of the world which are the main origins / sources of participation. Informal organizations vary according to region, level, society, culture, economic situation and religion. For example, in a rich religion society there will be many informal religion oriented mosque and church committees for the welfare, as well as some missionary activities. Rich socio-cultural communities consist of many informal institutions such as Panchayat in India (Gent, 1992) and in the Punjab Province of Pakistan, Hujra and Jarga are informal institutions in the KPK (Czech, 1996) and Balochistan Province (Bonfiglioli, 1997) of Pakistan. Many social welfare and self-help institutions are available in the agro based communities which are the main sources of participation and can be effectively involved in any development effort. Most of the institutions such as Jarga and Hujra are “invisible” and can be mobilized for any developmental activity.

The other sources for community participation are some formal community based institutions existing in the society. Such institutions are developed and formally registered with the government for some social, welfare, environmental and development oriented activities. For example in KPK, Pakistan, there are 1485 formal community based institutions out of which 509 have been registered with the government (NGO Directory, 1998-99). Most of the NGOs and government sponsored community based projects are utilizing their knowledge and have involved them in their activities.

Almost all formal and informal institutions are self-mobilized. However, in the category of formal institutions, there are some organizations which are created by the government or large scale NGOs for carrying out developmental activities through them.

The third important source of participation in the rural communities is elders (white bearded), religious scholars (like Ulluma* in Pakistan), and other influential people. Here a question arises that these elders or ulluma may be few or single at village or community so how will they participate in the development activities. But actually they are highly regarded and have a status in rural communities. They have a very deep rooted impact on the rural community. For example, in Pakistani rural communities, a youth cannot speak before the elder of the community and a man, young or old, cannot speak before Allim* (religious scholar). So the participation of an elder, or an Allim accounts for the participation of the whole community. The NGO crises in Pakistan (1999-2000) happened because of the Ulluma. The Ullima were not consulted and were not taken into confidence. Therefore, NGOs activities were stopped in various locations of the country. NGOs are blamed for pursuing women's freedom and other non Islamic activities (Frontier Post, 2001). On the other hand, Pak-German Integrated Rural Development Project at Mardan, Pakistan, adopted a new approach (Czech, 1996) by consulting and taking up the confidence of all the formal and non formal institutions as well as the elders and Ulluma. As a result of this approach, the project activities were run very successfully (Interview with Community Development Coordinator, IRDP, Mardan, and KPK at Pakistan).

Classification on the Basis of Sectors / Activities: Classification of the people's participation on the basis of sectors / activities is provided in table 1.3.

Table3. Classification on the basis of sector/activities: Participation for "what"

Sector	Activities
Political	Participation for political activities like peace, democracy, human rights, gender equity, women rights. Legal aid, humanitarian relief, child right, and labor right etc.
Economic	Participation for Poverty alleviation, Environmental protection, integrated rural and urban development projects, Women in development, gender and development, community development, economic research, family planning, small scale enterprise, employment/income generation, credit and savings, and basic job training etc.
Social Welfare and Religious.	Participation for welfare oriented activities like help to the poor and orphan students, providing food and clothes to the poor, sports and recreations, social research, rehabilitation of drug addicts, and culture arts and heritage etc.

Source: Self-developed

There are three main fields for the people to participate i.e. political, economic and social welfare/religious. Under these sectors people perform and participate in various activities, individually or through their formal or informal organizations. Some organizations are specific to only one sector or activity. For example in

agrarian communities most people are participating for agriculture based activities through their farmers' associations. Some people or their organizations have a multi-sectoral focus such as political, economic and welfare oriented activities.

In the KPK, 727 people's organizations have multi-sectoral focus, 473 focus on agriculture, 456 participate for credit and saving, 350 are busy in welfare oriented activities, 96 in human rights and 73 in humanitarian relief (NGOs Directory, 1998-99).

Classification on the Basis of Beneficiaries: On the basis of beneficiaries, a classification model for people's participation has been developed and shown in table 1.4.

Table 4. Classification on the basis of beneficiaries: Participation for "whom"

Beneficiaries	Participatory activity(es)
Community	Participation in the project(s)/ Programme (s)/activity (es) for community development.
Religious Minorities	Participation in the project(s) / programme (s) / activity (es) designed for the development of minorities.
Members only	Participation in the project(s) / programme (s) / activity (es) which serve members of the project only.
Non –Members	Participation in the project(s) / programme (s) / activity (es) whose beneficiaries are non members.
Elders	Participation in the project(s) / programme (s) / activity (es) which have been designed for the welfare of elder people.
Students	Participation in the project(s) / programme (s) / activity (es) which provide benefit to the students community.
Youth	Participation in the project(s) / programme (s) / activity (es) which is useful for the youth and young generation.
Children	Participation in the project(s) / programme (s) / activity (es) which focus on the development of children.
Men	Participation in the project(s) / programme (s) / activity (es) which serve only men of the community.
Women	Participation in the project(s) / programme (s) / activity (es) which serve only women of the community.
Disabled	Participation in the project(s) / programme (s) / activity (es) design for the welfare and development of disabled people of the community.
Drug Addicts	Participation in the project(s) / programme (s) / activity (es) designed for the welfare of drug addicts.
Patients	Participation in the project(s) / programme (s) / activity (es) to help all kinds of patients.

In the beneficiaries based classification, the focus is on the various individuals or groups getting benefits as well as participants in the projects. Some people participate and develop an organization for the welfare or development of a specific group. Their focus is a particular group of the community and not a sector or activity. They design various programmes/ projects/activities just for the welfare/development of particular group(s). For example, there are many people's organizations which are designed to develop or benefit women or children.

In the KPK, there are 836 people organizations which serve the whole community, 710 for women development, 606 for students' welfare and 536 for patients (NGOs Directory, 1998-99).

How to Promote People's Participation In Development

People's participation is a very complex process and there is no single recipe for its promotions. Different countries have taken different approaches, techniques and methods. It is not possible to present some specific guidelines that can be used for the promotion of people's participation in development because the issues are different in each setting. It all depends upon people's behavior, their social customs, traditions, religions, norms etc.

The main issues in the promotion of popular participation are: a) how to locate the deprived, b) how to enter in the circle of a poor community, c) how to give them voice and d) how to enhance their capacity of skill and knowledge. According to Picciotto (1999), poor are weak, too numerous, too dispersed and too diverse in their interest to form effective coalitions. How to give voice to the voiceless poor; how to give them a seat at the table when development programmes are debated and policy priorities are set; how to channel their scattered energies and extraordinary skills into productive pursuits is the fundamental challenge of development assistance.

To locate the poorest in the programme area one needs to understand the development profile of the area and to find out various dimensions of poverty (economic, social or human development dimensions etc.) that exists in the community and the target groups. Once we find out the poorest, their problems and the target groups, then the next important issue is how to reach and enter in the community of the poor. This is not an easy job because in this regard we have to study their social,

cultural and religious norms and values. Violation of their norms and values will lead to the failure of the programme. In this regard it is very important to locate the influential individual(s) like political persons, teachers, religious leaders or elders of the community and take them into confidence. Moreover, it is important to contact the formal and informal institutions if already existing in the community. Once the influential individuals and local institutions are consulted and taken into confidence it becomes easy to mobilize the poor and carry out the programme activities in a sustainable and equitable manner. In case there are no such institutions, then a united platform of the poor in the form of formal grass-root organization is necessary to be formed first.

The third issue is how to give voice to the poor, to mobilize them in order to participate in the programme activities and to build their capacity to act. In this regard we need to raise their level of consciousness and to organize, gather and unite them under one platform by the formation of their own organization (if not available) or by strengthening the existing one. The poor need to be aware of the socio-economic realities around them, of the forces that keep them in poverty, and of the possibilities for bringing about changes in their conditions through their own reflections and collective activities. According to Wignaraja (1992), this constitutes a process of self- transformation through people's praxis when they grow and mature as human beings. Similarly, it is very difficult for the poor to break away from the vicious circle of dependence and poverty individually. It is only group effort organization that can reduce dependence and initiate a course of participatory, self-reliant development. In this way, the voice of the poor for their development and empowerment will arise. To mobilize the poor and to build their capacity to act, the World Bank (1996) has suggested the following steps:

- Keep the primary objective of the project which is to learn from poor and collaborate with the poor. This will build the confidence, knowledge and capacity of the poor for action.
- Strengthen the organization and financial capacity of the people so that they can act for themselves.
- Organize community; provide them training and one-way flows of resource through grant. The provision of benefits delivered to people is not sustainable in the long term and may not improve the ability of people to act for self.
- When the capacity of poor people is strengthened and their voices begin to be

heard and they start demanding and paying for goods and services from government and private agencies, they become “clients”. In such a situation move away from welfare oriented approach and focus on things such as building sustainable market based financial systems, decentralizing authority and resources and strengthening local institutions.

- Now, when clients ultimately become the owners and managers of the assets and activities, this is the highest stage or rank in terms of intensity of participation. In this stage, then, involve poor in the planning and decision processes.

However, in many countries there are policy constraints in the organization and involvement of the poor. Therefore, a suitable policy environment is required to allow all stakeholders, especially poor and disadvantaged groups.

Basis or Principles of Participation

It is very important to establish the basis or the set of principles for any development project to be adopted. Without such principles it will be very difficult to build an appropriate strategy or to determine how the project is to be implemented. According to the UNDP (1997a), participatory development is not ‘blue-print’ development but it is a strategy which constructs its approach in relation to the demands of the project context. There is a need of some principles or it requires some basis which helps planners to determine what the participatory approach should be in their development projects and programmes. UNDP (1997a) has developed the following principles which are considered to be more important:

Target Group: The first principle of participation is to keep the poorest of the poor as a target group in the development of projects and strategies. Techniques and methods should be adopted to identify the poorest and then how to reach and involve them in the projects’ activities.

Decision Making Process: People must be the decision makers of the whole development process. Their decisions should be made at all stages of project cycle and an equal importance and weightage should be given to all groups of the community. A free environment should be provided in which each individual can participate in the decision making process and people are encouraged to participate.

People Capabilities: People's knowledge, skill and capabilities must be kept in the strategies and should be incorporated in the planning, implementation, monitoring and evaluation. People's knowledge and expertise should be build, strengthened and encouraged to reduce their dependency on external assistance.

Sense of Responsibility, Ownership and Control: The most important principle to be kept in any project's strategy is to produce a sense of responsibility and ownership among the beneficiaries. This principle is important for sustainability. Encourage people to gain control over project activities and outcome. According to the UN report, people should be involved so that they rather act as "contributors" than mere "beneficiaries" of development.

Women Empowerment: The gender component is also important and should be incorporated in development projects. Usually, there are various cultural and social barriers for women to participate in the activities. They are not allowed to participate in the developmental activities. Therefore, social and cultural changes should be created so that voice of women could be heard and their participation be secured.

Ways of People's Participation

There are numerous ways world over for people's participation in development projects and programmes. However, their participation depends upon the nature and policy of projects to be executed in their area and the social, cultural, religious, educational and financial capabilities of the people and community. Below are some ways of people's participation adopted by the government and various NGOs in their respective projects and programmes in Pakistan.

Land Provision: There are some developmental projects for which community provides land without cost. For example, in Pakistan, land for schools and water supply schemes as provided by the communities.

Labor provision: In some development projects, people participate by providing free labour. For example, in construction of rural access roads in Pakistan, people participate by working themselves as laborers.

Material Support: People some time participate by providing material to the projects and other expenditures are undertaken by the project implementers. For example, in Pakistan, people participate in the construction of road/street by providing materials such as sand, mud, crush stones etc.

Technical and Professional Support: Every community has some technical and professional people such as doctors, engineers, teachers, carpenters, painters etc. These people voluntarily provide their services in the planning and implementation activities.

Financial Support: In many cases, people participate by providing financial support to the projects. Sometimes the projects policy makes it compulsory for the people to provide some percentage of the project cost. So, the people contribute in the form of money. In some cases, people participation starts after the completion of the project. In such cases, the completed project is handed over to the communities and all the Operation and Maintenance (O&M) cost is passed onto them.

Arguments against Participation

Despite various benefits and arguments in favour of people's participation, few arguments against participation are found in the literature. According to the UNDP (1997a) participation costs more time and money, process of participation is irrelevant and luxury in situations of poverty, participation can imbalance existing socio-political relationships and threaten the continuity of development work, participation can result in the shifting of the burden onto the poor and the relinquishing by national governments of their responsibilities to promote development with equity. Similarly, the Inter-American Development Bank also criticized participation. According to Bank (IADB, 2000) participation generates important benefits for many activities, but not necessarily for every type of activity or project, and is no substitute for technical competence at any stage of the project cycle. Moreover, participation generally requires more time and increased costs, particularly in the stages of project identification and design. High requirements of time and resources are strong disincentives to participation for executing agencies, stakeholders and the Bank itself. Most important is the opportunity cost that participation imposes on the poor for whom time is a valuable resource.

As far as high financial cost is concerned, FAO (1990), on the basis of experience from the participatory development project indicated that "the poor's contribution to project planning and implementation represents savings that reduces project costs. The poor also contribute their knowledge of local conditions, facilitating the diagnosis of environmental, social and institutional constraints, as well as the search of solutions."

Similarly, two case studies (Shahzada, 1998 and Ali, 1999) regarding participatory forestry and infrastructure projects at Pakistan, found that the cost of the forestry project decreased by 38% and infrastructure project by 33% using participatory approach.

Conclusion

People's participation in development used worldwide including Pakistan is an optimum way to achieve sustainable development. The paper reflects that participation is an alternative to the bottom-up approach. Various approaches to involve people in development projects and programmes have been developed and adopted in various countries. Similarly, various methods, level, degree and forms of participation have evolved indicating the quality and extent of participation. The paper helps in establishing the degree to the extent people's participatory approach stands in term of need, results and level of success in literature and practice.

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(Endnotes)

- * Ulluma (singular Allim) means religious scholars of Muslims in Pakistan. They are also called Immam or Mullah. Usually their activities are limited to Mosque and Muslims pray behind them. They also serve at death and marriage occasions.

A Simple Model Referring Evasion Case in Albanian Pension System

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ABSTRACT

This study deals with the relationship between underreported earnings, savings and old-age pension. The presented model is taken from the paper "Underreported Earnings and Old-Age Pension System: An Elementary System" of Hungarian Academy of Science and is applied to the Albanian data. Three pension systems have been compared: 1- the proportional, 2- the proportional plus basic pension and, 3- the proportional with means testing. The workers are grouped such as, a- well-paid who report their full earnings (so-called the evaders), b- well-paid who report only the minimum earnings and c- the poorly paid. It is assumed that the evaders have a hidden part of earnings for their old-age. The main result of the study is the following: if the evaders can be recognized and excluded, then the best system is the means-tested one.

JEL Codes: H55, D91

KEYWORDS

Reporting Earnings, Proportional Pension, Basic Pension, Means-tested Pension

ARTICLE HISTORY

Submitted: 16 September 2011

Resubmitted: 4 January 2012

Resubmitted: 10 February 2012

Accepted: 27 March 2012

Introduction

As far as global economy is considered, the pension system is found to be one of the most discussed systems as the main pillar of the life-long expenditure distribution. Ex-communist countries, such as Albania, are often found face to face with the immediate need of reforms in such systems. Developing countries have difficulties in choosing the appropriate pension system because of a large gamma of variable that can be used in the model, different characteristics countries and the lack of a fix “receipt”. Meanwhile, the experience of the developed countries have to be considered important.

The aim of this paper is to develop a model of pension system by using the Albanian official Statistical Data and considering general knowledge about this market.

There exist two pure forms of mandatory pension systems: the proportional, which reflects the life-long contributions, and the basic benefit, which relies in fixed quote (defined benefit). Proportional pension system transforms the workers’ savings into pensions proportionally to their earnings, while the flat benefit, is paid independently to the earnings. At the same time there can exist a lot of combinations between these two extrem systems (Disney, 2004). For example, the British system provides a flat benefit for each individual, whereas additional pensions are taken into consideration in the mean-testing. Another example can be the case of Hungarian pension system, a combination of proportional and basic system (Augusztinovics and Martos, 1996)

This study is based on the study made by the Institute of Economics, Hungarian Academy of Science (2008). The Hungarian system is a combination of both systems, the proportional and the basic one. The third system we deal with is that of means-tested, which take into consideration additional pensions.

There exist a debate to remove the fixed component, which favorize the poorly-paid workes with short contrats. The debates pushed toward proposals such as the immediate need of a new system combining the fixed component and the proportional one. This study presents the means-tested system which has lower costs and increases the low pensions only.

The level of the informal economy in the region countries and especially in Albania, is widely studied but often without coming to a consolidate conclusion. However, this phenomenon prompted the Albanian government in 2006 and 2007 to un-

dertake a more comprehensive survey conducted in the labor market. The aim was to minimize the underreporting of private sector wages. The Council of Ministers, in 4th of May, 2007 determined the monthly reference salary to be used for the calculation of social security contributions and health, and personal income tax, according to the nomenclature of economic activity (for employees in the non-public performing unskilled jobs).

Self-employed workforce in the agricultural sector is considered poorly-paid (the minimum legal quota). While those who claim less income than they earn, are the people who ignore the old-age pension and thus save some of the hidden income for the period of retirement.

Literature Review

There exist two main forms of mandatory systems. The first one is known to be the German system. In this system, a benefit proportional to lifetime contributions which provides a generous relative pension for everybody but requires quite high mandatory contribution rate. The second one is known to be the original British system. In this system, a universal flat pension which alleviates old-age poverty with modest mandatory contribution rate but requires complementary benefits. Another type of pension system can be considered the means-tested system. The fixed quota is conditional and if the proportional benefit is lower than the minimum value, then the benefit is topped up to the minimum. Friedman and Cohen (1972) have dialed with the comparison of a universal flat pension and the means-tested and have suggested the reduction of the welfare program size by replacing the former by the latter.

According to Feldstein (1987), the fact that the optimal choice between a means-tested program and a universal program depends on the character of the working population has an important general implication for the design of social security programs. It implies that, if the working population can be subdivided into groups that differ in the relevant parameters, it may be optimal to have a means-tested program for some groups and a universal program for others. He found that welfare is higher in the optimal means-tested system compared to the universal one. In his model he neglected wage heterogeneity and labor supply flexibility. As a consequence the flat plus benefit reduces to a flat benefit and the means-tested benefit is

zero for the life-cyclers. The study of Augusztinovics (2005) has shown that there will be considerable differences among cohorts in the wage level and also a large part of the cohorts retiring in the next decades will have quite low pensions. A later study of Augusztinovics and Köllő (2008) demonstrated the occurrence of differences through the cohort. As a solution of poverty these studies have suggested: 1- a significant scaling down of the present proportional benefits and contribution rate and 2- introducing a universal flat benefit, to be financed from new taxes.

Barr and Diamond (2008) following the analysis of Varian (1980) have strongly emphasized the insurance provided by the progressive pension system when the future earnings are uncertain at the start. The insurance function of the pension system has been neglected here. They studied the Chile's means-tested pension system where they founded that the lower-paid savings would increase, whereas the others savings would have a decrease. But the overall situation would slightly improve. In another study, Fehr and Habermann (2008) have founded that their optimum is a strong progressive system. They computed a general equilibrium model by taking into consideration the individual risk of career paths and life spans. They used the concept of a socially optimal "progressive pension arrangement" by determining the key parameters. The means-tested was excluded from their analysis.

Models of pension systems

Proportional Pensions

In this study the model of Hungarian Academy of Science is used and applied for the Albanian case. The population number is taken unchanged, making the assumption that each young is active in the labor market and each old person is in retirement. R is the symbol of working years for a normal worker and S , the years spend in pension. Dependency ratio defined as the rapport between the pension years and the working years is $\mu = S/R$. The "wage" presents the total wage cost, which is used as total wage and denoted by w . Contribution of each individual in the pension fond is forecasted to be equal to the rate τ of total reported wage. Fiscal effects have been eliminated. Another assumption in the model is that the reporting or not of the exact income will not be directly related the the pension system applied in the country. Lastly, the system is taken in equilibrium, the incomes equals the expenses.

The rate of informal economy is found to be the largest in Albania compared to the other countries in the region (approximately 50% of GDP). This is the main reason of categorizing the workers in three different types:

- 1) Poorly-paid workers (denoted L)
- 2) Middle or highly-paid workers categorized according to their reporting status:
 - The workers reporting all their incomes (R)
 - The workers unreporting their incomes (U).

The frequency per each type of worker is as follows: f_R, f_U and f_L , being all positives and having a sum of 1. In some special case of developed economies where fiscal evasion is pretty nothing, one of these frequencies can be equal to 0. Considering the total work force as a unit, the worker number is stated to be equal to 1.

In the attempt to proximate the aim of the actual albanian system, (by focusing on the undertaken reforms), it is supposed that in the basic system the individuals receive what they report, which is denoted by τ^* . τ^* represents the contribution rate in this system. The actual earnings of the workers are: $w_R = w_U$ and w_L , while their benefits are: b_R^* and $b_U^* = b_L^*$. Based on the above assumptions, the benefits are proportional to the reported earnings; $b_R^* = \beta^* w_R$ and $b_U^* = \beta^* w_L$, where β^* is the replacement rate in the proportional system. Some important details such as the case of w_L to be legally the minimum wage when the there is no actual and fictitious partial employment will be simplyfied in this model. (Kertesi and Kollo, 2003 and Tonin, 2005).

The total reported earnings are denoted by (W_L) , and the actual ones are (W_L) , which are equal to:

$$W_L = f_R w_R + (f_U + f_L) w_L \quad \text{and} \quad W_R = (f_R + f_U) w_R + f_L w_L$$

Since the system is supposed to be in equilibrium, then, $\tau^* W_L = \mu \beta^* W_L$. So the relation between the contribution rate, τ^* and the replacement rate is $\beta^* : \tau^* = \mu \beta^*$

Given that the replacement rates are higher, it is assumed that those who report all their earnings will not save money to consume in the future. However, the evaders will save proportionally to what they do not report in order to consume in the old-age. Saving rate is supposed to be: $0 < \sigma < \tau^*$, and annual savings: $\sigma(w_R - w_L)$. The efficiency ratio is: $\rho R / \sigma S$ which can be equal to, smaller or greater than 1.

The comparison between “Young-Age Consumption” and “Old-Age Consumption” is used to have the full picture of the whole life cycle consumption.

Young-age consumption is:

$$c^*_R = (1 - \tau^*)w_R; \quad c^*_U = (1 - \tau^*)w_L + (1 - \sigma)(w_R - w_L); \quad c^*_L = (1 - \tau^*)w_L$$

Old-age consumption is:

$$d^*_R = b^*_R; \quad d^*_U = b^*_L + \rho(w_R - w_L); \quad d^*_L = b^*_L$$

In the proportional system, the actual or reported low earning ensure a low pension and a low consumption in the old-age.

Basic Pension System

In this system, the contribution rate is supposed to be given as: b_0 which is financed from a consumption tax rate $\hat{\tau}$. Each individual will pay his/her proportional tax after each consumption. This kind of reform, the scaling-down of the proportional system and a simultaneous introduction of a basic pension, has been inspired by the work done of several authors (Augusztinovics, 2005; Barabas, 2006). The gross pensions are as follows:

$$\hat{b}_R = \hat{\beta}w_R + \frac{b_0}{1 - \hat{\tau}} \quad \text{and} \quad \hat{b}_U = \hat{b}_L = \hat{\beta}w_L + \frac{b_0}{1 - \hat{\tau}}$$

Different from the pension contribution, the payment of the consumption taxes are assumed to be unavoidable. However, this kind of system can be difficult to be applied in Albania. The lack of box offices, the problem of tax evasion, indirectly VAT calculation method, (all included in the informal economy), are some of the problematic issues making the application of this system difficult.

No saving is assumed to be present in the basic pension system. Total consumption is equal to total production, being equal to total incomes too. Since μ pensioners correspond to 1 worker, the tax equation is as follows:

$$\mu b_0 = \hat{\tau}W_R$$

The down-scaled contribution τw finance only the reduced labor pension $\hat{\beta}w$: $\hat{\tau}W_L = \mu\hat{\beta}W_L$, so $\hat{\tau} = \mu\hat{\beta}$.

The equation below emphasizes the assumption that all total expenses are unchanged.

$$\hat{\tau}W_L + \hat{i}W_R = \tau^*W_L$$

By replacing \hat{i} from old equation to the new one then,

$$\hat{\tau}W_L + \mu b_0 = \tau^*W_L$$

The reduced contribution can be determined as follows:

$$\hat{\tau} = \tau^* - \frac{\mu b_0}{W_L}$$

It is supposed that $\mu b_0 \leq \tau^*W_L$ in order to have positive contribution so, $b_0 \leq \tau^*W_L / \mu$.

Young consumption is:

$$\hat{c}_R = (1 - \hat{i})(1 - \hat{\tau})w_R; \hat{c}_U = (1 - \hat{i})(1 - \hat{\tau})w_L + (1 - \sigma)(w_R - w_L);$$

$$\hat{c}_L = (1 - \hat{i})(1 - \hat{\tau})w_L$$

Old consumption is:

$$\hat{d}_R = (1 - \hat{i})\hat{b}_R; \hat{d}_U = (1 - \hat{i})[\hat{b}_L + \rho(w_R - w_L)]; \hat{d}_L = (1 - \hat{i})\hat{b}_L$$

Benefits and consumption of workers who report lower incomes / or actually have low incomes, have increased significantly compared to the proportional system. The benefits of type R have been reduced.

Means-tested Pension System

This is the last type of the pension systems analysed in this paper. The two previous systems can have some evident problems. For example, in the basic system, the workers reporting their full earnings, (R), will benefit less than those in the proportional system. Those who do not fully report their earnings, (U), will benefit more than the part they do not report. The third system, means-tested, will try to enhance the problematic issues faced in the presented systems. In this case the goverment can distinguish the needy person (L) and the evader (U).

Now there are three types of benefits: $\bar{b}_R = \bar{\beta}w_R$; $\bar{b}_U = \bar{\beta}w_U$ and $\bar{b}_L = \hat{b}_L$ where $\hat{b}_L = \bar{\beta}w_L$. In this model the benefits of needy persons are the only ones to be financed by the taxes: $\mu f_L(\hat{b}_L - \bar{\beta}w_L) = \bar{i}W_R$

Contributes $\bar{\tau}w$ are financed from the proportional component $\bar{\beta}w$: $\bar{\tau} = \mu\bar{\beta}$. By using the last equation then,

$$\begin{aligned}\bar{\tau}W_L + \bar{i}W_R &= \tau^*W_L \\ \bar{\tau}W_U + \mu f_L \hat{b}_L - f_L \bar{\tau}w_L &= \tau^*W_L\end{aligned}$$

The contribution rate in the model of means-tested is:

$$\bar{\tau} = \frac{\tau^*W_L - f_L \mu \hat{b}_L}{W_L - f_L w_L}$$

It is supposed that $\tau^*W_L \geq f_L \mu \hat{b}_L$ in order to have a positive contribution rate. The only difference between the means-tested system and proportional one is the exclusion of the evaders. By excluding the evaders, the needy pension increases and the pension of highly-paid persons decreases, without making the distinguish between fully reported or not.

Albanian Case

Data specification and determination

Based on the the statistical data of average mean for the Albanian population working average years before retiring are $R = 35$. Subtracting the working average years from average living years, which is found to be 74 years for the albanians, and supposing that the average years of entering to labor market is 20 (taking into account both qualified and unqualified workers), it is calculated that the average time spend in retirement is 20 years, denoted by S . The dependency ratio, which is the rapport of retirement years to working years, is $\mu = 0.57$.

The calculations related to the revenues are based on employment data of average salaries according to sectors published by INSTAT (2007). The following assumption have been done because of the lack of detailed data corresponding employment salaries.

- 1- All the labor force founded in public institutions or in private sectors (except the agricultural sector) are categorised as well-paid individuals.
- 2- The work force founded in the agriculture sector are assumed to be poorly-paid individuals.
- 3- The Albanian informal economy, (in year 2004 OECD “measured” that the informal level in Albania to be 30%-60%), is assumed to be 50%.
- 4- All the individuals working at public institutions report their fully earnings.

Based on the above assumptions and data of INSTAT, employers distributions is as below:

$$f_R = 0.3; f_U = 0.12 \text{ and } f_L = 0.58$$

The rapport of earning distribution between well-paid and poorly-paid is calculated to be 4.3 (It is assumed that the average salary in the privat sector is 60.000 ALL, in the public sector 35.650 ALL and the minimal wage in the privat sector, excluding agricultural sector, is 14.000 ALL). Briefly, the earning distribution is $w_R = 4.3$, $w_L = 1$. The average reported wage is $W_L = 2$, which is consistend to albanian data published by the Institute of Statistics, $2 \times 140000 = 28000$ ALL.

In addition, it is assumed also that the basic benefit is equal to the half of the average proportional pension $b_0 = \tau W_L / (2\mu)$ and the contribution evander saves half the money that the Social Security would save from him from his hidden earnings, $\sigma = \tau/2$.

Table 1. Main Parameters

Parameter	Population distribution according to their reporting			Saving Rates, σ
	f_R	f_U	f_L	
Base Run	0.3	0.12	0.58	0.119
Full Reporting	0.42	0	0.58	0.119
Every low earner evander	0.3	0.7	0	0.119

Base Run

The distribution is as follows:

$$f_R = 0.3; f_U = 0.12 \text{ and } f_L = 0.58$$

Table 2 presents the parameters and the benefits of the evader in three systems while table 3 summarises the consumption vectors.

Table 2. Parameters of three pension systems

Type	Contribution Rate	Tax Rate	The Evader's Benefit
	τ	t	b_U
Proportional	0.239	0	0.42
+ Basic Benefit	0.119	0.099	0.674
+ Means-tested Benefit	0.179	0.05	0.314

Contribution rate is founded to be 0.239 for the Albanian case. This is the rate paid by the employer to the Social Securities. The Albanian system is near to the proportional system analyzed in this paper.

In the basic benefit system contribution rate is approximately halved, meanwhile a consumption tax of about 9.9% is added up. This system increases the benefits of evaders by around 60% but it does not make any distinction between full reports (R) and underreports (U).

A partial solution for this problem can be found by integrating a component of tested-means. By this, a considerable increase of contribution rate compared to basic benefits is found where consumption tax decreases from 9.9% to 5%.

The impact of explained systems in the consumption vectors can be seen in Table 3.

Table 3. Characteristics of three pension systems

Type	Young-age Consumption			Old-age Consumption		
	c_R	c_U	c_L	c_R	c_U	c_L
Proportional	3.272	3.668	0.761	1.806	0.813	0.420
+ Basic Benefit	3.413	3.701	0.794	1.229	0.999	0.607
+ Means-tested Benefit	3.354	3.687	0.780	1.350	0.811	0.674

The benefits of type R and L, without taking into account the taxes, are equal to the respective consumption in old-age. Not the same implication happens to the U type, which saves for consumption during the retirement. Even if the rate of U is not high enough, there is nothing to worry about U type individual consumption, because as seen in table 3, his consumption is 1.94 times greater than L type individual.

If the consumption level of young-age and old-age of different systems are compared, then the means-tested system is found to be superior to the basic one because this system supports the need's old-age consumption (L) rather than the evader's consumption.

Table 3.a. Characteristics of three pension systems in terms of W_R

Type	Young-age Consumption			Old-age Consumption		
	c_R	c_U	c_L	c_R	c_U	c_L
Proportional	1.363	1.528	0.317	0.753	0.339	0.175
+ Basic Benefit	1.422	1.542	0.330	0.512	0.416	0.253
+ Means-tested Benefit	1.397	1.536	0.325	0.563	0.338	0.281

No evaders

Even if the used assumption is non-realistic for the Albanian case, it is important to present the case when there are no evaders.

$$f_R = 0.42 \text{ and } f_U = 0$$

The contribution rate is the same as in the proportional system, $\tau = 0.239$. Table 4 includes the new parameters, while table 5 presents all the results according to the last parameters.

Table 4. Parameters of three pension systems (no evaders)

Type	Contribution Rate	Tax Rate
	τ	t
Proportional	0.239	0
+ Basic Benefit	0.119	0.119
+ Means-tested Benefit	0.175	0.064

Since the evaders disappeared, in the basic system the tax rose from 9.9% to 11.9% and in means-tested system from 5% to 6.5%, while the contribution rate decreases from 17.9% to 9%.

Table 5. Characteristics of three pension systems (no evaders)

Type	Young-age Consumption			Old-age Consumption		
	c_R	c_U	c_L	c_R	c_U	c_L
Proportional	3.272	-	0.761	1.806	-	0.420
+ Basic Benefit	3.337	-	0.776	1.276	-	0.683
+Means-tested Benefit	3.320	-	0.772	1.320	-	0.775

The consumption changes are more complex. In the proportional system there is no change, while in the basic one the consumption of young-age increases (independently from income level), and the consumption of old-age decreases relating their income levels. The underlying fact is that these variations in the consumption levels are very low or insignificant. The means-tested system advantage compared to the basic one is diminished insignificantly. Low income elders' consumption decreases in both systems.

Every low-paid is evader

This model supposes that low-paid individual is an evader.

$$f_R = 0.3 \text{ and } f_U = 0.7$$

Based on the definitions, means-tested system is reduced to a proportional system (since there are no individuals in need), this is the reason why we do not examine this case. Table 6 represents the new parameters while table 7 gives the results.

Table 6. Parameters of three pension systems (all evaders)

Type	Contribution Rate	Tax Rate	Evader's Benefits
	τ	t	b_U
Proportional	0.239	0.000	0.420
+ Basic Benefit	0.119	0.056	0.653

Here it can be observe just one change comparing to the basic system, the tax rate decreases from 11.9% to 5.6%.

Table 7. Characteristics of three pension systems (all evaders)

Type	Young-age Consumption			Old-age Consumption		
	c_R	c_U	c_L	c_R	c_U	c_L
Proportional	3.272	3.668	-	1.806	0.813	-
+ Basic Benefit	3.576	3.738	-	1.267	1.407	-

The changes occurred in the pension basic system are as follow: the consumption of individuals which are no-evader and are high-paid is increased compared to the basic system. In the same time, the problem of pension basic system are found to be more evident, in this case the evaders exploit the full contributors.

Conclusion

The aim of this study is to find possible answer to the question: Which of the social insurance systems is the best for the Albanian case? Three system types have been analysed by applying the actual albanian values. The findings of this study strongly support the means-tested system, given that this system has positive impact on the needy fraction of the population and shows only an increase in the pension of the low income people compared to basic system.

After all these detailed calculations, it can be concluded that, if all the evaders are excluded, and without making difference between the pension systems, the government has to choose the means-tested system and not that of basic one. In case the evaders can not be excluded, the solution is not so simple. Briefly, if the savings are directly connected to pension system, then the difference between consumption rates in both, means-tested and basic system are insignificant.

Another important issue to be mentioned is that the lower the part of proportional component in total pension, the higher the well-paid individuals number which underreport their wages.

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